IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA Plaintiff, v. APPLE, INC., HACHETTE BOOK GROUP, INC., HARPERCOLLINS PUBLISHERS, L.L.C. VERLAGSGRUPPE GEORG VON HOLTZBRINK PUBLISHERS, LLC d/b/a MACMILLAN, THE PENGUIN GROUP, A DIVISION OF PEARSON PLC, PENGUIN GROUP (USA), INC. and SIMON & SCHUSTER, INC., Defendants.	)	Civil Action No.12-CV-2826 (DLC)

COMMENTS OF *AMICUS CURIAE* BOB KOHN

REGARDING PROPOSED FINAL JUDGMENT AS TO DEFENDANTS
THE PENGUIN GROUP, A DIVISION OF PEARSON PLC
AND PENGUIN GROUP (USA), INC.

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INTRODUCTION

These comments are respectfully submitted in opposition to several provisions of the proposed Final Judgment (hereinafter, "Penguin Settlement")[1] between the United States (the "Government") and defendants The Penguin Group, A Division Of Pearson Plc. and Penguin Group (USA), Inc. (collectively, "Penguin").

In a nutshell, if the Defendants' agency agreements, by definition, eliminated price competition at the retail level, and if those agreements were intrinsically legal—as the Government has admitted and as the District Court has now held—then the e-book price adjustments that followed the adoption of the agency agreements were not the result of any wrongdoing by the Defendants, but were instead the result of the correction of a pre-existing market failure brought about by the undisputed, systematic below marginal cost pricing of such e-books by Amazon, which the Court also determined had the market power (i.e., an undisputed "90 percent monopoly") to later recoup its losses.[2] By imposing restrictions upon agency pricing, the settlements in this proceeding reverse the adjustment of such e-book prices back up to their efficient equilibrium (i.e., Amazon's marginal cost) and therefore, as a matter of law, such restrictions have a negative impact upon the relevant market and the public generally.

Accordingly, it would be in the public interest for the Court to approve a revised settlement in a way that eliminates the restrictions upon Defendants' use of the agency model while maintaining the decree's remaining provisions to deter exchanges of competitive

[1] Penguin Settlement (Dkt#162-1)

[2] Thus, the comments herein are focused upon the applicability of several key rulings of the District Court in its Opinion & Order dated September 5, 2012 (Dkt# 113), which was issued *after* the previous submissions of *amicus curiae* in this matter regarding the Final Judgment as to Hachette, HarperCollins, and Simon & Schuster (the "Initial Final Judgment"). That is, after the submission of Comments of Bob Kohn (ATC-0143, April 30, 2012), Proposed A*micus Curiae* Brief of Bob Kohn dated August 13, 2012 (Dkt#97-1), and *Amicus Curiae* Brief of Bob Kohn dated September 4, 2012 (Dkt#110).

information and monitor compliance during an appropriate timeframe.[3] The recently proposed settlement between the United States and defendants Verlagsgruppe Georg Von Holtzbrink Gmbh and Holtzbrink Publishers, LLC d/b/a Macmillan ("Macmillan") [4] should similarly be revised before entry.[5] Finally, this *amicus curiae* is seeking appeal of the Final Judgment[6] entered with respect to Hachette, HarperCollins, and Simon & Schuster for the purpose of achieving the same effect. *Kohn v. United States*, 12-4017 (2d Cir., filed October 4, 2012).

This *amicus curiae* has no quarrel with the business decisions made by the five Publisher Defendants to settle this action. The conviction that "it's hard to settle when you've done nothing wrong" is courageous, but courage can turn to foolhardiness when simply having your day in court becomes commercially impossible. The fact that certain defendants stood firm in that conviction for as long as they have is an honor to them and their faith in our system of justice. (Indeed, it will be a sad day when practical due process becomes a privilege enjoyed only by the *Fortune 100* companies, heroic characters of popular fiction, and foolish *amicus curiae* who have nothing to lose but their time). Be that as it may, the five major publishers, and the executives who run them, have suffered enough. As one of them recently conceded, it is, indeed, time "to move on." While I am hopeful that that these settlements will achieve for them that simple objective—putting the legal expense, management distraction, and enormous potential risks of this litigation behind them—I am convinced that these men and women remain the victims of an injustice which extends far beyond the economic interests of the companies they manage. Leaving aside the personal affront suffered by the falsely accused, the mechanisms for settlement wrought by the Government—insofar as they restrict agency pricing—have had, and

[3] The District Court has the power to do so under Second Circuit precedent cited in Section IV below.
[4] Macmillan Settlement (Dkt#174-1)
[5] *Amicus curiae* Bob Kohn intends to submit comments on the Macmillan Settlement prior to the close of the corresponding 60-day comment period which began on February 25, 2013.
[6] Initial Final Judgment (Dkt#119).

will continue to have, a disturbing impact upon consumers, authors, competition in the market for trade e-books, and the public generally.

It is not too late to remedy these errors in a way that will allow the parties to close the door on this litigation while ending the harm to the public that these settlements are causing. More important, perhaps, there remains an opportunity to establish a precedent that may discourage the Department of Justice from jumping to conclusions that are not only unreasonable, but seem all too ridiculous to even the casual observer.[7]

The Department of Justice, at this juncture, is not expected to redeem itself by reversing its position on the settlements, but it is hoped the courts will be more receptive to some considered arguments which have benefited from several of the District Court's important findings and insights enunciated in its Opinion & Order dated September 5, 2012. Dkt#113.

Recall that, in its Complaint, the Government repeatedly alleged that "price competition among retailers"—which, it contends, was good for consumers—was unlawfully eliminated by the Defendants' conduct. Dkt#1 (Complaint) at ¶¶ 3, 4, 5, 6, 8, 56, 66, 79, 92, 95, 97, and 98. Yet, these statements were facially inconsistent with the Government's admission that it "does not object to the agency method of distribution in the e-book industry." Dkt#81 (Gov't Response to Comments) at vi. Indeed, the District Court found, as the Government recognized, that the terms of the agency agreements (including the retail price restraints and the Price MFN clauses) used by the Defendant Publishers were *not* "intrinsically unlawful." Dkt#113 (Entry Order) at 17. That finding, combined with the District Court's further finding that it was undisputed that Amazon had "a 90% monopoly" of the trade e-book market (Dkt#113 at 34-35), as shown

[7] See, for example, David Carr, "Book Publishing's Real Nemesis," *New York Times* (April 15, 2012) (Describing the Justice Department's action in this case as "the modern equivalent of taking on Standard Oil but breaking up Ed's Gas N' Groceries on Route 9 instead").

below, leads to only one logical conclusion: the District Court should not enter a judgment imposing restrictions on agency pricing, because such restrictions are not in the public interest.

It is self-evident that the purpose and effect of the agency agreements, *by definition,* was *to eliminate e-book price competition among e-retailers*. This is because, under the agency model, price competition for e-books occurs among the publishers, not the retailers. If the agency agreements used by the Defendant Publishers were not "intrinsically unlawful," as this Court has found, then any alleged conduct by Defendants *for the purpose of* limiting pricing competition through their agency agreements could not, as a matter of law, have been illegal.

It should be clear, then, that this action was never about eliminating e-book price competition at the retail level. To do so was perfectly legal, because the agency agreements used to accomplish that end were intrinsically lawful. That being the case, the Government's Complaint boils down to simply this: that after the shift to the agency model, it was not legal that *e-book prices went up*. Yet, when boiled down to that, the Government's conclusion that these settlements are in the public interest evaporates.

