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

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| UNITED STATES OF AMERICA,<br><br>Plaintiff,<br><br>v.<br><br>APPLE, INC., et al.,<br><br>Defendants. | Civil Action No. 12-CV-2826 (DLC)<br><br>ECF Case |

**COMPETITIVE IMPACT STATEMENT**

Pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA" or "Tunney Act"), 15 U.S.C. §§ 16(b)-(h), Plaintiff United States of America ("United States") files this Competitive Impact Statement relating to the proposed Final Judgment against Defendant Penguin Group (USA), Inc. and The Penguin Group, a division of Pearson PLC, (collectively these two entities are referred to herein as "Penguin"), submitted on December 18, 2012, for entry in this antitrust proceeding.

## I. NATURE AND PURPOSE OF THE PROCEEDING

On April 11, 2012, the United States filed a civil antitrust Complaint alleging that Apple, Inc. ("Apple") and five of the six largest publishers in the United States ("Publisher Defendants") restrained competition in the sale of electronic books ("e-books"), in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. Shortly after filing the Complaint, the United States filed a proposed final judgment ("Original Judgment") with respect to Defendants Hachette Book Group, Inc. ("Hachette"), HarperCollins Publishers L.L.C. ("HarperCollins"), and Simon & Schuster, Inc. ("Simon & Schuster"). That Original Judgment settled this suit as to

those three defendants. Following a thorough Tunney Act review process, the Court granted the United States' Motion for Entry of the Original Judgment. (Docket No. 119).

Penguin has now agreed to settle on substantially the same terms as those contained in the Original Judgment. A proposed Final Judgment with respect to Penguin ("Penguin Final Judgment" or "PFJ") that embodies that settlement was filed today. Of course, the case against the remaining Defendants—Apple, Inc., Verlagsgruppe Georg von Holtzbrinck GmbH, and Holtzbrinck Publishers, LLC d/b/a Macmillan—will continue.

The Penguin Final Judgment is described in more detail in Section III below. Because the language of the Penguin Final Judgment closely follows the language of the Original Judgment, this Competitive Impact Statement incorporates but does not repeat the extensive record relating to the Original Judgment.

The United States and Penguin have stipulated that the Penguin Final Judgment may be entered after compliance with the APPA, unless the United States withdraws its consent. Entry of the Penguin Final Judgment would terminate this action as to Penguin, except to the extent that Penguin has stipulated that it will cooperate in the United States' ongoing prosecution of the remaining Defendants, and that this Court would retain jurisdiction to construe, modify, and enforce the Penguin Final Judgment and to punish violations thereof.

## II. BRIEF SUMMARY OF THE EVENTS GIVING RISE TO THE ALLEGED VIOLATION OF THE ANTITRUST LAWS

As described in detail in the United States' Complaint (Docket No. 1), and the Competitive Impact Statement relating to the Original Judgment ("Original CIS," Docket No. 5), Publisher Defendants desired to raise retail prices for e-books. (Compl. ¶ 3.) They were primarily upset by Amazon.com, Inc.'s ("Amazon's") pricing of newly released and bestselling

e-books at $9.99 or less. (Compl. ¶¶ 32-34.) Publisher Defendants feared that Amazon would resist any unilateral attempt to force an increase in e-book prices and that, even if an individual Publisher Defendant succeeded in such an attempt, that Publisher Defendant would lose sales to any competitors that had not forced the price of their books to supracompetitive levels. (Compl. ¶¶ 35-36, 46.) They met privately to discuss ways to collectively solve "the $9.99 problem." (Compl. ¶¶ 39-45.) Ultimately, Publisher Defendants agreed to act collectively to raise retail e-book prices. (Compl. ¶¶ 47-50.)

Apple's entry into the e-book business provided a perfect opportunity to coordinate the Publisher Defendants' collective action to raise e-book prices. (Compl. ¶ 51.) At the suggestion of two Publisher Defendants, Apple began to consider selling e-books under an "agency model," whereby the publishers would set the prices consumers ultimately paid for e-books and Apple would take a 30 percent commission as the selling agent. (Compl. ¶¶ 52-54, 63.) Apple recognized that, under this scheme, "the customer" would "pay[] a little more," but that Apple would realize margins far in excess of what other retailers then averaged on their sales of newly-released and bestselling e-books. (Compl. ¶ 56.) To achieve this goal, Apple first expressly proposed to each Publisher Defendant that it adopt an agency pricing model with every outlet that would compete with Apple for retail e-book sales, Compl. ¶ 58, and later replaced that express requirement with a unique most favored nation ("MFN") pricing provision that effectively enforced the Publisher Defendants' commitment to impose the agency pricing model on all other retailers. (Compl. ¶¶ 65-66.) This MFN protected Apple from price competition from other retailers, guaranteeing that its 30 percent margin would not be disturbed. (Compl. ¶ 65.) Apple kept each Publisher Defendant informed about the status of its negotiations with

other Publisher Defendants. (Compl. ¶ 61.) In January 2010, Apple sent to each Publisher Defendant substantively identical term sheets that Apple told them were devised after "talking to all the other publishers." (Compl. ¶¶ 62-64.) Those term sheets formed the basis of the nearly identical agency agreements signed by each Publisher Defendant ("Apple Agency Agreements"). The purpose of these agreements was to raise and stabilize e-book prices. (Compl. ¶ 66.) Apple CEO Steve Jobs explained to one Publisher Defendant that the Apple Agency Agreements provided a path for the Publisher Defendants away from $9.99 and to higher retail e-book prices. (Compl. ¶ 71.) He urged the Publisher Defendants to "[t]hrow in with Apple and see if we can all make a go of this to create a real mainstream e-books market at $12.99 and $14.99." *Id.* Apple and the Publisher Defendants adopted these price points in all of the Apple Agency Agreements, which all were signed within a three-day span in January 2010. (Compl. ¶¶ 74-75.) 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. (Compl. ¶¶ 90-93.)

## III. EXPLANATION OF THE PENGUIN FINAL JUDGMENT

The language and relief contained in the Penguin Final Judgment is largely identical to the terms included in the Original Judgment. Below, we describe, in abbreviated form, the purpose of each provision of the Penguin Final Judgment. Penguin's decision to join the other settling Publisher Defendants in agreeing to the settlement terms will provide prompt, certain, and effective remedies that will continue the effort to restore competition to the marketplace. Settlement likely will lead to lower e-book prices for many Penguin titles; prices for titles offered by HarperCollins, Hachette, and Simon & Schuster fell soon after those publishers

entered into new contracts as a result of the Original Judgment.[1] The requirements and prohibitions included in the Penguin Final Judgment will eliminate Penguin's illegal conduct, prevent recurrence of the same or similar conduct, and establish a robust antitrust compliance program.

A. Required Conduct (Section IV)[2]

The Penguin Final Judgment begins by addressing those agreements used collusively to raise and stabilize e-book prices across the industry, requiring that Penguin terminate its Apple Agency Agreement within seven days of this Court's entry. *See* PFJ § IV.A. Because this agreement included an MFN clause—ensuring that Penguin would remove retail pricing control from e-book retailers—Section IV.B requires that Penguin's contracts with retailers that restrict retailer pricing or include a Price MFN also be terminated. *See* PFJ § IV.B. Penguin must take the steps required under each contract to terminate beginning no later than ten days after the Court enters the Penguin Final Judgment. Section IV.B also allows any retailer with such a

