From: Robin Straus [mailto:robi[REDACTED]]
Sent: Friday, June 08, 2012 1:16 PM
To: Read, John
Subject: DOJ Publishing settlement

Dear Mr. Read,

I am writing to express my complete disagreement with the recent DOJ settlement with three major US publishers. I know you recently received the following email from Simon Lipskar of Writers House and I want to say I completely agree with all he says. Please reconsider!

Sincerely,

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From Simon Lipskar:

The settlement with three major publishers recently announced by the Department of Justice demonstrates that the government has a fatally flawed understanding of the economics and history of the emerging ebook industry and, as such, has constructed a settlement that undermines a healthy market defined by robust competition. It is my obligation as the president of one of the industry's leading literary agencies to write and try to persuade the court not to approve this ill-conceived settlement.

There are three significant areas in which the settlement is flawed, the first creating the greatest confusion: simply put, the settlement seeks to provide a remedy for alleged behavior that has caused no discernible damage. Beyond that,

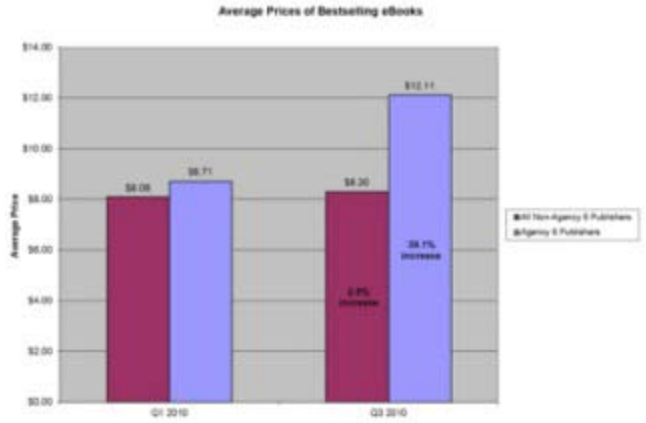
the settlement has ambiguous and unenforceable provisions, which make the terms agreed to untenable on the basis of actual business practice. And equally importantly, the government has failed in its obligations to provide "a description and evaluation of alternatives to such proposal actually considered by the United States," as demanded by the Tunney Act.

I. Did the Alleged Collusion Cause Consumer Harm?

The government's investigation into agency pricing springs from a flawed premise. On Page 8 of the Competitive Impact Statement, the United States makes a claim that is wholly unsupported by fact: "As a result of Defendants' illegal agreement, consumers have paid higher prices for e-books than they would have paid in a market free of collusion."

A. Actual Price Consequences of Agency Pricing

The only thing that clearly happened as a result of the switch to agency by the five original agency publishers named in the Department of Justice's suit is that the prices for a limited number of titles published by these publishers increased, i.e. those ebooks that were digital editions of newly released bestselling hardcover titles. Amazon had quite explicitly promised its consumers that these titles would be available at $9.99, and with the switch to agency pricing, these titles did indeed increase in price, mostly to $12.99. This is clearly demonstrated by an illustration included in the related class action filing:



B. No Price Increase for Non-Bestselling Titles

It is important to note what this data represents and what it does not: this data only purports to show that the average prices of bestselling ebooks published by

the five agency publishers increased by 39.1% between Q1 and Q3 2010. In the flawed logic of both the attorneys for the class action plaintiffs and the Department of Justice, **the increase in the price of a specific set of ebooks is erroneously generalized into a broader increase in the price of all ebooks**, which is demonstrably untrue. As an example of this kind of generalization, in Section II.A. of the Competitive Impact Statement, the government notes that Amazon was only discounting "a portion" of the catalog at $9.99, primarily ebook editions of *New York Times*-bestsellers – though the document glosses over the fact the issue at hand was the ebook pricing of hardcover bestsellers, not all bestsellers – but by Section II.B. and following, all references to "bestselling" disappear in favor of broad and false assertions about a general "$9.99 price for e-books."

In fact, **prior to the change to agency pricing, many ebooks were sold by Amazon for significantly more than $9.99** (the price that is widely and incorrectly perceived by the government and the public to be the highest price for an ebook before agency). As reported by Publishers Lunch, an industry newsletter, on February 24, 2009, "Using two different methods for checking Kindle price data in Amazon's system, we find that roughly 30 percent of the 240,000 or so Kindle titles sell for more than $9.99 (and well over 20 percent sell for more than $20)." In other words, the data shown in the graph above demonstrates only that the price for the average bestselling ebook increased, which is quite a different sentence than the one in the Competitive Impact Statement, which in its vagueness implies that consumers paid higher prices generally as a consequence of agency.