We start by assuming that e-book prices actually went up after the adoption of the agency model. Even though the parties and some commentators have disputed that fact, the Government's allegation that e-book prices went up should be accepted as true at this stage of the proceeding.

What should not be accepted as true is the Government's *conclusion* that the higher prices that ensued after the adoption of the agency contracts harmed consumers. If it can be shown, *as a matter law*, that such higher prices could not have harmed consumers, then Government's conclusions about the proposed settlement were unreasonable and the Penguin Settlement cannot be in the public interest. Moreover, to the extent the Penguin Settlement

results in lower e-book prices, which is its stated purpose[8], consumers will, in fact, be harmed—just as they are being harmed by the Final Judgment entered by this Court last year.

In a five-page brief dated September 4, 2012 (Dkt #110), this *amicus curiae* attempted to illustrate the Government's mistaken view of pricing in the realm of antitrust analysis:

The point is that there is nothing inherently unlawful about higher prices. Obviously, a rise in price as a result of an increase in demand or a decrease in supply is a natural correction of a working market and is not unlawful under the antitrust laws. Similarly, prices that rise in correction of a *market failure* caused by an action that is judicially-recognized as economically inefficient and illegal—such when a competitor with overwhelming market power sells below marginal cost (see, *Brook Group* and *Northeastern*, *infra*)—are also not unlawful. Any antitrust hornbook or economics textbook would attest to the fact that consumers benefit from *higher prices* in each of these instances because they benefit from a more efficient allocation of resources.

When, in its Response to Public Comments, the Government admitted that it "does not object to the agency method" (Dkt#81 at vi), it necessarily admitted, *by definition*, that it does not object to a method of distribution whereby price competition at the retail level is eliminated.

[8] See Dkt#5 (CIS). Also, Dkt #81 (Govt. Response to Comments) at 18 ("Consumers, the Victims of the Conspiracy, Will Benefit as Limits on Retail Discounting are Lifted").

Accordingly, what is left of their case is their objection that, as a result of the switch to the agency model, higher e-book prices ensued. But, for some reason, the Government failed to appreciate why the shift to the agency model resulted in higher e-book prices: under the retail model, Amazon was selling e-books at below marginal cost. Under such circumstances, the shift to the agency model could only have resulted in an increase in those prices back up to marginal cost.

Accordingly, **the e-book price increases were not caused by any wrongdoing of the Defendants**, but were caused by (1) Amazon's below marginal cost pricing in combination with (2) the lawful elimination of retail price competition by means of agency agreements, which the Government has admitted, and the Court has ruled, were intrinsically legal. The result benefited consumers, because the elimination of Amazon's selling below cost—i.e., the correction of the market failure—resulted in a more efficient allocation of resources.

By entering the Initial Final Judgment in this case, the District Court has made a regrettable error that—by virtue of the restrictions on the agency pricing—has saddled consumers with an unnecessary misallocation of resources in the trade e-book market—lasting the next two years, perhaps longer. This *amicus curiae* has appealed that decision to the Second Circuit. In the meantime, the Court should not compound its mistake by entering the proposed Penguin Settlement—at least not without modification.[9] The Court is urged to do the same with respect to the announced settlement with Defendant Macmillan. Only by modifying all of the settlements in this case to remove their respective restrictions on the Defendant's agency agreements will the settlements align with the public interest.

[9] The public interest does not require that the proposed Penguin Settlement be rejected in its entirety. The District Court is urged to enter a revised Penguin Settlement comprised only of provisions that do not unravel the pro-competitive effects that Defendants' conduct had upon the relevant market and the public generally. See, Section IV below.

I. STANDARD OF REVIEW FOR TUNNEY ACT CASES IN THIS CIRCUIT

Prior to entry of a proposed final judgment, the Tunney Act requires a court to determine that such entry is "in the public interest." 15 U.S.C. § 16(e)(1). Though the statute does not define that phrase, the Second Circuit has held that such words "take meaning from the purposes of the regulatory legislation." *United States v. American Cyanamid Co.*, 719 F.2d 558, 565 (2d Cir. 1984). More specifically, "the Court should look to the elements of that species of antitrust violation." *United States v. Int'l Bus. Machines Corp*., 163 F.3d 737, 742 (2d Cir. 1988).

The Government touched upon the alleged species of antitrust violation when it stated in this action that, "Low prices, of course, are one of the principal goals of the antitrust law." Dkt#81 (Gov't Response) at 22 (citing, *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340 (1990) (opinion by Justice Brennan). But, in citing *Atlantic Richfield*, the Government omitted Justice Brennan's crucial caveat, which Justice O'Conner specifically included when she quoted Justice Brennan: "Low prices benefit consumers regardless of how those prices are set, *and so long as they are above predatory levels, they do not threaten competition*." *Brook Group v. Brown and Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (opinion by Justice O'Conner quoting, *Atlantic Richfield* at 340) (emphasis added).

As noted, this case is *not* about limiting e-book price competition at the retail level through the adoption of the agency model. It's about *the rise in e-book prices after the switch to the agency model*. The operative terms of each of the settlements restricts the agency model such that e-book prices will be lowered for a period of time, at not only cost to the Publisher Defendants, but to competitors of Amazon, independent booksellers, authors of copyrighted works, and the public at large who will suffer from the misallocation of resources. It is in that context the Penguin Settlement is to be considered, and the Tunney Act directs courts to consider

several factors, including "the impact of entry of such judgment upon competition in the relevant market or markets" and its impact "upon the public generally." 15 U.S.C. § 16(e)(1).

Though normally a court makes only the minimal determination of whether a settlement agreement is to be accorded the status of a judicially enforceable decree, the court has a "larger role" where the consent judgment resolves "antitrust suits brought by the United States." *Int'l Bus. Machines*, 163 F.3d 737, 740 (quoting *Janus Films v. Miller*, 801 F.2d 578, 582 (2d Cir. 1986)).

Some courts, including the District Court, have held that "the relevant inquiry is whether the Government has established an ample 'factual foundation for the Government's decisions such that its conclusions regarding the proposed settlement are reasonable'." Dkt#113 at 14 (quoting *United States v. Keyspan*, 783 F.Supp.2 633, 637-38 (S.D.N.Y. 2011). Research by this writer has been unable to uncover a single decision by the Second Circuit of Appeals which adopts the *Keyspan* standard of review. The standard in this Circuit appears to be that which was established in *American Cyanamid* and *IBM*, cited above.

In any event, the argument below remains unaffected should the District Court again embrace the *Keyspan* formulation. Even under the *Keyspan* standard, the courts may "give due respect to the government's perception of its case" (*Keyspan* at 638) and may be "deferential to the government's predictions as to the effect of the proposed remedies" (*Microsoft*, 56 F.3d at 1461), but such respect is *not due*, and such deference is *not earned*, where the Government's *conclusions* regarding the settlement are unreasonable. *Keyspan* at 637-38.

In inquiring whether the Final Judgment is in the public interest, or whether Government's conclusions are reasonable, the courts need not engage, as the Government has suggested, in a "full-blown, lengthy and expensive trial." Dkt#81 (Gov't Response to Comments)

at 44. On the contrary, the courts may inquire into the reasonableness of the Government's conclusions assuming all of the factual allegations regarding defendants' conduct in the Complaint, stripped of their bare conclusions (i.e., the subject of this inquiry under *Keyspan*), are true. To defer to both the Government's alleged facts as well as their conclusions would indeed make "a mockery of judicial power."

Amicus curiae is not suggesting that the Court "construct [its] own hypothetical case and then evaluate the decree against the case," or "redraft the complaint to inquire into other matters that the United States did not pursue" or "engage in an unrestricted evaluation of what relief would best serve the public." Dkt#5 (Initial CIS) §VII (quoting *United States v. Microsoft Corp*., 56 F.3d 1448, 1459-62 (D.C. Cir. 1995); *Keyspan* at 638; *United States v. BNS, Inc*., 858 F.2d 456, 462 (9th Cir. 1988)). Nor is the Court being asked to "reach beyond the complaint to evaluate claims the government did not make." *Microsoft*, 56 F.3d at 1459.

On the contrary, in evaluating the reasonableness of the Government's *conclusions*, the District Court need simply assume all of the Government's *factual allegations* as true, and add to those allegations the Court's own *factual findings*. It is respectfully submitted that, when Reason is applied to the factual foundation, the District Court's only conclusion can be that elements of the Penguin Settlement that restrict the operation of the agency model, for however short a period, are not in the public interest.

II. A SETTLEMENT WHICH RESTRICTS AGENCY PRICING IS NOT IN THE PUBLIC INTEREST

The Government's alleged factual foundation, and the District Court's previous factual findings, taken together, should be all the District Court needs to consider in reviewing whether the Penguin Settlement is in the public interest. The undisputed facts and the District Court's findings show conclusively that the Penguin Settlement unwinds both the pro-competitive impacts of Defendants' conduct upon the relevant market and the favorable impacts of such conduct upon the public generally.

A. Defendants' Conduct Could Not, As a Matter of Law, Have Harmed Consumers

Based on the facts it alleged, the Government *concluded* that the Defendants' alleged conduct was harmful to consumers. Dkt#5 (Initial CIS) §III; Dkt#163 §III (Penguin CIS). If it can be shown, as a matter of law, that Defendants' conduct, as alleged, could *not* have harmed consumers (or that, in fact, it could only have benefited consumers), then the Government's conclusions regarding the settlement are unreasonable. A settlement, which has the stated intention of benefiting consumers while, as a matter of law, does the opposite, cannot be in the public interest.

1. Summary of Argument

As noted, the District Court found that the terms of the agency agreements (including the retail price restraints and Price MFN clauses) used by Defendant Publishers were not "intrinsically unlawful." Dkt#113 (Entry Order) at 17. *By definition,* the effect of the agency agreements was *to limit e-book price competition among e-retailers*. Indeed, the Government's admission that the elimination of price competition at the retail level is perfectly legal is virtually

codified in each of the settlements.[10] If the agency agreements were legal, then any alleged conduct by defendants *for the purpose of* limiting such competition through their agency agreements could not, as a matter of law, be illegal.

What is left of the Government's Complaint is that, following a number of alleged "opportunities" (i.e., phone logs and dinner meetings) to have conversations pertaining to the *lawful* elimination of e-book price competition by switching to the agency model[11], *e-book prices went up*. Yet, such price increases were not caused by any wrongdoing of the Defendants, but were caused by (1) Amazon's below marginal cost pricing in combination with (2) the lawful elimination of retail price competition by means of lawful agency agreements. The result benefited consumers, because the elimination of Amazon's selling below cost resulted in correction of a market failure and a more efficient allocation of resources. It is therefore submitted that, based on the factual foundation alleged by the Government and the District Court's finding of facts, consumers, as a matter of law, must have benefited to the extent e-book

[10] See, for example, Penguin Settlement (Dkt#162-1) at §V.D. ("After the expiration of prohibitions in Sections V.A. and V.B of this Final Judgment, this Section V.D. shall not prohibit Penguin from unilaterally entering into or enforcing any agreement with an E-book Retailer that restricts, limits, or impedes the E-book Retailer from setting, altering, or reducing the Retail Price of any of Penguin's E-books or from offering price discounts or any other form of promotions to encourage consumers to Purchase any of Penguin's E-books"). Oddly, in support of its ruling that the Government met the "minimal" standard of review for the initial Final Judgment, the District Court found that it was "undisputed that the Agency Agreements disallowed retail price discounting" and that after the adoption of such agreements "a consumer could not find Publisher Defendants' newly-released and bestselling books for $9.99 at any retailer." Dkt#113 (Order) at 32-33. If the District Court was suggesting here that the agency agreements, by disallowing discounting, were somehow unlawful, then the District Court will need to explain how the agency agreements, which intrinsically eliminate price competition at the retail level, can be considered unlawful and "not intrinsically unlawful" at the same time. *Cf*. Dkt#113 (Order) at 17. If all the District Court was suggesting was that e-book prices rose above the $9.99 price, it has not explained how such price rises could have harmed consumers or were otherwise unlawful. If the Court is suggesting here that all price increases harm consumers or are necessarily unlawful, then it clearly adopted the Government's mistaken view of pricing under the antitrust law as its own.

[11] When you eliminate all of the hot rhetoric in the Complaint about the elimination of retail price competition—"hot" in the sense that the Complaint is trying to make something legal sound illegal—you are left with a set of vacuous assertions, such as Publisher Defendants had an "opportunity" to discuss pricing at private meetings among publisher CEOs (Complaint at ¶45).

prices went up (at least up to the level of their marginal cost).

2. Argument

It is undisputed that, under the retail model, Amazon sold newly-released and bestselling e-books made available by the defendant publishers and by most, if not all, independent book publishers, at below its marginal cost, consistently, "[f]rom the time of its Kindle launch" until Amazon's acceptance of the agency model. See, Dkt#5 §II.A. The Government directly alleged facts in its Complaint and Competitive Impact Statement that Amazon was selling e-books at below their marginal cost, something which the Government has *never* denied.[12] Amazon's marginal cost, under the retail model, was at least equal to the fixed wholesale price (e.g., $13.00, which is 50% of a typical list price of $26.00) it pays to the publishers for each *incremental* e-book it sells.[13] Dkt#5 (CIS) §II.A. These books were re-sold by Amazon for "$9.99-or-less." Id.; Dkt#1 (Complaint) at ¶30. Thus, for example, at a marginal cost per e-book of $13.00, Amazon was selling such e-books at $3.01 (more than 23%) below its marginal cost.

The Government stated it "reviewed data from Amazon and others" to investigate Amazon's e-book distribution business. Dkt#81 (Gov't Response) at 21. By the end of its investigation, the Government concluded that Amazon was not engaging in predatory pricing. Id. Dkt#1 (Complaint) ¶30. **It is noteworthy, however, that in reaching such *conclusion*, the Government *never* alleged or asserted that Amazon was *not* selling below marginal cost**. The Government merely asserted that no objector supplied evidence that "Amazon threatens to drive out competition and obtain monopoly power." Dkt#81 at 22. Needless to say, that is not the

[12] It may well be that the District Court was mislead by certain carefully crafted statements about Amazon's pricing policies set forth in the Government's Complaint and Response to Public Comments dated August 3, 2012, discussed below.

[13] Amazon has additional marginal costs, such as the cost of wirelessly delivering each incremental e-book to a *Kindle* e-reader, which is estimated to cost nearly 15 cents per e-book delivery. See, *Kindle Direct Publishing Agreement, Pricing Page* (as of July 28, 2012).

same as saying Amazon did not re-sell e-books below its marginal cost—a necessary element of predatory pricing.