[1] *See, e.g.*, Scott Nichols, *HarperCollins Offering Discounted eBooks After Price Fixing Settlement*, TechRadar (Sept. 12, 2012), http://www.techradar.com/news/portable-devices/portable-media/harpercollins-offering-discounted-ebooks-after-price-fixing-settlement-1096467 ("Bestselling ebooks from the publisher such as 'The Fallen Angel' and 'Solo' can now be found for $9.99 on Amazon, Barnes and Noble, and other online retailers."); Nate Hoffelder, *Hachette Has Dropped Agency Pricing on eBooks*, The Digital Reader (Dec. 4, 2012), http://www.the-digital-reader.com/2012/12/04/hachette-has-dropped-agency-pricing-on-ebooks/ ("Amazon is discounting the ebooks by $1 to $4 from the list price, and both Barnes & Noble and Apple are making similar discounts"); Jeremy Greenfield, *Simon & Schuster Has a New Deal With Amazon, Other Retailers*, Digital Book World (Dec. 9, 2012), http://www.digitalbookworld.com/2012/looks-like-simon-schuster-has-a-new-deal-with-amazon-other-retailers/ ("Ebook prices were lowered for Simon & Schuster titles over the weekend on sites like Amazon and Nook.com to levels several dollars below what they had been earlier in the week.").

[2] Like the Original Judgment, Sections I–III of the Penguin Final Judgment contain a statement acknowledging the Court's jurisdiction; definitions; and a statement of the scope of the proposed Final Judgment's applicability. As with the settling defendants in the Original Judgment, the definition of Penguin has been drafted to ensure that the Judgment does not bind subsidiaries of Penguin's parent corporation that are not in the book publishing business. Additionally, the definition has been modified to avoid any doubt that if Penguin and Random House, Inc. combine, as recently proposed, the future entity will be subject to the decree. *See* PFJ § II.K.

contract the option to terminate its contract with Penguin on 30 days notice. *See also* Original CIS § III.A.1.

Further, in order to reduce the risk that Penguin may use future joint ventures to eliminate competition among Publisher Defendants, Section IV.C requires that Penguin provide advance notice to the Department of Justice before forming or modifying a joint venture between it and another publisher related to e-books. *See also* Original CIS § III.A.2. Anticipating this requirement, the Penguin Final Judgment notes that Penguin already has provided appropriate notice to the United States of its intent to form a joint venture with Random House, Inc.

Finally, to ensure Penguin's compliance with the Penguin Final Judgment, Section IV.D requires that Penguin provide, on a quarterly basis, each e-book agreement it has reached with any e-book retailer on or after January 1, 2012.

B. Prohibited Conduct (Section V)

In order to ensure that e-book retailers can compete on the price of e-books sold to consumers in the future, the Penguin Final Judgment also prohibits terms that prevent retail price competition. Sections V.A, V.B, and V.C limit Penguin's ability to enter new agreements (and enforce old agreements) that contain two components of the Apple Agency Agreements: the ban on retailer discounting, and the retail price-matching MFNs that ensured agency terms were exported to all e-book retailers. Sections V.A. and V.B. prevent Penguin, for a two-year period, from forbidding retailers to offer price promotions or discounts on its e-books. Allowing e-book retailers to negotiate new contracts with Penguin, without permitting Penguin, for a set period, to prohibit retailers from discounting, will help ensure that new contracts will not be set under the collusive conditions that produced the Apple Agency Agreements. *See* PFJ §§ V.A–B. For a

five-year period, Section V.C also stops Penguin from entering into an agreement with an e-book retailer that contains a Price MFN (defined as an MFN relating to price, revenue share or commission available to any retailer). This will eliminate Penguin's ability to use these MFNs to achieve, for a second time, the results of the collusive agreements. *See also* Original CIS § III.B.1.

Further, Penguin may not retaliate against or punish an e-book retailer based on the retailer's e-book prices or its discounting or promotional choices. PFJ § V.D. Nor may Penguin repeat its previous attempt to retaliate by proxy, as this provision bars Penguin from encouraging another company to retaliate against an e-book retailer on its behalf. However, the anti-retaliation provision does not prohibit Penguin from unilaterally entering into and enforcing agency agreements with e-book retailers after the two-year proscription, required in Sections V.A and V.B, has expired. *See also* Original CIS § III.B.2.

