

June 25, 2012

John R. Read
Chief, Litigation III Section
United States Department of Justice
450 5th St NW
Suite 4000
Washington DC 20530

Dear Mr. Read,

A number of publicly posted letters have analyzed the inadequacy of the proposed settlement to the Department of Justice's recent suit against Harper Collins, Simon & Schuster and Hachette from a variety of different angles. It is clear that the settlement is woefully inadequate and results in a situation diametrically opposed to the desired remedies of the Competitive Impact Statement. While all of the points raised in the letters are valid and important, Barnes & Noble's recently published letter specifically points out the anti-competitiveness of the settlement document. To expand upon B&N's argument, this letter notes that in addition to punishing third parties and the public, the settlement actually rewards the alleged colluders with competitive advantages, placing all other publishers, including the one agency publisher not charged with collusion, at a competitive disadvantage in the marketplace. It is the purpose of this letter to demonstrate the unfairness of the settlement terms to the non-accused publishers. Surely the government and the court should consider the effects of the proposed settlement on innocent third parties.

The proposed settlement clearly states that the agency model is, in and of itself, a completely legal model for selling e-books. As a result, all settling publishers are permitted to enter into a new agency agreement, provided that they follow the restrictions of the settlement. The settling publishers are still free to determine the retail list price of any e-book insofar as it a.) does not restrict an e-book retailer from setting, altering or reducing the retail price or running price promotions, b.) excludes a MFN related to consumer price, and c.) does not retaliate against any e-book retailer. Crucial to the settlement is the restriction upon the e-book retailer that, for periods of one year, an e-book retailer is only permitted to discount its

titles by an aggregate amount equal to the total commissions it is paid by each publisher. All existing agency agreements by non-settling publishers are permitted to stand, and all other players in the e-book industry will be free to conduct business as usual, with or without agency agreements.

What does this mean for the alleged colluders, the settling-publishers? The lack of a MFN, in addition to new agency agreements, creates a hybrid wholesale-agency model that delivers the advantages of both models to the retailer. The publisher is free to set retail prices as high or low as they choose, knowing that retailers are free to discount each title as they choose. It follows, then, that publishers might seek to increase the retail price on *New York Times* bestselling titles during their initial hardcover period. Based on past experience in the industry, it appears likely that retailers would choose to discount this set of titles to \$9.99, though under the proposed terms of the settlement nothing would prevent their discounting these titles to an even greater extent to encourage consumer purchases. This scenario creates the opportunity for settling publishers to simultaneously increase their margin on every sale while simultaneously reaping the promotional benefits of lower consumer prices. Consider the following example:

Settling Publisher A enters into a new agency agreement with E-book Retailer X with a negotiated commission of 30%. A new title, by a previous *New York Times* bestselling author, is published. Because they are allowed to set prices at the price point of their choosing, they set the retail price of the title is \$17.99 during the initial hardcover period. Settling Publisher A earns \$12.59 per copy sold. E-book Retailer X sees value in this desirable title, and discounts the title to \$9.99, or even lower, to encourage a greater number of purchases. In either event, at \$9.99, Publisher A's bestselling titles are attractively priced below the \$12.99 price set by a non-accused agency publisher.

What does this same example look like for innocent parties—agency publishers not accused of collusion, non-agency publishers, or non-traditional publishers? This is what might happen **for an innocent publisher using the agency model:**

Publisher B's agency agreements with E-Book Retailer X are not terminated by the Department of Justice's Final Judgment. They, too, have a commission rate of 30% and publish a new title by a previous *New York Times* bestselling author at the same time as Settling Publisher A. They set a retail price of \$12.99 to compete with current market prices. At this price point, Publisher B earns \$9.09 on each title. However, Publisher B's title will not be discounted with the same flexibility as Settling

Publisher A. Therefore, in order to compete with Settling Publisher A, Publisher B must either sacrifice sales or reduce their price to \$9.99, sacrificing \$2.10 per copy sold for total revenue of \$6.99.

Settling Publisher A, in both cases, earns more than Publisher B. What the government's terms have created is a situation in which an innocent agency publisher would be making 44% less per sale than Settling Publisher A, as shown in the example above, in order to compete on price with a similar title. In other words, an agency publisher utilizing a legally valid method of selling its e-books faces an absurd, governmentally-mandated dilemma: lose sales to lower priced competitors who nonetheless receive greater profit per copy sold or lose profit per copy sold in order to match its competitors' prices.

For non-traditional publishers, such as independently published titles:

Given the new freedom for a retailer to discount any title (given they do not exceed the commissions paid), it follows that retailers will discount certain titles to a much lower list price, or even give them away for free as part of a subscription service. As the e-book industry has expanded, there has been an explosion of new publishers selling books at very low prices, \$0.99 to \$4.99, for example. As a result of traditionally published books potentially becoming available at much lower prices, consumers will not have the same incentives to purchase these independently published titles as they have been incentivized to do so in the current marketplace. These publishers, and these titles, are filling a market need and are profiting from doing so—a benefit of a capitalist marketplace free of unwarranted governmental regulation.

These examples demonstrate that, at the hand of the Department of Justice, alleged colluders are rewarded with a competitive advantage while innocent competitors are punished with significant disadvantages. This achieves the opposite of the proposed settlement's intent. It does not punish the alleged colluders. Rather, the unnecessary regulatory interference of the Department of Justice introduces the opportunity for higher e-book retail prices and forces innocent parties to adapt to a new and unstable e-book marketplace.

The young and growing e-book market has allowed new business entities to arise (and profit), has spurred creative innovation in new technologies, and, contrary to the DoJ's belief, has resulted in lower and competitive prices for consumers, as demonstrated clearly by data presented by Barnes & Noble and others. These are all the benefits of a free market economy, the very foundation of which an anti-trust and price-fixing suit aims to protect. If the goal of

the settlement is to bring an end to the alleged anti-competitiveness of the settling publishers, the settlement cannot be permitted to stand in its current form. Not only is it shortsighted and lacking compelling or sufficient data, it is also anti-competitive by virtue of its own nature. It would be a grave failure of the court to not require a closer examination of pro-competitive and satisfactory settlement terms.

Sincerely,

A handwritten signature in black ink, appearing to read 'K. Zaneccchia', with a stylized flourish at the end.

Katie Zaneccchia
Digital Rights Manager
Writers House