Being unable to deny facts which it provided in its Complaint and CIS, and then without ever categorically denying that Amazon was selling e-books at below marginal cost, the Government jumped to its peculiar conclusion: based on its investigation and review of data from Amazon and others, "Amazon's e-book distribution business has been consistently profitable." Dkt#1 ¶30; repeated in Dkt#81 (Gov't Response) at 4, 21-22).

Implicit in that conclusion was the legal standard which the Government applied to its review of data. The Government provides no citation for the proposition that the standard for predatory pricing under Section 2 of the Sherman Act (15 U.S.C. §2) is whether the predator's business "has been consistently profitable."

In *Brook Group v. Brown and Williamson Tobacco Corp.*, 509 U.S. 209, 222-24 (1993), the Supreme Court set forth two elements for an action for predatory pricing. The first is to establish that prices were set at "below an appropriate measure of its rival's costs." Interpreting its prior holdings, the Court stated, "below-cost prices should suffice." Id at 223. This was consistent with the standard previously adopted by the Second Circuit. *Northeastern Telephone Co. v. American Tel. & Tel. Co.*, 651 F.2d 76, 86-89 (2d. Cir. 1981), cert. denied, 455 U.S. 943 (1982) ("The relationship between a firm's prices and its marginal costs provides the best single determinate of predatory pricing"). Marginal cost is traditionally defined as "the increment to total cost that results from producing an additional increment of output." *Northeastern* at 87 (quoting Areeda & Turner).

This prerequisite is clearly satisfied by the Government's own factual allegations. By selling e-books for "$9.99-or-less" that it purchased at higher amounts Amazon was selling such

e-books at below their marginal cost. Unless the price cutter can show that its low price is purely "'promotional,' *e.g.*, a 'free sample'," or "show that it expects costs to fall when sales increase," then "the firm cannot rationally plan to maintain the low price." *Barry Wright Corp. v. ITT Grinnell Corp.,* 724 F.2d 227, 230-34 (1st Cir. 1983) (opinion by Circuit Judge Breyer).

Amazon's practice of below marginal cost pricing was no Macy's "promotion." These were not "free samples" or "loss leaders." Amazon's below-cost pricing was consistently applied to newly-released and bestselling trade e-book made available by the Defendant Publishers and by most, if not all, independent book publishers, from the time of its Kindle launch until Amazon's acceptance of the agency model. Dkt#5 §II.A. "Without special circumstances there is little to be said in economic or competitive terms for such a price cut." *Barry Wright,* 724 F.2d 227, 231. The Government has supplied neither the public nor the District Court with any evidence of special circumstances to justify Amazon's below marginal cost pricing.[14]

Nor can Amazon expect its marginal cost for e-books to decrease with volume. Amazon's marginal cost for selling each *incremental* e-book having a list price of $26.00 will always remain $13.00, whether Amazon sells one copy or one million copies. "At a minimum, one would wonder why this firm would cut prices on 'incremental production' below its 'avoidable' costs unless it later expected to raise its prices and recoup its losses." *Barry Wright,* 724 F.2d 227, 232.

At first, the District Court seemed to embrace the Government's odd conclusion that "Amazon's e-book business was 'consistently profitable'." Dkt#113 (Order) at 39. But then, it went on to elucidate the law of predatory pricing correctly, only to *overlook* the Government's own factual allegations supporting Amazon's below cost pricing and the apparent care the

[14] If the Government has materials or documents that would shed light on this key issue—containing a "smoking gun" or its "exculpatory opposite"—it is bound by the Tunney Act to share it with the public and the District Court. See discussion below in Section II.E.

Government took never to deny it.

For example, this is how the Government defended Amazon against the charges by hundreds of commentators of below cost pricing:

> No objector to the proposed Final Judgment has supplied *evidence* that, in the dynamic and evolving e-book industry, Amazon threatens *to drive out competition and obtain the monopoly pricing power* which is the ultimate concern of predatory pricing law. [Dkt#81 (Gov't Response) at 22 (emphasis added)].

While addressing the *ultimate* concern of predatory pricing law, the Government left out the law's *immediate* concern, the first prong of the test under *Brook Group* and *Northeastern*: whether Amazon was selling at below marginal cost. The Government *never denied* this, because the "evidence" of Amazon's selling below marginal cost was not only obvious and abundant, it was factually supported in the Government's own Complaint and CIS.

Yet, when the District Court addressed the issue of below marginal cost pricing, it stated,

> [W]hile comments complain that Amazon's $9.99 price for newly-re-leased and bestselling e-books was 'predatory,' none of them attempts to show that Amazon's e-book prices as a whole were below marginal cost. [Dkt#113 at 39].

Of course, none of public commentators attempted to "show" it, because none of them had to. It was *undisputed*. As the Government observed, Amazon's below-cost pricing was the "overarching theme" of the public comments. Dkt#81 at 2. Facts supporting it were directly alleged in the Government's own Complaint and Competitive Impact Statement and the Government has never since denied that Amazon was selling e-books at below marginal cost. Indeed, the express terms of each of the proposed settlements—which allow each Publisher Defendant to prevent Amazon from selling the publisher's "entire catalogue at a sustained loss"—is an express admission by the Government that Amazon was selling below marginal cost. See, for example, Competitive Impact Statement as to Penguin (Dkt#163) at 8; Penguin Settlement (Dkt#162-1) at Section VI.B.

In its criticism of the public's failure to come forth with sufficient facts regarding Amazon's below marginal cost pricing, the District Court seemed careful to use the phrase "as a whole," somehow suggesting that it has to be shown that Amazon's below-cost pricing of e-books had to concern all of the e-books they offered or that they were "as a whole" sold below marginal cost. Even if the District Court was meaning to suggest that such a showing is an essential element of an action against for predatory pricing, it is beside the point: to judge the reasonableness of the Government's *conclusions* regarding the proposed settlements, it need not be proven that that Amazon would actually be liable in an action for predatory pricing in order to show that the rise in e-book prices that occurred after the switch to the agency model could not have harmed to consumers. That is, **it cannot logically be denied that such increase in e-book prices constituted a correction of the market failure that Amazon created with respect to the huge number of e-books it systematically, and undisputedly, sold below its marginal cost**.

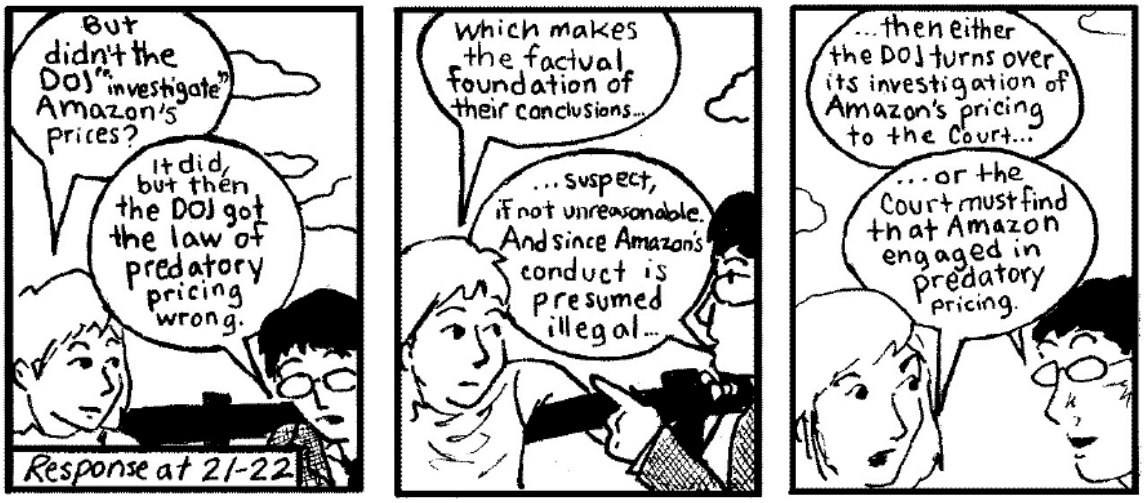
At a procedural level, what the District Court has done here is suggest that it was not the Government's, but the public's responsibility somehow "to show" that Amazon was selling below marginal cost. Where in the Tunney Act does the public have the right to conduct discovery on Amazon's marginal costs? (How else could they have learned this information?) Needless to say, nowhere. On the contrary, the Tunney Act specifically puts the burden of producing such facts upon the Government, requiring that "materials and documents that were considered determinative" in formulating the settlement shall "be made available to the public at the district court." 15 U.S.C. § 16(b).

