

UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA	)	
	)	
Plaintiff	)	
	)	
v.	)	
	)	
APPLE, INC.,	)	Civil Action No. 12-cv-2826
HACHETTE BOOK GROUP, INC.,	)	
HARPERCOLLINS PUBLISHERS L.L.C.,	)	THE PENGUIN GROUP ANSWER
VERLAGSGRUPPE GEORG VON	)	
HOLTZBRINCK GMBH,	)	
HOLTZBRINCK PUBLISHERS, LLC	)	
d/b/a MACMILLAN,	)	
THE PENGUIN GROUP,	)	
A DIVISION OF PEARSON PLC,	)	
PENGUIN GROUP (USA), INC.,	)	
and SIMON & SCHUSTER, INC.,	)	
	)	
Defendants.	)	
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COMES NOW THE PENGUIN GROUP, A DIVISION OF PEARSON PLC, and PENGUIN GROUP (USA), INC. (collectively “Penguin” or “Penguin Group”), and in response to plaintiffs’ Complaint, states the following:

PREAMBLE

Penguin did not conspire to fix the prices of eBooks with other publishers or with Apple. Penguin, at the invitation of Apple, independently negotiated and ultimately entered into a vertical distribution agreement with Apple. Penguin did so, as the Complaint must concede, because Apple wanted to open an online bookstore and it needed access to eBooks in order to do so—and not just Penguin’s eBook titles, but enough breadth and variety of titles from different publishers in order to have a bookstore where consumers would want to shop. From Penguin’s perspective, Apple’s technology platform, marketing expertise and its millions of customers presented an opportunity to expand Penguin’s distribution and sell more eBooks, and develop

and sell new types of enhanced eBooks compatible with Apple’s advanced technology. Apple, as the Complaint must also concede, wanted to have a profitable business if it was to open an iBookstore—otherwise there would have been no iBookstore.

The form of the vertical relationship—agency—made independent business sense to Penguin. The agency distribution model has existed for far longer than the federal antitrust laws and has specifically been found by the U.S. Supreme Court to be a legitimate way to do business. The agency distribution model—like vertical distribution agreements generally—has incontrovertible pro-competitive aspects. It also cannot be discounted that Apple’s entry and the adoption of the agency model demolished what was widely recognized in the book industry as a “barrier to entry”—Amazon’s business practice of selling certain new release eBooks below-cost for certain periods of time—and prevented Amazon from cementing itself as a monopolist that would continue to dominate the sale of eBooks and eReaders.

A vertical distribution agreement is presumptively pro-competitive. New entry is presumptively pro-competitive. Broader distribution is presumptively pro-competitive. Lower barriers to entry are presumptively pro-competitive. Yet the Government intentionally ignores these facts with regard to Penguin’s decision to distribute its eBooks through Apple and instead sides with a monopolist.

## I. INTRODUCTION

ALLEGATION 1. Technology has brought revolutionary change to the business of publishing and selling books, including the dramatic explosion in sales of “e-books”—that is, books sold to consumers in electronic form and read on a variety of electronic devices, including dedicated e-readers (such as the Kindle or the Nook), multipurpose tablets, smartphones and personal computers. Consumers reap a variety of benefits from e-books, including 24-hour

access to product with near-instant delivery, easier portability and storage, and adjustable font size. E- books also are considerably cheaper to produce and distribute than physical (or “print”) books.

PENGUIN’S RESPONSE: Penguin admits that competition in the book industry is complex and robust. Part of this dynamism involves eBooks, a new, exciting, and rapidly developing means of distributing literary content. Penguin admits that this dynamic competition is characterized by continuing innovations in the format and content of eBooks (including enhanced eBooks), development and changes in the number and quality of eReading devices, the 2010 entry of Apple into the eBookstore business, and technological giant Microsoft’s recent investment in the Barnes & Noble Nook line of business. Penguin also admits that eBooks provide a number of attractive features for consumers, and, so long as there is continued development of content and technology spawned by new entry, a diverse marketplace, and the ability of authors to make a livelihood producing a varied assortment of literary works, there will continue to be other innovations affecting eBooks that will benefit both consumers and publishers like Penguin. Penguin otherwise denies the allegations contained in paragraph 1.

ALLEGATION 2. E-book sales have been increasing rapidly ever since Amazon released its first Kindle device in November of 2007. In developing and then mass marketing its Kindle e-reader and associated e-book content, Amazon substantially increased the retail market for e-books. One of Amazon’s most successful marketing strategies was to lower substantially the price of newly released and bestselling e-books to \$9.99.

PENGUIN’S RESPONSE: Penguin admits that eBook sales have increased since 2007 because publishers, including Penguin, have invested time and resources to convert frontlist (i.e., new releases) and backlist titles into eBook format, partnered with authors to develop innovative,

enhanced eBooks, and worked with a variety of distribution partners including Amazon, to expand the distribution and sale of eBooks. Penguin also admits that Amazon's below-cost selling of certain newly released and bestselling e-books for \$9.99, initiated shortly after the launch of the Kindle, was a successful strategy for locking consumers into its proprietary Kindle platform and raising a significant barrier to entry. Penguin otherwise denies the allegations contained in paragraph 2.

ALLEGATION 3. Publishers saw the rise in e-books, and particularly Amazon's price discounting, as a substantial challenge to their traditional business model. The Publisher Defendants feared that lower retail prices for e-books might lead eventually to lower wholesale prices for e-books, lower prices for print books, or other consequences the publishers hoped to avoid. Each Publisher Defendant desired higher retail e-book prices across the industry before "\$9.99" became an entrenched consumer expectation. By the end of 2009, however, the Publisher Defendants had concluded that unilateral efforts to move Amazon away from its practice of offering low retail prices would not work, and they thereafter conspired to raise retail e-book prices and to otherwise limit competition in the sale of e-books. To effectuate their conspiracy, the Publisher Defendants teamed up with Defendant Apple, which shared the same goal of restraining retail price competition in the sale of e-books.

PENGUIN'S RESPONSE: Except as stated in this Response, Penguin denies the allegations contained in paragraph 3. Penguin consistently has embraced eBooks and views eBooks as an important opportunity to increase sales, both in volume and in diversity. As Penguin Group (USA)'s CEO David Shanks testified during the DOJ investigation:

[O]ver the 30 years that I've been in the business there are far fewer places to purchase books than there were in the past and this opportunity that the internet is giving our industry and the consumer of having an unlimited amount of places to buy books is

great for the book business and I feel ultimately will be great for the consumer, but only having one place to buy eBooks doesn't seem to make sense to me, to Penguin.

Penguin admits that it viewed some of Amazon's business practices, most especially its practice of sometimes selling new release eBooks and eBooks versions of *New York Times* bestselling titles well below the prices paid by Amazon to Penguin for these eBook titles, as anticompetitive and detrimental to the long term process of expanding opportunities for developing authors and creating more content. As the Complaint is careful to avoid stating, prior to Apple's entry, Amazon's share of eBook sales was 80 to 90 percent. This dominant monopolist<sup>1</sup> position, coupled with a strategy of sales below cost –or “loss-leading”— raised barriers to entry for other actual and potential distributors of eBooks, including both online and traditional bookstores (referred to in the industry as “brick-and-mortar” sellers). While Amazon undoubtedly may have furthered its own interests in using eBook best sellers as loss leaders to install itself as a permanent monopolist and sell its Kindle (a closed device), it threatened the long-term, overall health of the book publishing industry by creating barriers to entry, undercutting the margins and incentives of other sellers, fostering a perception of eBooks as low-cost commodities, and threatening the viability of book publishers and authors, as well as other book selling outlets vital to the marketing and promotion of books. Penguin was especially concerned about brick-and-mortar outlets like Borders and Barnes & Noble that have traditionally played a critical role in marketing book titles and encouraging the discovery and

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<sup>1</sup> Amazon was a *monopolist* as far as sales of eBooks (and eReaders) to consumers were concerned because Amazon controlled approximately 90% of those sales and imposed barriers for new retailers to enter the market, but also a *monopsonist* on the supply side because Amazon controlled approximately 90% of the purchases of eBooks as far as publisher/ manufacturers were concerned. “Monopolist” is used throughout for ease of reference.

development of new authors and titles. Amazon's one-size-fits-all practice of pricing certain titles at certain times at \$9.99 also incorrectly signaled that these eBooks were of equal value. Books are not widgets. Each has its own unique literary, cultural and other intellectual value; each has its own unique production costs, driven primarily by the craft of authorship and each author's muse; each has its own unique customer appeal, with no single book title being an actual direct substitute for another.

ALLEGATION 4. The Defendants' conspiracy to limit e-book price competition came together as the Publisher Defendants were jointly devising schemes to limit Amazon's ability to discount e-books and Defendant Apple was preparing to launch its electronic tablet, the iPad, and considering whether it should sell e-books that could be read on the new device. Apple had long believed it would be able to "trounce Amazon by opening up [its] own ebook store," but the intense price competition that prevailed among e-book retailers in late 2009 had driven the retail price of popular e-books to \$9.99 and had reduced retailer margins on e-books to levels that Apple found unattractive. As a result of discussions with the Publisher Defendants, Apple learned that the Publisher Defendants shared a common objective with Apple to limit e-book retail price competition, and that the Publisher Defendants also desired to have popular e-book retail prices stabilize at levels significantly higher than \$9.99. Together, Apple and the Publisher Defendants reached an agreement whereby retail price competition would cease (which all the conspirators desired), retail e-book prices would increase significantly (which the Publisher Defendants desired), and Apple would be guaranteed a 30 percent "commission" on each e-book it sold (which Apple desired).

PENGUIN'S RESPONSE: Penguin denies the allegations contained in paragraph 4. To the contrary, Penguin neither devised nor engaged in any joint "scheme" with other publishers

related to Amazon. In fact, in December 2009, at the very time Penguin first learned that Apple was considering launching its iBookstore, Penguin was not “windowing” eBooks (i.e., delaying the introduction of an eBook version of a title when a hardcover version is first released); nor did it ever have plans to do so. Penguin’s business behavior was contrary to that undertaken by other publishers. If windowing eBooks is one of the “schemes” that is supposed to demonstrate a conspiracy, Penguin’s very public stance not to window eBooks proves Penguin was not part of the claimed publisher conspiracy.

Although Penguin is without information or knowledge as to the beliefs of Apple in this regard, Penguin notes that it was not “intense price competition” that drove “the retail price of popular eBooks to \$9.99,” but rather the predatory, below-cost pricing practices of monopolist retailer Amazon,<sup>2</sup> apparently designed to exclude competition and control the pricing of eBooks, that was the reason for the \$9.99 price point for certain eBook titles. It is self evident that Apple, like any potential entrant, would not have found attractive the prospect of selling eBooks at a loss. However, Penguin viewed Apple’s possible entry as a way to broaden its distribution and increase output—not to mention that no business wants to depend on one distributor for 80 to 90 percent of its sales.

Hence, Penguin and Apple shared the common objective of opening a successful and viable iBookstore and making eBooks available to the tens of millions of Apple customers. Penguin wanted to foster broader distribution and a broader market for eBooks by sponsoring new entry, new innovation, and new types of enhanced eBooks (such as Penguin’s enhanced version of A.A. Milne’s classic *Winnie the Pooh*, which is pre-loaded as a complementary eBook

on every iPad) that were previously not possible because the Amazon Kindle was not then capable of accommodating color or other enhancements. This interest was “joint” only in the sense that a successful iBookstore had to have a wide and diverse range of titles—which required that multiple publishers agree to provide content to Apple.

Penguin also denies the Complaint’s conclusory statements about diminished retail price competition. Price competition did not “cease” under the agency model; it has simply moved to the manufacturer (publisher) level with regard to publishers that have adopted that model. And rather than having one price for certain categories of eBook titles set by a monopolist distributor (Amazon), under the agency model there is dynamic eBook pricing determined by each publisher based on each specific title. Moreover, whatever the effect on Penguin’s pricing, other publishers, retailers, and even self-published authors’ retail price competition continues.

Penguin admits that it agreed to pay Apple a commission to distribute Penguin eBooks in order to incentivize Apple to enter. As a result, under the agency model, the amount of money that Penguin receives on a per title basis for each eBook is significantly less than under the retail/wholesale model.

The reason that Penguin was willing to accept less revenue on a per unit basis was that at the time of Apple’s entry, Penguin’s internal business analysis showed that by moving to the agency model and making it profitable for other distributors to enter or become more viable, Penguin’s overall sales volume would increase. As Penguin Group (USA) Inc. CEO David Shanks testified during the DOJ investigation:

We had our finance people do an analysis of what it would mean to our revenues to just plug in the agency pricing scheme versus the wholesale model ... and what it would mean to us because it was going to generate less revenue on a pure one for one basis. So the discussion was around what kind of lift we would get by having more the availability of having more players in the mix than just



Amazon and Sony .... [W]e felt that there were so many additional players that we anticipated could come in once they were reasonably assured that they would not lose money selling e-books that we could make that up, make up the fact that we were making less money.

ALLEGATION 5. To accomplish the goal of raising e-book prices and otherwise limiting retail competition for e-books, Apple and the Publisher Defendants jointly agreed to alter the business model governing the relationship between publishers and retailers. Prior to the conspiracy, both print books and e-books were sold under the longstanding “wholesale model.” Under this model, publishers sold books to retailers, and retailers, as the owners of the books, had the freedom to establish retail prices. Defendants were determined to end the robust retail price competition in e-books that prevailed, to the benefit of consumers, under the wholesale model. They therefore agreed jointly to replace the wholesale model for selling e-books with an “agency model.” Under the agency model, publishers would take control of retail pricing by appointing retailers as “agents” who would have no power to alter the retail prices set by the publishers. As a result, the publishers could end price competition among retailers and raise the prices consumers pay for e-books through the adoption of identical pricing tiers. This change in business model would not have occurred without the conspiracy among the Defendants.

PENGUIN’S RESPONSE: Penguin denies the allegations contained in paragraph 5. Penguin did not make an agreement with any other publisher related to the agency model; it entered into a vertical distribution agreement with Apple. Further, there was nothing “longstanding” about the wholesale model as applied to eBooks, a line of business still in its infancy. Indeed, Penguin was selling eBooks directly to the consumer through its own website (and setting its own prices) prior to the “adoption” of the agency model, which was clearly not a “wholesale model.” Penguin was also selling eBooks through the Apple App Store under the

agency model prior to the introduction of the iPad. Besides, there is no reason to assume that what was the business practice for print books should have been ipso facto the business practice for eBooks. Indeed, the complaint alleges that eBooks are a completely separate product market from print books. The allegation that there was “robust retail price competition” prior to the adoption of the agency model ignores the indisputable fact that the “competition” was nothing more than the below-cost, predatory, market-domination strategy of a monopolist distributor. Moreover, the agency model is and has been a legitimate and accepted business model since well before the enactment of the Sherman Act and has been routinely upheld as a presumptive and preferred method by courts, including the Supreme Court.

Finally, Penguin denies that it ended retail price competition by entering into an agency agreement with Apple. Penguin simply became the seller of its own eBook titles with pricing authority, subject to price ceilings that were insisted upon by Apple. Penguin not surprisingly resisted the imposition of the price ceilings during its negotiations with Apple.

**ALLEGATION 6.** Apple facilitated the Publisher Defendants’ collective effort to end retail price competition by coordinating their transition to an agency model across all retailers. Apple clearly understood that its participation in this scheme would result in higher prices to consumers. As Apple CEO Steve Jobs described his company’s strategy for negotiating with the Publisher Defendants, “We’ll go to [an] agency model, where you set the price, and we get our 30%, and yes, the customer pays a little more, but that’s what you want anyway.” Apple was perfectly willing to help the Publisher Defendants obtain their objective of higher prices for consumers by ending Amazon’s “\$9.99” price program as long as Apple was guaranteed its 30 percent margin and could avoid retail price competition from Amazon.

PENGUIN’S RESPONSE: Penguin denies the allegations contained in paragraph 6. Retail price competition has not ended nor for that matter has competition among agents ended either. Penguin, as the direct seller under the agency model, competes at the retail level. As for the agents, Apple competes against Amazon, both at the device level (eReader) and with regard to the strength of their respective eBook stores. Penguin is without knowledge of Steve Jobs’ business strategy, and on that basis denies those allegations.

ALLEGATION 7. The plan – what Apple proudly described as an “aikido move” – worked. Over three days in January 2010, each Publisher Defendant entered into a functionally identical agency contract with Apple that would go into effect simultaneously in April 2010 and “chang[e] the industry permanently.” These “Apple Agency Agreements” conferred on the Publisher Defendants the power to set Apple’s retail prices for e-books, while granting Apple the assurance that the Publisher Defendants would raise retail e-book prices at all other e-book outlets, too. Instead of \$9.99, electronic versions of bestsellers and newly released titles would be priced according to a set of price tiers contained in each of the Apple Agency Agreements that determined de facto retail e-book prices as a function of the title’s hardcover list price. All bestselling and newly released titles bearing a hardcover list price between \$25.01 and \$35.00, for example, would be priced at \$12.99, \$14.99, or \$16.99, with the retail e-book price increasing in relation to the hardcover list price.

PENGUIN’S RESPONSE: Penguin admits that on January 25, 2010 it entered into a distribution agreement with Apple, which provides that “Publisher hereby appoints Apple as its non-exclusive agent for the marketing and delivery of eBooks through the Online Store on Publisher’s behalf in the Territory to end-users for their personal, non-commercial use, and Apple accepts such appointment.” Under that Agreement, Penguin retained its legal right to set the

price for its own titles, subject to a set of complicated price ceilings and a provision insisted upon by Apple to enable it to always compete with the lowest eBook prices in the marketplace (which the government characterizes as a “most favored nation” clause), which was essentially a contractual obligation not to price discriminate against Apple—an obligation that notably already exists in the context of most wholesale/retail relationships under federal antitrust law in the Robinson Patman Act, 15 U.S.C. § 13.

Under one set of price ceilings that applied only to eBooks associated with New Release hardcover titles, Penguin’s prices were limited by an Apple-dictated formula based on Penguin’s list prices for the hard cover version of the book. However, if any such title became listed on one of forty-two (42) defined slots on the *New York Times* Bestseller List, the maximum price ceilings dropped even lower. Likewise, for all books published in mass market or trade paperback editions on or after March 15, 2010 with a suggested list price of \$22.00 or less, Penguin was subject to a price ceiling of \$9.99. In short, the pricing formula insisted upon by Apple and agreed to by Penguin was a maximum price restriction and Penguin had full discretion to set its eBook prices at any level below these price ceilings.

Penguin’s eBook prices for New Release hardcover titles were also subject to a price protection or MFN term. That term states: “Commencing March 15, 2010, or the date on which Apple begins marketing and soliciting orders for eBooks in the Online Store, whichever occurs later, if, for any particular New Release in hardcover format, the then-current Customer Price at any time is or becomes higher than the a customer price offered by any other reseller (“Other Customer Price”) then Publisher shall designate a new, lower Customer Price to meet such lower Other Customer Price.” Penguin specifically denies that its distribution agreement with Apple required that Penguin would raise retail eBook prices at all other eBook outlets.

Otherwise, Penguin had complete discretion on how to set its prices, including the prices for eBooks associated with hardcover new releases with a list price over \$30.00, hardcovers released at least twelve months, all paperback editions of books published before March 15, 2010, all paperback books with a list price over \$22.00 (whenever published), and graphical or illustrative books, such as children's titles.

Penguin otherwise denies the allegations contained in paragraph 7.

ALLEGATION 8. After executing the Apple Agency Agreements, the Publisher Defendants all then quickly acted to complete the scheme by imposing agency agreements on all their other retailers. As a direct result, those retailers lost their ability to compete on price, including their ability to sell the most popular e-books for \$9.99 or for other low prices. Once in control of retail prices, the Publisher Defendants limited retail price competition among themselves. Millions of e-books that would have sold at retail for \$9.99 or for other low prices instead sold for the prices indicated by the price schedules included in the Apple Agency Agreements—generally, \$12.99 or \$14.99. Other price and non-price competition among e-book publishers and among e-book retailers also was unlawfully eliminated to the detriment of U.S. consumers.

PENGUIN'S RESPONSE: Penguin denies the allegations contained in paragraph 8. For Penguin, every potential agent with the exception of one—Amazon—welcomed Penguin's offer to move to the agency model for eBook distribution and negotiated an agency agreement with Penguin.

Under the agency model, price competition has moved from the retail level to the publisher level. Price and non-price competition both among publisher and among eBook retailers has exponentially increased as a result of the move to the agency model. For example,

there is more dynamic pricing of eBooks, which has resulted in lower consumer prices on many, many eBook titles, more robust competition at the device level in terms of both the cost and variety of eReading devices, handsome and imaginative enhanced, full-color eBooks, which did not even exist as a category before Apple introduced the iPad, and more vibrant and differentiated marketing of eBooks by Penguin's agents, all to the benefit of consumers.

ALLEGATION 9. The purpose of this lawsuit is to enjoin the Publisher Defendants and Apple from further violations of the nation's antitrust laws and to restore the competition that has been lost due to the Publisher Defendants' and Apple's illegal acts.

PENGUIN'S RESPONSE: Penguin denies the allegations contained in paragraph 9 and avers that the remedies that Plaintiff seeks in this lawsuit, if implemented by the Court, could result in the re-establishment of Amazon as the totally dominant monopolist and the elimination of many or most competitors in eBook retailing.

ALLEGATION 10. Defendants' ongoing conspiracy and agreement have caused e-book consumers to pay tens of millions of dollars more for e-books than they otherwise would have paid.

PENGUIN'S RESPONSE: Penguin denies the allegations contained in paragraph 10. Penguin did not participate in a conspiracy or enter into an agreement with other publishers. Penguin entered vertical agency agreements with Apple and other agents. These agency agreements have resulted in more dynamic eBook pricing (with some eBook prices going up and some eBook prices going down from prior prices charged by monopolist Amazon), more dynamism in the market generally, new, lower-priced and more frequently improved eReading devices, enhanced eBooks, increased overall output of sales and number of eBooks titles, and greater consumer choice.

ALLEGATION 11. The United States, through this suit, asks this Court to declare Defendants' conduct illegal and to enter injunctive relief to prevent further injury to consumers in the United States.

PENGUIN'S RESPONSE: Penguin admits that this is the relief the United States seeks, but denies that the relief sought will prevent injury to consumers. To the contrary, if the relief sought by the United States were to be granted, this relief is likely to result in restoring and reinforcing Amazon's monopoly power in the eBook retailing, weakening and eliminating other eBook retailers, and reduction in competition in terms of both price and service.

## II. DEFENDANTS

ALLEGATION 12. Apple, Inc. has its principal place of business at 1 Infinite Loop, Cupertino, CA 95014. Among many other businesses, Apple, Inc. distributes e-books through its iBookstore.

PENGUIN'S RESPONSE: Penguin admits the allegations contained in paragraph 12, except denies knowledge that 1 Infinite Loop, Cupertino, CA 95014 is the principal place of business of Apple, Inc.

ALLEGATION 13. Hachette Book Group, Inc. has its principal place of business at 237 Park Avenue, New York, NY 10017. It publishes e-books and print books through publishers such as Little, Brown, and Company and Grand Central Publishing.

PENGUIN'S RESPONSE: Penguin admits the allegations contained in paragraph 13, except denies knowledge that 237 Park Avenue is the principal place of business of Hachette Book Group, Inc.

ALLEGATION 14. HarperCollins Publishers L.L.C. has its principal place of business at 10 E. 53rd Street, New York, NY 10022. It publishes e-books and print books through publishers such as Harper and William Morrow.

PENGUIN'S RESPONSE: Penguin admits the allegations contained in paragraph 14, except denies knowledge that 10 E. 53rd Street is the principal place of business of HarperCollins Publishers L.L.C.

ALLEGATION 15. Holtzbrinck Publishers, LLC d/b/a Macmillan has its principal place of business at 175 Fifth Avenue, New York, NY 10010. It publishes e-books and print books through publishers such as Farrar, Straus and Giroux and St. Martin's Press. Verlagsgruppe Georg von Holtzbrinck GmbH owns Holtzbrinck Publishers, LLC d/b/a Macmillan and has its principal place of business at Gänsheidestraße 26, Stuttgart 70184, Germany.

PENGUIN'S RESPONSE: Penguin is without knowledge as to the allegations contained in paragraph 15 and therefore denies them.

ALLEGATION 16. Penguin Group (USA), Inc. has its principal place of business at 375 Hudson Street, New York, NY 10014. It publishes e-books and print books through publishers such as The Viking Press and Gotham Books. Penguin Group (USA), Inc. is the United States affiliate of The Penguin Group, a division of Pearson plc, which has its principal place of business at 80 Strand, London WC2R 0RL, United Kingdom.

PENGUIN'S RESPONSE: Admit.

ALLEGATION 17. Simon & Schuster, Inc. has its principal place of business at 1230 Avenue of the Americas, New York, NY 10020. It publishes e-books and print books through publishers such as Free Press and Touchstone.



PENGUIN'S RESPONSE: Penguin admits the allegations contained in paragraph 17, except denies knowledge that 1230 Avenue of the Americas, New York, NY 10020 is the principal place of business of Simon & Schuster, Inc.

### III. JURISDICTION, VENUE, AND INTERSTATE COMMERCE

ALLEGATION 18. Plaintiff United States of America brings this action pursuant to Section 4 of the Sherman Act, 15 U.S.C. § 4, to obtain equitable relief and other relief to prevent and restrain Defendants' violations of Section 1 of the Sherman Act, 15 U.S.C § 1.

PENGUIN'S RESPONSE: Penguin admits that Plaintiff United States of America purports to bring this action pursuant to Section 4 of the Sherman Act, but denies the remaining allegations contained in paragraph 18.

ALLEGATION 19. This Court has subject matter jurisdiction over this action under Section 4 of the Sherman Act, 15 U.S.C. § 4, and 28 U.S.C. §§ 1331,1337(a), and 1345.

PENGUIN'S RESPONSE: The allegations contained in paragraph 19 purport to state a legal conclusion and no responsive pleading is required.

ALLEGATION 20. This Court has personal jurisdiction over each Defendant and venue is proper in the Southern District of New York under Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. § 1391, because each Defendant transacts business and is found within the Southern District of New York. The U.S. component of each Publisher Defendant is headquartered in the Southern District of New York, and acts in furtherance of the conspiracy occurred in this District. Many thousands of the Publisher Defendants' e-books are and have been sold in this District, including through Defendant Apple's iBookstore.

PENGUIN'S RESPONSE: Penguin admits that personal jurisdiction and venue is proper in the Southern District of New York and that many active readers live and work here but otherwise denies the allegations contain in paragraph 20.

ALLEGATION 21. Defendants are engaged in, and their activities substantially affect, interstate trade and commerce. The Publisher Defendants sell e-books throughout the United States. Their e- books represent a substantial amount of interstate commerce. In 2010, United States consumers paid more than \$300 million for the Publisher Defendants' e-books, including more than \$40 million for e-books licensed through Defendant Apple's iBookstore.

PENGUIN'S RESPONSE:

Penguin admits that its business activities substantially affect interstate trade and commerce in the United States. Penguin lacks information or knowledge regarding the statistics cited in paragraph 21 and therefore denies them.

#### IV. CO-CONSPIRATORS

ALLEGATION 22. Various persons, who are known and unknown to Plaintiff, and not named as defendants in this action, including senior executives of the Publisher Defendants and Apple, have participated as co-conspirators with Defendants in the offense alleged and have performed acts and made statements in furtherance of the conspiracy.

PENGUIN'S RESPONSE: Denied.

#### V. THE PUBLISHING INDUSTRY AND BACKGROUND OF THE CONSPIRACY

##### *A. Print Books*

ALLEGATION 23. Authors submit books to publishers in manuscript form. Publishers edit manuscripts, print and bind books, provide advertising and related marketing services, decide when a book should be released for sale, and distribute books to wholesalers and retailers.

Publishers also determine the cover price or “list price” of a book, and typically that price appears on the book’s cover.

PENGUIN’S RESPONSE: Penguin denies that Allegation 23 adequately describes the publishing industry. Prior to manuscript submission, publishers often consult with and advise authors on subject matter and style. In almost all instances, there are also literary agents who work on behalf of authors and play a material role in the publication process. Penguin admits that as a publisher, Penguin edits manuscripts, hires third parties to print and bind books, provides advertising and marketing for its authors and titles, and distributes books to retailers and wholesalers. Publishers like Penguin also maintain sales staffs to sell books to retail and on-line stores, and also to obtain customer views on the marketplace generally and for particular titles and authors. Penguin decides what the list prices should be, and (including sometimes in consultation with the literary agents and author), when its titles should be released for sale.

ALLEGATION 24. Retailers purchase print books directly from publishers, or through wholesale distributors, and resell them to consumers. Retailers typically purchase print books under the “wholesale model.” Under that model, retailers pay publishers approximately one-half of the list price of books, take ownership of the books, then resell them to consumers at prices of the retailer’s choice. Publishers have sold print books to retailers through the wholesale model for over 100 years and continue to do so today.

PENGUIN’S RESPONSE: Penguin is without knowledge as to the specific details of how any other publisher sells its books under a wholesale model and therefore denies those allegations contained in paragraph 24. Penguin admits that retailers purchase print books either directly from Penguin or through a wholesaler, and then resells the books to consumers. Penguin’s wholesale contracts with retailers and wholesalers differ; generally, the price that

retailers or wholesalers pay is about half of the list price of the book. Retailers and wholesalers have discretion to set the retail price of print books. Retailers and wholesalers also typically have the right to return unsold print books to Penguin for credit.

B. *E-books*

ALLEGATION 25. E-books are books published in electronic formats. E-book publishers avoid some of the expenses incurred in producing and distributing print books, including most manufacturing expenses, warehousing expenses, distribution expenses, and costs of dealing with unsold stock.

PENGUIN'S RESPONSE: Penguin admits that eBooks are books published in electronic formats and that a small percentage of the costs of producing print books are saved with eBooks, but otherwise generally denies the allegations contained in paragraph 25.

ALLEGATION 26. Consumers purchase e-books through websites of e-book retailers or through applications loaded onto their reading devices. Such electronic distribution allows e-book retailers to avoid certain expenses they incur when they sell print books, including most warehousing expenses and distribution expenses.

PENGUIN'S RESPONSE: Penguin admits that consumers can purchase eBooks through various methods and that some costs of distributing eBooks versus print books are both higher and lower but otherwise generally denies the allegations contained in paragraph 26.

ALLEGATION 27. From its very small base in 2007 at the time of Amazon's Kindle launch, the e- book market has exploded, registering triple-digit sales growth each year. E-books now constitute at least ten percent of general interest fiction and non-fiction books (commonly known as "trade" books<sup>1</sup>) sold in the United States and are widely predicted to reach at least 25 percent of U.S. trade books sales within two to three years.

GOVERNMENT FN 1: Non-trade e-books include electronic versions of children's picture books and academic textbooks, reference materials, and other specialized texts that typically are published by separate imprints from trade books, often are sold through separate channels, and are not reasonably substitutable for trade e-books.

PENGUIN'S RESPONSE: Penguin admits that its sales of eBooks have grown tremendously since their introduction and since Apple's entry. Penguin lacks sufficient knowledge or information to respond to the remaining allegation in paragraph 27 & footnote 1 and therefore denies them.

C. *Publisher Defendants and "The \$9.99 Problem"*

ALLEGATION 28. The Publisher Defendants compete against each other for sales of trade e-books to consumers. Publishers bid against one another for print- and electronic-publishing rights to content that they expect will be most successful in the market. They also compete against each other in bringing those books to market. For example, in addition to price-setting, they create cover art and other on-book sales inducements, and also engage in advertising campaigns for some titles.

PENGUIN'S RESPONSE: The allegations contained in paragraph 28 are oversimplified and inaccurate in a number of respects: books are not widgets; they are highly differentiated written works imbued with literary, cultural, and intellectual significance. The allegations in paragraph 28 are therefore denied. Penguin, under the agency model, presently sells its eBook titles to consumers directly using its agents. Other entities, including other publishers, online sellers like Amazon.com, brick-and-mortar stores, authors, or others also sell non-Penguin eBook trade titles to consumers. Different titles may or may not have any comparative competitive significance. The vast majority of eBook titles are not, in the minds of

consumers, publishers, or bookstores, substitutes for one another. For example, Deadlocked from the Sookie Stackhouse Series by Charlaine Harris (published by the Ace imprint of Penguin Group (USA)) is hardly a substitute for Steve Jobs, the biography by Walter Isaacson (published by Simon & Schuster)—yet both are currently *New York Times* Bestsellers. Penguin also admits that there is a measure of competition between itself and other publishers in the seeking of publishing rights, but this competition is in no material way affected by the vertical relationship between publishers and agents.

ALLEGATION 29. The Publisher Defendants are five of the six largest publishers of trade books in the United States. They publish the vast majority of their newly released titles as both print books and e-books. Publisher Defendants compete against each other in the sales of both trade print books and trade e-books.

PENGUIN'S RESPONSE: Penguin admits that it believes that by certain measures it is the second largest trade publisher in the United States and that the other four Publisher Defendants represent numbers three through six. Penguin further admits it is Penguin's policy to release most new trade titles in both print and Ebook format and to do so at the same time. Penguin otherwise denies the allegations contained in paragraph 29.

ALLEGATION 30. When Amazon launched its Kindle device, it offered newly released and bestselling e-books to consumers for \$9.99. At that time, Publisher Defendants routinely wholesaled those e-books for about that same price, which typically was less than the wholesale price of the hardcover versions of the same titles, reflecting publisher cost savings associated with the electronic format. From the time of its launch, Amazon's e-book distribution business has been consistently profitable, even when substantially discounting some newly released and bestselling titles.

PENGUIN’S RESPONSE: Penguin admits that for some period of time, Amazon offered some new release and other eBook titles for approximately \$9.99 for some period of time after the date of release. However, Penguin denies that this practice was by any means consistent. For some significant points in the life cycle of nearly every new release eBook, the price at Amazon.com might be as high as \$16.99 or more—significantly higher than new release eBooks are ever priced under Penguin’s agency agreements. Penguin also denies the allegation that its wholesale prices for eBooks were “about th[e] same” as Amazon’s \$9.99 price point or that its wholesale prices for eBooks reflected publisher cost savings associated with the electronic format in any way: Penguin routinely wholesaled eBooks for the same price it wholesaled print books—for half of the list price printed on the cover—and this reflected the reality of the publishing business, which involves fixed costs associated with each individual book title no matter what the format. Penguin also denies that Amazon’s \$9.99 pricing, when it occurred, involved anything other than selling product at a loss. Penguin is without information as to the profitability of Amazon’s “e-book distribution business,” but would suspect that it depends on how that “business” is defined and whether it includes sales of Amazon’s eReading device, the Kindle. To the extent the allegation in paragraph 31 about Amazon’s profitability is based on both sales of eBooks and sales of the Kindle, it contradicts the product market definition in the Complaint that the market consists of all trade eBooks.

ALLEGATION 31. To compete with Amazon, other e-book retailers often matched or approached Amazon’s \$9.99-or-less prices for e-book versions of new releases and *New York Times* bestsellers. As a result of that competition, consumers benefited from Amazon’s \$9.99-or-less e-book prices even if they purchased e-books from competing e-book retailers.

PENGUIN'S RESPONSE: Penguin admits that other eBook retailers were forced into a position of selling certain eBook titles at a loss because of the below-cost pricing practices of monopolist retailer Amazon, but denies the remaining allegations contained in paragraph 31, including that this situation was representative of "competition," or fostered the type of real consumer benefits that are apparent under the agency model.

ALLEGATION 32. The Publisher Defendants feared that \$9.99 would become the standard price for newly released and bestselling e-books. For example, one Publisher Defendant's CEO bemoaned the "wretched \$9.99 price point" and Penguin USA CEO David Shanks worried that e-book pricing "can't be \$9.99 for hardcovers."

PENGUIN'S RESPONSE: Penguin admits that its executives were concerned that Amazon's below-cost pricing strategy for certain new release titles would be detrimental to the long term health of the book industry, including by devaluing books and treating them as one-size-fits-all widgets rather than unique, individually crafted products, raising barriers to entry for other distributors, and destroying the value chain that supports authors, agents, book sellers (both on and offline) and publishers, among other industry participants. Penguin further admits that on December 2, 2009, Penguin USA CEO David Shanks wrote a personal email to Glen Moreno, Chairman of the Board of Pearson PLC, welcoming the advent of eBooks and commenting about how much he personally enjoyed reading eBooks on his Kindle and Mr. Shanks opined:

When you think about the lack of availability of English language books (or any books for that matter) in the rest of the world, the potential is great. We have to have a proliferation of reading devices, be they single purpose readers or mobile phones or small tablet laptops first. Then ebooks could be something. We also have to hassle out the ebook pricing model. It can't be \$9.99 for hardcovers. Still a lot of shaking out to do but the potential is there.

Penguin otherwise denies the remaining allegations contained in paragraph 32.



ALLEGATION 33. The Publisher Defendants believed the low prices for newly released and bestselling e-books were disrupting the industry. The Amazon-led \$9.99 retail price point for the most popular e-books troubled the Publisher Defendants because, at \$9.99, most of these e-book titles were priced substantially lower than hardcover versions of the same title. The Publisher Defendants were concerned these lower e-book prices would lead to the “deflation” of hardcover book prices, with accompanying declining revenues for publishers. The Publisher Defendants also worried that if \$9.99 solidified as the consumers’ expected retail price for e-books, Amazon and other retailers would demand that publishers lower their wholesale prices, further compressing publisher profit margins.

PENGUIN’S RESPONSE: Penguin admits that its executives were concerned that Amazon’s below-cost pricing strategy for certain new release titles would be detrimental to the long term health of the book industry, including by devaluing books and treating them as one-size-fits-all widgets rather than unique, individually crafted products, raising barriers to entry for other distributors, and destroying the value chain that supports authors, agents, book sellers (both on and offline) and publishers, among other industry participants. Penguin otherwise denies the remaining allegations contained in paragraph 33.

ALLEGATION 34. The Publisher Defendants also feared that the \$9.99 price point would make e-books so popular that digital publishers could achieve sufficient scale to challenge the major incumbent publishers’ basic business model. The Publisher Defendants were especially concerned that Amazon was well positioned to enter the digital publishing business and thereby supplant publishers as intermediaries between authors and consumers. Amazon had, in fact, taken steps to do so, contracting directly with authors to publish their works as e-books— at a higher royalty rate than the Publisher Defendants offered. Amazon’s move threatened the

Publisher Defendants' traditional positions as the gate-keepers of the publishing world. The Publisher Defendants also feared that other competitive advantages they held as a result of years of investments in their print book businesses would erode and, eventually, become irrelevant, as e-book sales continued to grow.

PENGUIN'S RESPONSE: Penguin denies the allegations of paragraph 34 as they relate to Penguin and lacks sufficient information or knowledge regarding the state of mind of other publishers and therefore denies the allegations in paragraph 34.

D. *Publisher Defendants Recognize They Cannot Solve "The \$9.99 Problem" Alone*

ALLEGATION 35. