

Dear DOJ: Please Reconsider on E-Books

Market Watch

June 12, 2012

The following column is an open letter to the U.S. Department of Justice, as part of the public comment period, to protest the proposed settlement in the case of the United States v. Apple Inc., et al., 12-cv-2826 (DLC) (SDNY).

To John R. Read, Esq. Chief, Litigation, III, Antitrust Division, U.S. DOJ:

Do you have a favorite neighborhood bookstore that has managed to survive the turmoil in the book business?

It could end up on the endangered list or eventually shuttered, along with every other physical bookseller still operating in the U.S., if the Department of Justice's current proposed settlement on allegations of price fixing in electronic books goes through.

The lawsuit against Apple Inc. and the two publishers that would not settle with the DOJ seems misplaced, and focused on the wrong parties.

In a rare instance of harmony among often-fractured groups, a consumer electronics giant, two major book publishers, authors, and even a top book-selling chain, Barnes & Noble all agree on the potential outcome of this settlement: Amazon could become a monopoly.

In November 2007, Amazon.com Inc. gave birth to an electronic reader, the Kindle, and in a move to get consumers to embrace this nascent market, it started selling electronic books at \$9.99 a pop. So well did this razor-and-razor blade strategy work that, according to a recent protest submitted to your department by Barnes & Noble Inc., that Amazon grabbed a 90% share of the electronic book market.

"They are apparently favoring a monopolist," Gene DeFelice, general counsel of Barnes & Noble, said in an interview last week after the company voiced its views to the DOJ, in which it said the settlement would be bad for consumers and for the bookselling business in general. "Amazon had a 90% market share before the agency model was introduced. Our view is they are attacking this model, it could go back to potentially go the way it was." Read about Barnes & Noble's response.

Publishers and booksellers were outraged by this pricing of electronic books because Amazon was selling them below its own cost.

In 2010, Apple offered publishers another option to selling electronic books, by letting them set the prices for e-books sold on its new iPad, the first real option to Amazon.com's Kindle e-book reader. So as the publishing industry jumped into a lifeboat offered by Apple to get off the

Titanic, and changed the market dynamics and cut into Amazon's still dominant share, the DOJ sees this as collusion and price fixing.

The settlement that three publishers — Hachette Group, CBS's Simon & Schuster, and HarperCollins, owned by News Corp., (which also owns MarketWatch) — all agreed to will give the DOJ power to police an industry it seems to know nothing about.

Fortunately, two publishers, Macmillan and Penguin Group, and Apple Inc. are not agreeing to the settlement.

“I don't believe the Department of Justice really understands the nature of this business and what this can lead to,” said Al Greco, a professor of marketing, communications and media management at Fordham University. “This is a complicated industry, it's not the same as other industries...I think you will see a restraint of trade....and highly likely that you will see an increase in parties and certain parties not part of this litigation badly hurt [if the proposed settlement is approved].”

Apple's lifeboat is called the agency model, in which they represent the publishers, which set the prices for their electronic books. Apple does not set the prices, as Amazon was doing before Apple arrived.

“When Macmillan changed to the agency model we did so knowing we would make less money on our e-book business,” wrote Macmillan CEO John Sargent, in a blog post in April “We made the change to support an open and competitive market for the future, and it worked.”

Greco said that if the proposed DOJ settlement wins final approval, Amazon will likely return to its previous practices of selling many e-books at \$9.99. Apple stated in its complaint that it would not have entered the e-book business, if it had not been able to sign agency agreements with publishers, which then priced electronic books at slightly higher prices. Apple receives a 30% commission on sales in its iBookstore, as it does in the Apple App Store for the iPhone.

“Independent booksellers were saying if we sell this same book at \$9.99, we will lose \$2.50 to compete with Amazon,” Greco said. “The agency model leveled the playing field, whether you were an independent bookseller or a big box retailer,” Greco said.

Apple states in its answer to the DOJ complaint that its entry in electronic books “benefitted consumers.”

“Apple's entry brought competition where none existed,” Apple said. “Prior to Apple's entry, Amazon effectively stood alone and unchallenged. No longer.... As a result — even as the government is compelled to admit — output has exploded. Consumers enjoy vastly increased choice. Amazon has had to compete and innovate beyond its small black and white eReader, enriching the experience for consumers across all platforms.”

If Amazon become the only or entrenched seller of e-books, there is nothing to stop it from eventually raising prices, if its competitors fade further away. The DOJ settlement could actually lead to less competition and to the disappearance of even more beloved community bookstores.

“None of this is good for the American public,” said DeFelice of Barnes & Noble told me.

I agree. The DOJ needs to rethink its proposed settlement.

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