The District Court has simply turned the Government's statutory responsibility to the public on its head: instead of the Government, the public is now somehow responsible for filing

with the District Court materials and documents that could be the "smoking gun" (or exculpatory opposite) of Amazon's below marginal cost pricing. See, discussion in Section III below regarding *United States v. Bleznak*, 153 F.3d 16 (2d Cir. 1998).

The District Court should either require the Government to produce its documents relating to its investigation of Amazon's trade e-book pricing or appoint a special master under the Tunney Act, Section 16(f), to conduct discovery directly on Amazon to achieve that end.

The second prerequisite for predatory pricing is a demonstration that the predator has a "dangerous probability[] of recouping its investment in below-cost pricing." *Brook Group*, 509 U.S. 209, 224. In order to recoup their losses, the predator "must obtain enough market power to set higher than competitive prices." Id. at 225. **This prerequisite was satisfied by the District Court's *factual finding* that Amazon achieved a "90 percent monopoly" of the e-book market.** Dkt#113 34-35. The existence of the requisite market power ordinarily may be inferred from the predominant share of the market. See, *United States v. Grinnell Corp*., 384 U.S. 563, 571 (1966) (in which 87% of the market constituted "monopoly power").



Moreover, in the Second Circuit, once the first prerequisite is demonstrated, the second is *presumed*. With such a presumption in hand, the Government should not have been expecting members of the public to produce "evidence" of Amazon's threat to drive out competition (Dkt#81 at 22), but disclosing to the District Court exculpatory facts that would overcome that presumption. **Without the presence of facts to overcome the presumption, conduct that resulted in raising illegally-low (consumer welfare-harming) prices back up to the consumer welfare-optimizing level of marginal cost could not have, as a matter of law, harmed consumers.**

If there is nothing intrinsically unlawful about *limiting e-book price competition among e-retailers* through the use of defendants' agency agreements, then the only potentially legitimate Complaint the Government offers is that, as a result of defendants' other alleged conduct, e-book prices went up to the detriment of consumers. But if higher e-book prices under these circumstances could not, as a matter of law, have harmed consumers, then the Government's conclusion in this regard about the settlement was not reasonable. Since that conclusion went to the essence of the settlement—which has the stated purpose of lowering prices for the benefit of consumers—aspects of the Penguin Settlement that restrict agency pricing cannot be in the public interest.

B. Defendants' Conduct Could Not, As a Matter of Law, Have Been a Horizontal Restraint At All

1. Summary of Argument

Because the District Court held, as the Government recognized, that Defendants' agency contracts were lawful (Dkt#113 at 17), the Government's surviving complaint is the alleged "collusive use" of the lawful agency model. Dkt#81 at vi. But that collusive use could not, as a

matter of law, have constituted an illegal horizontal restraint, because (i) the switch to agency pricing, as the Government has alleged, could not have been accomplished without the alleged collusive conduct and (ii) it is undisputed that such conduct did not involve any restraint whatsoever on the right of any publisher defendant to sell its own e-books to any e-retailer at any price. Moreover, notwithstanding the allegation that Defendants colluded in the migration to the agency model, and even if the result of that collusion was a correction of prices back up to the efficient marginal cost level, a settlement which reverses the benefits of that correction, causing the public generally to suffer a misallocation of resources, cannot be in the public interest.

2. Argument

Indeed, in resolving conditions which put the objectives of both copyright and antitrust in concert, the courts have "never examined a practice like this one before." But, in examining those conditions, the District Court can look back to when the Second Circuit was confronted with analogous circumstances of first impression.

As the District Court recognized (Dkt#113 at 39), the U.S. Supreme Court in *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979) held that "blanket licenses" for music performances in the market for network television were not *per se* unlawful. Indeed, such holding did not provide a "blanket exception" to the *per se* rule against horizontal price fixing, but in so ruling the Supreme Court did rule for the first time that *not all horizontal price fixing will constitute a* per se *violation*. This is because collusive conduct may be sustained under the rule of reason where there is a "countervailing procompetitive virtue—such as for example, the creation of efficiencies in the operation of a market or the provision of goods and services." *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 459 (1986) (citing *Broadcast Music*). See also, IP Guidelines, *infra*, at §3.4 (The Government "will assess whether the restraint in question can be expected to

contribute to an efficiency-enhancing integration of economic activity," citing *Broadcast Music*, 441 U.S. at 16-24). [15]

The high court remanded *Broadcast Music* back to the Second Circuit for further proceedings, including an assessment of the horizontal price restraint under the rule of reason. *Broadcast Music*, 441 U.S. at 25; *CBS v. ASCAP*, 620 F.2d 930, 932 (2d Cir. 1980). After remand, however, the Second Circuit never had to evaluate the restraint under the rule of reason, because it held that the collusive activity among the music publishers that resulted in the blanket license did not constitute a restraint *at all*.

This is because (i) the blanket license could not have been accomplished without the music publishers' collusive conduct (see, *Broadcast Music,* 441 U.S. at 23) and, though the publishers engaged in "literal" price fixing to establish the blanket license, (ii) neither their collusive conduct nor the resulting blanket license placed any restraint on the right of any individual copyright owner to sell its own individual compositions separately to any buyer at any price. See, *CBS v ASCAP*, 620 F.2d. 930, 938 (2d Cir. 1980); *Buffalo Broadcasting Co. v.*

[15] The Supreme Court reiterated this principal in *NCAA v. Board of Regents*, 468 U.S. 85 (1984), when seven Justices declared a horizontal agreement on the price of college football television rights unlawful under the rule of reason, expressly declining to condemn it under the *per se* rule. See also, *Indiana Fed'n of Dentists*, 476 U.S. 458-59 ("We have been slow to…extend *per se* analysis to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious," citing as examples *Broadcast Music* and *NCAA*). See generally, Richard S. Wirtz, *Rethinking Price-Fixing*, 20 Indiana L. Rev. 531, 627 (1987) ("After *Broadcast Music* and *NCAA*, the question is not whether exceptions to the general prohibition against agreements among competitors will be recognized, but rather when. Potentially pro-competitive collaboration among competitors is to be encouraged, within limits, even if it involves agreement on prices"); R.G. Lipesy & Kevin Lancaster, *The General Theory of Second Best*, 24 Rev. Econ. Stud. 11 (1956-57) ("The distorting effect of overconsumption could be made worse if, in cases of horizontal price fixing, antitrust laws are used to decrease prices"); Christopher R. Leshe, *Achieving Efficiency Through Collusion: A Market Failure Defense to Horizontal Price Fixing*, 81 California Law Rev. 243, 270. See also, *Northwest Wholesale Stationers v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985) (holding that the *per se* approach only applies if the boycott was "not justified by plausible arguments that [it was] intended to enhance overall efficiency and make markets more competitive"). *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 135 (1998) (upholding the Second Circuit's decision to allow defendants to justify the boycott before it would apply the *per se* rule); *Bogan v. Hodgkins*, 166 F.3d 509, 514 (2d Cir. 1999) ("Absent a showing that a presumption of anticompetitive effect is appropriate, we apply the rule of reason").

ASCAP, 744 F.2d 917, 933 (2d Cir. 1984).

The alleged collusive conduct of the Publisher Defendants in this case never approached the comprehensive price-fixing collaboration among music publishers required to set up and maintain the blanket license. Here, the alleged collusive conduct was merely to accomplish a one-time switch to the agency model, using agreements (including the retail price restraints) the District Court has already conceded were intrinsically lawful. Dkt#113 at 33. It is submitted that, consistent with *Broadcast Music* and *CBS v. ASCAP*, the questions for the Court to consider are:

(1) Could the switch to agency model only be accomplished by the alleged collusive conduct?

(2) If so, did such collusive conduct or the agency agreements restrain any of the defendant publishers from selling any of their individual e-books to the e-retailers or the public at any price?

1. The Switch to the Agency Model Could Only Be Accomplished by the Alleged Collusive Conduct

The Government specifically alleged,

> "This change in business model would not have occurred without the conspiracy among the Defendants." [Complaint ¶5]

The Complaint goes on, repeatedly, to allege facts that "Each Publisher Defendant knew that, acting alone, it could not compel Amazon to raise e-book prices and it was not in its self-interest to attempt unilaterally to raise retail e-book prices." Dkt#1 ¶35. We also know from the Complaint exactly what would happen—because it did happen—if a defendant publisher acted alone in approaching Amazon with an agency agreement. Dkt#1 ¶80 (i.e., Amazon's exercise of its "buy" button "nuclear option" against defendant Macmillan, effectively eliminating 90% of the publisher's e-book and 25% of its printed book revenues in an instant). The Complaint then

alleges that Amazon only agreed to the agency model after it "came to fully appreciate that not just Macmillan but all five Publisher Defendants had irrevocably committed themselves to the agency model across all retailers, including taking control of retail pricing and thereby stripping away any opportunity for e-book retailers to compete on price." Dkt#1 ¶84.

Thus, the Complaint alleges facts, which we here should assume as true, amply showing that switching to the agency model could only have been accomplished by defendants' alleged collusive conduct.

2. Neither Defendants' Alleged Collusive Conduct Nor the Agency Agreements Restrained Any of Defendant Publishers From Selling Their E-Books to the Public at Any Price

The Government has never alleged, and it remains undisputed, that Defendants' alleged collusive conduct did not restrain any of the Publisher Defendants from selling any of their individual e-books to the public at any price. See, *CBS v ASCAP*, 620 F.2d. at 938. See also, *NCAA,* 468 U.S. 85, 114 (with reference to *Broadcast Music*, "each individual remained free to sell his own music without restraint"); *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 355 (1982) ("the blanket license arrangement [in *Broadcast Music*] did not place any restraint on the right of any individual copyright owner to sell his own compositions separately to any buyer at any price" [footnote omitted]).

Neither the alleged information exchanges among the defendants, nor the terms of the agency agreements, were aimed at preventing, or could prevent, any one publisher from charging, for example, $4.95-or-less for each of its e-books in competition with the other publishers. If limiting price competition among e-retailers was not "intrinsically unlawful," then it is impossible to say there was a horizontal restraint to raise prices when there was *no allegation* of any restraint keeping a publisher from lowering the price of any e-book at any time.

Consistent with *Broadcast Music* and *CBS v ASCAP*, therefore, the Defendants' conduct could not, as a matter of law, have constituted a horizontal restraint. Even if it did, that finding would not justify the approval of a settlement containing market restrictions that are nowhere near within reach of the public interest.

C. Restrictions on Agency Pricing Have a Harmful Impact Upon the Relevant Market

The Penguin Settlement reverses at least two undisputed pro-competitive impacts upon the relevant market: reducing Amazon's monopoly power and monopsony power. Meanwhile, the settlement's only alleged pro-competitive impact has been found by the District Court not to exist.

1. Impact Upon Amazon's Monopoly Power

As noted, the District Court found that it is "undisputed" that Amazon had achieved a "90 percent monopoly" in the e-book market and that, following the course of defendants' conduct as alleged in the Complaint, Amazon's market share in trade e-books dropped from an undisputed 90% to 60%. Dkt#113 at 34-34. The restrictions placed on the Defendants' use of agency pricing set forth in the settlements unwind the pro-competitive effects which the District Court found to be undisputed.

2. Impact Upon Amazon's Monopsony Power

The Complaint itself alleges ample facts to demonstrate that defendant publishers faced in Amazon a single buyer generating 90% of their e-book revenues who both wielded and exercised demonstrable monopsony power. Dkt#1 (Complaint) at ¶80.[16] It has been said that a monopsony is the "mirror image" of monopoly. *Todd v. Exxon Corp.*, 275 F.3d191, 202 (2d Cir.

[16] Amazon's exercise of this power against Macmillan was not the first time. Doreen Carvajal, "Small Publishers Feel Power of Amazon's Buy Button," *New York Times* (June 16, 2008). See, Comments of Author's Guild (ATC-0214 at 3, 5-6. http://www.justice.gov/atr/cases/apple/comments/atc-0214.pdf.

2001). Under the textbook economic definition, the monopsonist, in depressing the price of the goods purchased, transfers wealth to itself from the supplier of the goods. According to the Government's own Merger Guidelines, the monopsonist will *not* pass along the lower price input to its downstream consumers. Horizontal Merger Guidelines of 2010 at §12.[17] And, as discussed infra, the use of monopsony power to reduce the price paid to publishers and authors for e-book distribution rights is antithetical to the exercise of the rights of copyright owners, whose pricing is already significantly constrained by the free-rider/piracy problem.[18]

When Amazon's 90% monopoly of the e-book market dropped to 60%, Amazon's monopsony power dropped correspondingly. Neither the Government nor the District Court disputed the fact that this pro-competitive drop in Amazon's monopoly and monopsony power were directly attributed to Defendants' switch to the agency model.

3. Alleged Pro-Competitive Impact Upon the Relevant Market Never Existed

Initially, in its CIS, the Government concluded that the agency price restrictions in the Final Judgment would have pro-competitive impact upon the relevant market, because the termination of defendants' agency contracts would reverse the elimination of e-book price competition among e-retailers. Dkt#5 §III.A.1. But the District Court has since ruled that this alleged pro-competitive impact never existed. Since the District Court found (Dkt#113 at 33), as the Government recognized (Dkt#81 at vi), that Defendants' agency contracts were not "intrinsically unlawful," the effect of the agency contracts—the replacement of e-book price

[17] U.S. Dept. of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (August, 19, 2010) http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf

[18] *Moor-Law* 527 F.Supp. 758, 763, discussed *infra*. See also, John Cirace, *CBS v. ASCAP: An Economic Analysis of a Political Problem*, 47 Fordham L. Rev. 277, 293-94 (1978-79) (the collusive conduct by music publishers in *Broadcast Music* was justified, not by reduced transaction costs, but by the need to balance the monopsony power of the three TV network buyers of musical performances), discussed in Proposed *Amicus Curiae* Brief of Bob Kohn (Dkt#97-1) at 12-14.

competition at the retail level with e-book price competition at the publisher level—was not "intrinsically" anticompetitive.

The worst that could be said about the shift to the agency model was that it had a neutral impact upon the e-book market. Thus, since the objective of the Penguin Settlement is to return e-book price competition to e-retailers (Dkt#5 III.A.1), such objective is not pro-competitive at all.[19]

D. Restrictions on Agency Pricing Have a Harmful Impact Upon the Public Generally

Defendants' conduct, as alleged, had undisputed positive impacts upon the public generally that would be unraveled by the Penguin Settlement.

1. Harms the Public Interest in Promoting the Creation of Works of Authorship

One of the essential the considerations in promoting the public interest underlying *copyright* and *antitrust* is the distinctive nature of the products at issue—copyrightable works of authorship delivered and consumed in *digital* form.

Recognizing the "tax"[20] that the copyright imposes upon consumers required to achieve

[19] Subsequent to entry of the initial Final Judgment, two of the world largest trade book publishers announced their intention to merge. Eric Pfannner & Any Chozick, "Random House and Penguin Merger Creates Global Giant," *New York Times* (October 29, 2012) ("The deal, analysts said, would give the new company, to be called Penguin Random House, greater scale to deal with the challenges arising from the growth of electronic books and the power of Internet retailers…companies [who have] the size to let them negotiate better terms on prices." Given the impact of the Final Judgment upon the relevant market, the proposed merger would appear, not unlike the alleged collusive switch to the agency model, to be a pro-competitive response to Amazon's monopsony power. See, Cirace, *supra*. Apparently, the Justice Department would not disagree, as it has announced that it will not raise an anti-trust objection to the merger. Leslie Kaufman, "Justice Department Approves Random House-Penguin Merger," *New York Times* (February 14, 2013).

[20] Though it results in "a tax on readers for the purpose of giving a bounty to writers" (*Golan v. Holder*, 132 S.Ct. 873, 899 (2012) (opinion by Justice Ginsburg, quoting T. Macaulay, *Speeches on Copyright* 25 (E. Miller ed. 1913), copyright remains an essential means by which "an important public purpose may be achieved." *Sony Corp. of America v. Universal Studios, Inc.*, 464 U.S. 417, 429 (1984).

its important public purpose, the Department of Justice and the Federal Trade Commission jointly devised a specific policy to be applied when enforcing the antitrust laws in cases involving copyrights and other forms of intellectual property. The antitrust enforcement policy of the United States with respect to copyrighted works, such as e-books, is stated in the *Antitrust Licensing Guidelines for the Licensing of Intellectual Property* (April 6, 1995) ("IP Guidelines").[21] The IP Guidelines recognize that intellectual property has important characteristics that distinguish it from other forms of property. IP Guidelines §2.1. Antitrust analysis must take these differences into account in evaluating specific market circumstances in which transactions regarding them occur. Id.

E-books, like music performances and downloads, have the classic characteristics of what are known as, "public goods." See, *Broadcast Music, Inc. v. Moor-Law, Inc*., 527 F.Supp. 758 (D. Del. 1981), *aff'd without published opinion*, 691 F.2d 490 (3d Cir. 1982). First, unlike private goods (e.g., apples or printed books), which can be withheld from the market and released only in exchange for payment, an e-book can be consumed without leaving any less for others to consume. See, *Moor-Law* at 763. Second, the digital nature of e-books facilitates the reproduction of perfect copies at virtually no cost, making it difficult for the copyright owner to exclude persons who do not pay for consuming the e-book—a problem known as the free rider problem,[22] misappropriation,[23] infringement,[24] illegal file sharing,[25] or piracy.

For these reasons, courts have recognized that "the natural market forces of supply and demand do not operate normally on pricing in this market." *Moor-Law* at 763. This is because the cost of acquiring a copy of and consuming an additional *printed book* costs the consumer

[21] http://www.justice.gov/atr/public/guidelines/0558.pdf.
[22] Id.
[23] IP Guidelines §1.0.
[24] *Copyright Act*, 17 U.S.C. §501(a).
[25] *A&M Records, Inc. v. Napster, Inc.*, 239 F.3d 1004, 1011 (9th Cir. 2001).

something. By contrast, because of the free rider or piracy problem, the marginal cost of acquiring and consuming an additional *e-book* can be as low as zero. *Moor-Law* at 763.

The public good characteristics of e-books make normal cost-based pricing infeasible. Id. For example, the price that a publisher can charge for an e-book is subject to a natural constraint: illegal competitors charging zero for the same e-book. In *Moor-Law,* the District Court found, as an observed fact, that "the free rider problem does provide a significant constraint on the price [the copyright owner] charges." Id. The free rider problem tends to make the copyright owner's enforcement costs high. Because higher enforcement costs can more than consume increased revenue from a higher price, the copyright owner considers this problem when setting a price. Id.

Thus, there is an inherent limit to how much "tax" may be exacted from consumers by book publishers for e-books, because they must compete with free riders who can readily take advantage of the e-books' digital form to cheaply trade in pirated copies without payment.

Amazon has repeatedly used its monopsony power in attempts to lower its cost for books. In January, 2008, Amazon removed the buy buttons from more than 1,000 self-published printed books and threatened that these books would be permanently removed from the Amazon website unless the books were published via Amazon's own BookSurge print-on-demand service. See, Comments of Authors Guild (ATC-0214) at 4. That 2008 incident was a precursor to what Amazon did to Macmillan on Friday, January 29, 2010. Dkt#1 ¶80. Had Amazon succeeded in putting Macmillan out of business, there would have been one less major publisher competing to acquire publishing rights from authors—resulting in authors being paid less for publication rights to their e-book manuscripts.

The use of monopsony power to reduce the price paid to publishers and authors for e-books is antithetical to the exercise of the rights of copyright owners, whose pricing is already

significantly constrained by the free-rider/piracy problem. *Moor-Law* at 763. At the same time, there is no corresponding benefit to consumers. According to the Government's own Merger Guidelines, the monopsonist will *not* pass along the lower price input to its downstream consumers. Horizontal Merger Guidelines of 2010 at §12.

These critical distinctions between e-books and printed books should have been part of the factual foundation underlying the Government's decisions in this case. Yet, no mention of these distinctions, nor mention of the IP Guidelines, can be found in any of the Government's filings in this action or the District Court's Entry Order. Dkt#113. By failing to take them into account, the Government's conclusions regarding the Penguin Settlement were not reasonable. By restricting the freedom of authors and publishers to control the price of their works to the public, in way that actually harms competition in the relevant market and the public generally, the proposed settlement unjustifiably interferes with the essential means by which the U.S. Constitution provides them for the purpose of promoting the important public interest in the creation of Writings.[26]

2. Harms the Public Interest in Efficient Prices for E-Books

While the public has a Constitutionally-recognized interest in the promotion of works of authorship, it does not have any interest in low prices. See, Dkt#81 at 21-22 (where the Government expresses its mistaken belief that "low prices" are a "core ambition" of free markets). *Low prices* are <u>not</u> the core ambition of either the law or the markets. *Efficient prices* are. As the Second Circuit has held, consumer welfare is not maximized by "low" pricing, but by "marginal cost" pricing. *Northeastern* 651 F.2d at 87-88.

[26] *U.S. Constitution*, Article I, §8; *Copyright Act*, 17 U.S.C. §101 *et.seq.; Sony Corp.,* 464 U.S. 417, 429 (1984).

By seemingly borrowing the Government's mistaken primacy of "low prices," the District Court was lead, for example, to reject the legitimate concerns expressed by "bricks & mortar" retailers. Retailers of printed books are not seeking protection from "the working of the market" or the "vicissitudes" of competition. Dkt#113 at 23-24. The digital disintermediation of printed book retailers may well be inevitable, but Amazon's below marginal cost pricing does not constitute a "working of the market" or "competition on the merits." As Areeda & Turner (at 712) explain, selling below marginal cost leads to an improper allocation of resources and "greatly increases the probability that rivalry will be extinguished or prevented for reasons unrelated to the efficiency of the monopolist." See, *Northeastern,* 651 F.2d at 87-88.

By allowing a predatory-induced market failure to resume for another two years, the Penguin Settlement will cause the natural disintermediation of physical bookstores to occur *faster* than they would in a competitive market, putting at risk the businesses of physical retailers, large and small, perhaps years before the digital evolution of the book industry would otherwise disintermediate them. The immediate beneficiary of this *accelerated* digital disintermediation is the predator itself, Amazon. This is precisely the kind of misallocation of resources that predatory pricing causes and why the Second Circuit makes it *presumptively* illegal. It invokes the very essence of the Second Circuit's declaration that the purpose of antitrust law is "not to protect businesses from the working of the market," but "to protect the public from the *failure of the market*." *United States v. Int'l Bus. Machines*, 163 F.3d 737, 741-42 (2d Cir. 1998) (emphasis added).

III. THE GOVERNMENT HAS FAILED TO COMPLY WITH THE TUNNEY ACT BY NOT DISCLOSING DOCUMENTS THAT WERE DETERMINATIVE

Compliance with the procedural requirements of the Tunney Act ensures the district court has before it the information it needs in order to make an informed determination whether the decree is in the public interest. *Massachusetts v. Microsoft*, 373 F.3d 1199, 1246 (D.C. Cir. 2004). Accordingly, the Act requires that the Government make available *to the public at the district court* "any other materials and documents which the United States considered *determinative* in formulating" the proposed decree. 15 U.S.C. §16(b) [emphasis added]. Such requirement is confined "to documents that are either 'smoking guns' or the exculpatory opposite." *United States v. Bleznak*, 153 F.3d 16, 20 (2d Cir. 1998).

In its CIS, the Government asserted that it considered "no determinative materials or documents" in formulating the settlement. Dkt#163§VIII. Given, however, that selling below marginal cost is *presumed* illegal in this Circuit, it is not up to objectors to supply "evidence" to the Government of Amazon's threat "to drive out competition." That threat was presumed when the Government alleged facts that Amazon was pricing below marginal cost. Dkt# ¶¶2, 30; Dkt#5 §II.A; Dkt#163 §II.A. Thus, the burden was not on the public, but rather on the Government to overcome that presumption with facts supporting their conclusion that Amazon's below marginal cost pricing was *not* exclusionary.

Accordingly, materials or documents supporting the Government's conclusion that Amazon's e-book business was "consistently profitable" would clearly constitute "either 'smoking guns' or the exculpatory opposite." *Bleznak*, 153 F.3d 16, 20. This is because, to the extent Amazon was pricing e-books at below its marginal cost, any conduct by defendants to raise prices back to the marginal level could not have harmed consumers. Since the alleged *harm to consumers* constituted a "substantial inducement to the government to enter into the consent

decree" (*Bleznak* at 21) such materials and documents were not merely relevant, but *determinative*. By failing to disclose them to the public, it is not in compliance with the Tunney Act and, because they go "to the essence of" the Government's conclusions regarding the Penguin Settlement, entry of such settlement must be denied unless and until such determinative documents are disclosed. See, *United States v. Bechtel Corp*., 648 F.2 660, 664 (9th Cir. 1981).

IV. THE COURT SHOULD APPROVE A REVISED PENGUIN SETTLEMENT

Defendants' conduct was a reasonable means to accomplish a worthy end, a market-based solution aimed at correcting a disruptive market failure resulting from below marginal cost pricing by an undisputed monopoly. Such pricing was harmful to consumer welfare, and Defendants' conduct which lawfully eliminated it resulted in undisputed pro-competitive benefits. *To the extent* it reverses these benefits the Penguin Settlement is an instrument of wrong to the public.

The Government alleges, however, that Publisher Defendants communicated competitive information to each other and that Apple helped transmit messages among them. Dkt#1 ¶¶61, 62. Assuming these allegations are true, which we must at this stage, it may be in the public interest to enjoin any such conduct and to establish a temporary mechanism for monitoring defendants' communications for compliance.

Accordingly, it is submitted that a settlement that contains only the following provisions is in the public interest: Sections I, II, III, V (E and F only), VI (A only), VII, VIII, IX, X, XI, and XII. The intention is to eliminate all of the restrictions on agency pricing, which would otherwise have the effect of unwinding the pro-competitive and impacts upon the relevant market and favorable impacts upon the public generally of Defendants' conduct. At the same time, the balance of the settlement would ensure that any future competitive information

exchanges between or among the Defendants will be enjoined and monitored for compliance over an appropriate timeframe.

The Government cites no Second Circuit authority for the proposition that the District Court's authority under the Tunney Act is limited to merely approving or disapproving a consent decree. Indeed, the Second Circuit, in *de novo* review of a District Court's decision, has held that itself may vacate a consent decree in part and "remand the case to the District Court for entry of a revised decree consistent with [its] opinion." *Guardians Assoc. New York Police Dept., Inc. v. Civil Service Comm'n of the City of New York*, 630 F.2d 79, 113 (2d Cir. 1980).

CONCLUSION

If the Defendants' switch to agency agreements, by definition, eliminated price competition at the retail level, and if those agreements were intrinsically legal, then the price adjustments that naturally resulted from the switch was not the result of any wrongdoing by the Defendants, but the result of the correction of a market failure brought about by Amazon's below marginal cost pricing. These adjustments benefited consumers and the public generally as would any price adjustment that takes place due to market prices returning to their efficient equilibrium—in this case, back up to Amazon's marginal cost. Restrictions on the agency model in the Initial Final Judgment and in the proposed settlements with Penguin and Macmillan have created market inefficiencies that have harmful impacts upon the relevant markets and the public generally. Such terms are no where within reach of the public interest.

In the Second Circuit, the courts have a "larger role" where a consent judgment resolves "antitrust suits by the United States." *United States v. Int'l Bus. Machines Corp*., 163 F.3d 737, 742 (2d Cir. 1988). The disinfectant of the Court's public interest determination under the Tunney Act need not be a placebo. *Cf*., *Broadcast Music, Inc. v.DMX, Inc.*, 683 F.3d 32, 49 (2d

Cir. 2012). The Court is urged to set aside the "rubber stamp" which the Government submitted in the form of its proposed standard of review and approve the proposed Penguin Settlement to the extent it is revised to eliminate all restrictions upon the use of agency pricing.

DATED: February 28, 2013 Respectfully submitted,

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