The Publisher's Lunch study from February 2009 in point of fact demonstrates that **the price of many non-bestselling ebooks decreased** when publishers moved to agency pricing. While I do not have access to historical price data at Amazon from that period, anecdotally, it was clear at the time that an ebook not priced down to $9.99 (because it was not part of the select set of bestselling titles Amazon chose to loss lead) was generally priced around fourteen or fifteen dollars. (As an aside, even today, most hardcover-period ebooks from non-agency publishers are sold by Amazon for prices well above $9.99, unless the title is a bestseller. This can be quickly and easily demonstrated by examining the ebook prices of recent hardcover releases from non-agency trade publishers; as an example, on May 4, the ebook prices at Amazon for new hardcover releases from the Bloomsbury USA winter catalog, spanning publications from January to

April, ranged from $11.54 to $16.50 with an average of $13.60. The wholesale model, with prices set by the retailer, is not leading to lower consumer prices for these titles; were they to be priced under the agency model, some prices would be marginally more, some would be marginally less. But in no case would one be able to argue that agency pricing was inherently causing increased prices for the consumer.)

What this means is that, counter to the endless claims made by the government that agency prices for ebooks raised the consumer price of all ebooks, in fact, by setting most hardcover-period ebooks to $12.99, agency publishers were raising the consumer price of a small set of bestselling titles but simultaneously **decreasing the price paid by the consumer on many other hardcover period ebooks**. The short-sighted focus by the government on the price effects of agency on only a limited number of bestselling titles demonstrates the inaccuracy of its larger and counter-factual generalizations about broader price consequences; the government here is straightforwardly guilty of the hasty generalization fallacy, in which a general rule is drawn from a single case.

C. Average Prices for eBook Bestsellers Today Are No Higher Than Before Agency

On April 27, I examined the prices of the Top 100 bestselling ebooks on the Amazon Kindle store and the data from that perfectly random and ordinary day demonstrates quite explicitly that the average price of bestselling ebooks has dropped from every measurable standpoint since Q3 2010 (n.b. I was only able to capture data on the top 80 titles before the site updated as it does every hour, so I am including only data on the top eighty bestsellers). Though at the present time, Amazon is estimated to represent only 60-65% of the ebook market, it is reasonable for our purposes to compare prices on the Kindle store today with the data presented in both the government's and the class action lawsuits, as the data in those filings was quite clearly provided to the plaintiffs in both cases by Amazon; therefore, evaluating present day Kindle pricing against the historical pricing data in the filing presents an apples-to-apples comparison that is consistent and reasonable.

Excluding non-book products (periodical subscriptions and software) and compilations, 60% of the ebooks in the top 80 bestselling products were priced under the agency model. Though the chart above does not provide a weighted

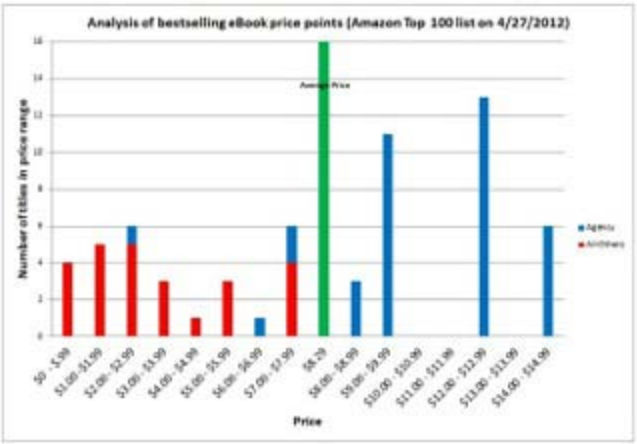
average of all ebook bestseller prices, given that in Q3 2010, Random House was still on the wholesale model, it is reasonable to conservatively assume that agency publisher ebooks represented 50% of all titles in the graph above. That would imply that the average price of a bestselling ebook was approximately $8.40 in Q1 2010 prior to the introduction of agency and approximately $10.20 in Q3.

Compare the data from the class action filing to that from April 27:

What this demonstrates is that **the price of the average bestselling ebook has decreased significantly**, from approximately $10.20 in Q3 2010 to $8.29 on April 27 – a decrease of 19% in the two years since the introduction of agency pricing – and that, furthermore, **the average price today is in fact lower than it was before the introduction of agency pricing**. (As a side note, it's also clear that even agency-priced ebooks themselves are now cheaper than they were shortly after the introduction of agency.)

D. Entry of New Competitors Creates Broad Competition and Price Decreases

How the average price of bestselling ebook titles has fallen by almost 20% since the advent of agency pricing can be seen from the following illustration, which further breaks down the data from April 27:



What we see here is that, two years into the introduction of agency pricing, we have **a broad range of prices for bestselling ebooks**. Why is that? While it is difficult to draw straight cause-and-effect conclusions, it is fairly obvious that the overall market has responded to higher pricing of a certain set of ebooks with exactly the healthy and dynamic results that economics would predict. The market has seen profoundly increased price competition, resulting in lowered ebook prices for consumers, via the introduction of new competition for the traditional publishers' offerings. On April 27, for example, 11 of the bestselling titles were self-published by their authors; these titles ranged in price from $.99 to $3.99. Seven of the titles were published by traditional print publishers (i.e. trade publishers other than the six agency publishers) under the wholesale model, with consumer prices ranging from $1.99-7.99. Two of them were published by Amazon's own publishing venture ($1.99 and $7.99). And four of them were published by new digital publishers that did not even exist in early 2010; their titles were priced from $1.99-7.96.

The point here is clear: it is impossible to look at today's ebook marketplace – from a price perspective alone – and not see that, rather than causing a general increase in prices, instead **the agency period has evidenced a remarkable explosion of competition**, with new publishers, self-publishers and retailer-owned publishers providing consumers ebooks at lower prices than the agency publishers and taking significant market share from them in the process.

In other words, the agency model period has seen greatly increased price competition, to the clear benefit of the consumer, in no small part because the original five agency publishers lacked, in economic terms, collective market power. The new entities that have arisen have taken advantage quite specifically of the competitive opportunity presented by agency pricing of bestselling titles,

and it seems quite clear that agency pricing of bestsellers has been one of the key factors fostering procompetitive market dynamics.

E. Agency Creates Proconsumer Competition

Furthermore, **agency has fostered more competition at every level**. It has increased competition between retailers (the market is no longer dominated by a single retailer with 90% market share, but is now a competitive field with multiple retailers with significant share, and there is reasonable likelihood that we will see more competitors enter the market). It has created new competition for established authors, who have seen self-published authors and new digital publishers take a meaningful share of the market. It has created dramatic new competition for traditional publishers, as previously shown. Lastly, it has **not increased the average price of bestselling titles** and, more generally, it may well have decreased the overall cost of all titles on average. In other words, competition, from every perspective, is healthy and well, and clearly in no need of governmental intervention.

One specific area of competition that benefits from further illustration is the way that agency pricing has fostered **aggressive competition in the area of the e-reading devices**, leading to extraordinary consumer benefit in the form of fast-paced innovation and dramatically lowered prices for the devices themselves. Since the introduction of agency, we have seen two strands of proconsumer development in this regard: 1) the development of new tablet devices, especially Amazon's Kindle Fire and Barnes & Noble's Nook Tablet, designed to compete with the Apple iPad and delivering tablet computing at a price point far below the market leader; and 2) the continued technological innovation and remarkable price competition of dedicated e-readers (generally based on e-ink technology), bringing the retailers' entry-level e-reading products down to $79 from Amazon's introductory price of $399 in November 2007, **a decrease of 82%** in the space of just a few years. It is literally impossible to imagine that the technological innovation and price competition that has unquestionably occurred would have delivered so much consumer benefit absent an economic model for the sale of bestselling content that engendered retail competition. And this yet again demonstrates the dangers of the government's simplistic and narrow-minded view of competition**; by refusing to use any lens other than examining the increased price of agency-**

model*bestsellers* to determine whether the market is procompetitive, the United States has completely misread the facts, seeing the price of specific books as a stand-in for the overall market and missing the substantial consumer benefits delivered by ferocious device innovation and price competition.

F. Summary and Examination of Government's Claims

In Section II.C. of the Competitive Impact Statement, titles "Effects of the Illegal Agreement," the government summarizes its case for the anticompetitive effects of the alleged collusion as follows:

As a result of Defendants' illegal agreement, consumers have paid higher prices for e-books than they would have paid in a market free of collusion. For example, the average price for Publisher Defendants' e-books increased by over ten percent between the summer of 2009 and the summer of 2010. On many adult trade e-books, consumers have witnessed an increase in retail prices between 30 and 50 percent. In some cases, the agency model dictates that the price of an e-book is higher than its corresponding trade paperback edition, despite the significant savings in printing and distributing costs offered by e-books.

If this is the government's entire argument as to the economic effects of the alleged collusion, it is safe to say that its case has no validity. The first sentence re-introduces the broad and false generalization about "higher prices for e-books." The second two sentences need to be read together to be understood. Two claims are made here: that the "average" price for ebooks published by agency publishers increased by 10% as a consequence of the alleged collusion and that for "many adult trade e-books," the prices increased by 30-50%. For the average price of all ebooks from these publishers to rise by 10% while a subset of those titles increased by 30-50%, by mathematical definition that subset must be either small in order to minimize the effect of this large an increase and/or there would have to be an offsetting decrease in the price of a different subset of titles. Either way, the broad generalization made in the first sentence does not match the government's own assertions about the price consequences: there cannot be generally "higher prices for e-books."

Furthermore, the government's assertion that prices increased by 30-50% for "many" trade e-books, without defining which books those are, is yet another

strained attempt to interpret the increased price of bestselling hardcover-period ebooks published by the agency publishers as a more general increase; the use of 30% and 50% as markers is self-evidently based upon the increase from $9.99 to $12.99 (i.e. 30%) in most cases and $14.99 (i.e. 50%) in others (Apple's price-banding requirements demanded that publishers only price hardcover period ebooks at $14.99 if their print prices exceeded a certain level, and most hardcovers at that time were below that price point); the quite specific consumer price increase of 30% and 50% for a limited set of hardcover-period bestselling ebooks does not in any way equate to a 30-50% increase in prices more generally, and it is the very use of the percentage increases attached to this one situation that underline the limitations and invalidity of the United States' broader argument.

Finally, the last claim is perhaps least compelling of all, that the agency model "dictates" that the prices for certain ebooks are higher than their corresponding trade paperback editions. Since agency model publishers continue to sell physical books under the traditional wholesale model, this is an apples-to-oranges comparison. As an example, if the trade paperback had a list price of $16, a typical price for this format, a retailer would pay the publisher approximately $8 per copy (after the near 50% discount); the ebook edition would likely be priced at $9.99 and would pay the publisher $7 per copy (after the 30% commission). The "significant savings in printing and distributing" that the government cites are in point of fact reflected in the decreased revenue to the publisher; the $1 (or 12.5%) decrease represents a very significant majority percentage of the actual cost savings. In any event, if the consumer price for a trade paperback is less than the ebook, that's not because the agency model "dictated" anything; it's because the retailer chose to discount the title aggressively enough that the price fell below the publisher-set ebook price. And, in fact, because the print prices are in effect always set by the retailer, it is wholly unreasonable to claim that the publisher is responsible for the differential. A retailer who wishes to price a print edition below the corresponding ebook is always free to do so, and the fact of that differential has nothing to do with publisher avarice or the agency model per se.

All in all, **the government's summarizing claims about the "effects" of the alleged collusion reveal themselves to be inconsistent with the**

facts. Indeed, it is only through selective and inconsistent use of data tied to hasty generalization that the government is able to make its ultimately unconvincing claims about these "effects." The actual facts utterly belie the United States' claims.

G. No Consumer Harm

For all these reasons, there has been no discernable consumer harm from the advent of agency pricing. Even if an individual consumer was unhappy with the agency pricing of bestsellers, the existence of other options, including new competitive ones that have thrived since agency, means that harm cannot be ascribed to the decision to buy a $12.99 ebook. Were there no other options beside agency model ebooks priced above previous bestselling ebook prices, there might be a case for consumer harm, but the market dynamics have instead delivered clear price benefits to consumers. On a basic level, the fact that average price for bestselling titles has not increased, which undermines the foundational claim made by the government, demonstrates conclusively that there can be no real consumer harm.

Absent demonstrable consumer harm, **there is no competitive reason for the United States to punish the alleged collusion in the manner suggested by the settlement**; rather, the terms mandated by the settlement should have focused on the collusion itself, not the damages from it, since there are none. In other words, the remedies prescribed by the settlement are designed to fix a non-existent problem. Despite the United States' narrow definition of competition being evidenced through price competition on agency-priced hardcover-period bestselling ebooks alone, it is clear that the settlement would disrupt the market and perhaps even disrupt the proconsumer pricing environment currently in place. This would be in nobody's interest, since a properly functioning market should be in every economic actor's interest, including not only the settling publishers and their authors, but all of the retailers, publishers and self-publishing authors whose businesses would almost certainly be directly damaged by the consequences of the new settlement.

Simply put, **the settlement fails the simple test of being in the public interest**. The United States has grievously misunderstood the actual consequences of agency pricing, and it has been led by its misunderstanding to demand a settlement that demands remedies where there is no harm, undermining the vibrancy and resilience of the marketplace. There can be no

wisdom in approving the government's unwarranted intervention in a functional and competitive market: it is impossible to see how this can be in the public interest.

II. Settlement Terms Are Ambiguous and Unenforceable

The settlement also fails by permitting only ambiguous and unenforceable terms with retailers. Settling publishers attempting to negotiate with retailers are permitted only one restraint on discounting, which is that the aggregate discount on all of a specific publisher's ebooks offered to consumers may not exceed the total commissions on the sales of that publisher's ebooks during a period not to be less than one year. However, there are no mechanisms permitted for monitoring and enforcing this provision. Even if publishers are given sufficient data from the retailers to monitor the running aggregate discount (which is hardly guaranteed by the settlement and without which the whole provision becomes meaningless), how, within the tremendous restrictions of the settlement, is a publisher to prevent a retailer from exceeding that permitted discount? For example, if after three quarters, a retailer has an aggregate discount totaling more than the commissions paid by the publisher, what mechanisms does the settlement permit to prevent the retailer from unilaterally refusing to limit its discounting in the next quarter in order to finish the year period without exceeding the ultimate aggregate discount? Publishers are not permitted to use any mechanism but the requirement to adhere to the overall total, but without any realistic ability to limit that discounting during the period if it is mathematically obvious that the discount will be exceeded, it is nearly impossible to imagine that the discount limits would not be exceeded in the example cited above. **The ambiguity of the permitted discount terms makes them unenforceable** – and more importantly, puts them in conflict with the Tunney Act's requirement that the settlement terms be unambiguous.

III. Failure to Describe and Evaluate Alternatives to Settlement

Lastly, and significantly, the statute requires that the United States provide the court the information needed to determine whether the settlement is in the public interest. Specifically, the Tunney Act requires that the United States provide "a description and evaluation of alternatives to such proposal actually considered by the United States." In the Competitive Impact Statement, the United States' "description and evaluation of alternatives" is limited to the

following: “At several points during its investigation, the United States received from some Publisher Defendants proposals or suggestions that would have provided less relief than is contained in the proposed Final Judgment. These proposals and suggestions were rejected.” It’s self-evident that these two sentences fall decidedly short of “description and evaluation of alternatives,” instead simply asserting that the publishers’ alternatives would provide less relief (a questionable notion in itself, given the lack of demonstrable harm that demanded said relief). **It is nearly impossible to imagine how the government’s cursory and dismissive compliance with the Tunney Act’s provisions permit the court to make an assessment** of whether the particular settlement terms demanded by the United States, having “rejected” the publishers’ suggestions, are the correct approach or whether other, less disruptive, intrusive and ultimately anticompetitive terms, might better serve the demands of competition and the public interest as a whole.

IV. Suggestions for Procompetitive Alterations to Settlement

Despite the government’s unwillingness to consider reasonable alternatives, it is easy to see, even within the outlines of the current settlement, the basis for a more rational agreement. The list of existing settlement terms that could easily form the foundation of a new settlement might be:

- Required termination of existing ebook contracts with Apple as well as other retailers.
- Removal of all terms that limit **negotiated** retail and promotional innovation, such as MFNs (most favored nations clauses) related to consumer price, requirements for print and ebook editions to be released simultaneously, retailer-set pricing bands and other such anticompetitive restrictions.
- Oversight by the Department of Justice over the formation of new joint ventures between settling publishers.
- Banning of price-setting agreements between competitive publishers. Prohibition of illegal sharing of confidential or competitively sensitive information.
- Implementation of an antitrust compliance program, with continued governmental oversight.
- Governmental endorsement of the agency model per se.

Such a settlement would address exactly those aspects of the publishers' behavior that the government believes to be collusive and would not negatively impact the existing competitive market.

There are two clear central aspects of the current settlement, however, that would need to be removed to satisfy the public interest and the demands of the Tunney Act:

- Prohibition of publisher-enforced restrictions on non-negotiated retailer discounting.
- Overbroad and undefined prohibition on retaliation against retailers, which make the settlement terms ambiguous and unenforceable.

In conclusion, this settlement cannot be permitted to stand. It is demonstrably not in the public interest, and the United States has failed even in its straightforward obligations to the public and the court to provide the means to evaluate whether the settlement's terms offer the best outcome for the public at large and the market as a whole. I would ask the court to consider carefully whether to endorse this ill-conceived interference in the competitive workings of this dynamic marketplace or whether, instead, to reject the settlement and demand that the parties construct a more reasonable one in the name of true competition.

Yours,

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