In addition to addressing terms used in the Apple Agency Agreements to implement the conspiracy, the Penguin Final Judgment also forbids a recurrence of the alleged conspiracy, and prohibits industry practices that facilitated it. Section V.E prohibits Penguin from agreeing with other Defendants or e-book publishers to raise or set e-book retail prices or coordinate terms relating to the licensing, distribution, or sale of e-books. Section V.F likewise prohibits Penguin from directly or indirectly conveying confidential or competitively sensitive information to any other e-book publisher. Banning such communications is critical here, where communications among publishing competitors were a common practice, and led directly to the collusive agreement alleged in the Complaint. *See also* Original CIS § III.B.3.

C. Permitted Conduct (Section VI)

The Penguin Final Judgment also specifically carves out some conduct—which normally is permitted under the antitrust laws—that Penguin may unilaterally pursue. Section VI.A of the Penguin Final Judgment allows Penguin to compensate e-book retailers for services that they provide to publishers or consumers and help promote or sell more e-books. Section VI.B permits Penguin to negotiate a commitment from an e-book retailer that a retailer's aggregate expenditure on discounts and promotions of Penguin's e-books will not exceed the retailer's aggregate commission under an agency agreement in which Penguin sets the e-book price and the retailer is compensated through a commission. These provisions allow Penguin to prevent a retailer selling its entire catalogue at a sustained loss, while still permitting retailers to offer discounts under Sections V.A and V.B. Absent the collusion here, the antitrust laws would normally permit a publisher unilaterally to negotiate for such protections. *See also* Original CIS § III.C.

D. Antitrust Compliance (Section VII)

As outlined in Section VII, Penguin also must designate an Antitrust Compliance Officer, who is required to distribute copies of the Penguin Final Judgment; ensure training related to the Penguin Final Judgment and the antitrust laws; certify compliance with the Penguin Final Judgment; and conduct an annual antitrust compliance audit. This compliance program is necessary considering the extensive communication among competitors' CEOs that facilitated Defendants' agreement. *See also* Original CIS § III.D.

## IV. ALTERNATIVES TO THE PENGUIN FINAL JUDGMENT

The United States considered, as an alternative to the Penguin Final Judgment, a full trial on the merits against Penguin. The United States believes that the relief contained in the Penguin Final Judgment will more quickly restore retail price competition to consumers.

## V. REMEDIES AVAILABLE TO PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the Penguin Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the Penguin Final Judgment has no *prima facie* effect in any subsequent private lawsuit that may be brought against the Defendants.

## VI. PROCEDURES AVAILABLE FOR MODIFICATION OF THE PENGUIN FINAL JUDGMENT

The United States and Penguin have stipulated that the Penguin Final Judgment may be entered by this Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry of the decree upon this Court's determination that the Penguin Final Judgment is in the public interest.

The APPA provides a period of at least sixty (60) days preceding the effective date of the Penguin Final Judgment within which any person may submit to the United States written comments regarding the Penguin Final Judgment. Any person who wishes to comment should do so within sixty (60) days of publication of this Competitive Impact Statement in the Federal Register, or the last date of publication in a newspaper of the summary of this Competitive Impact Statement, whichever is later.

All comments received during this period will be considered by the United States Department of Justice, which remains free to withdraw its consent to the Penguin Final Judgment at any time prior to the Court's entry of judgment. The comments and the responses of the United States will be filed with the Court and published either in the Federal Register or, with the Court's permission, on the Department of Justice website.[3] Written comments should be submitted to:

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The Penguin Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for modification, interpretation, or enforcement of the Final Judgment

## VII. STANDARD OF REVIEW UNDER THE APPA FOR THE PENGUIN FINAL JUDGMENT

The Clayton Act, as amended by the APPA, requires that proposed consent judgments in antitrust cases brought by the United States be subject to a sixty-day comment period, after which the court shall determine whether entry of the proposed Final Judgment "is in the public interest." 15 U.S.C. § 16(e)(1). In making that determination, the court is directed to consider:

> (A) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration of relief sought, anticipated effects of alternative remedies actually considered, whether its terms are ambiguous, and any other competitive considerations bearing upon the adequacy of such judgment that the court deems necessary to a determination of whether the consent judgment is in the public interest; and

[3] The United States posts or links to all public materials regarding *United States v. Apple, Inc.* at: http://www.justice.gov/atr/cases/applebooks.html.

> (B) the impact of entry of such judgment upon competition in the relevant market or markets, upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e)(1)(A) & (B); *see generally United States v. KeySpan Corp.*, 763 F. Supp. 2d 633, 637–38 (S.D.N.Y. 2011) (WHP) (discussing Tunney Act standards); *United States v. SBC Commc'ns, Inc.*, 489 F. Supp. 2d 1 (D.D.C. 2007) (assessing standards for public interest determination).

In other words, under the Tunney Act, a court considers, among other things, the relationship between the remedy secured and the specific allegations set forth in the government's complaint, whether the decree is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. *See United States v. Microsoft Corp.*, 56 F.3d 1448, 1458-62 (D.C. Cir. 1995). The court's inquiry is necessarily a limited one as the government is entitled to "broad discretion to settle with the defendant within the reaches of the public interest." *Id.* at 1461; *accord United States v. Alex. Brown & Sons, Inc.*, 963 F. Supp. 235, 238 (S.D.N.Y. 1997) (quoting *Microsoft*, 56 F.3d at 1460), *aff'd sub nom. United States v. Bleznak*, 153 F.3d 16 (2d Cir. 1998); *United States v. KeySpan*, 763 F. Supp. 2d at 637 (same). With respect to the adequacy of the relief secured by the decree, a court may not "engage in an unrestricted evaluation of what relief would best serve the public." *United States v. BNS, Inc*., 858 F.2d 456, 462 (9th Cir. 1988) (quoting *United States v. Bechtel Corp.*, 648 F.2d 660, 666 (9th Cir. 1981)); *see also Alex. Brown & Sons*, 963 F. Supp. at 238. Instead, the court should grant due respect to the United States' "prediction as to the effect of proposed remedies, its perception of the market structure, and its view of the nature of

the case." *United States v. Archer-Daniels-Midland Co.*, 272 F. Supp. 2d 1, 6 (D.D.C. 2003). After all, the court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is "*within the reaches of the public interest*." *Bechtel*, 648 F.2d at 666 (emphasis added) (citations omitted); *accord Alex. Brown*, 963 F. Supp. at 238.[4]

## VIII. DETERMINATIVE DOCUMENTS

There are no determinative materials or documents within the meaning of the APPA that were considered by the United States in formulating the Penguin Final Judgment.

Dated: December 18, 2012

Respectfully submitted,

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[4] *Cf. BNS*, 858 F.2d at 464 (holding that the court's "ultimate authority under the [Tunney Act] is limited to approving or disapproving the consent decree"); *United States v. Gillette Co.*, 406 F. Supp. 713, 716 (D. Mass. 1975) (the court is constrained to "look at the overall picture not hypercritically, nor with a microscope, but with an artist's reducing glass"). *See generally Microsoft*, 56 F.3d at 1461 (discussing whether "the remedies [obtained in the decree are] so inconsonant with the allegations charged as to fall outside of the 'reaches of the public interest'").

## C**ERTIFICATE OF SERVICE**

I, Stephen T. Fairchild, hereby certify that on December 18, 2012, I caused a copy of the United States' Competitive Impact Statement to be served by the Electronic Case Filing System, which included the individuals listed below.

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Additionally, courtesy copies of this Competitive Impact Statement have been provided to the following:

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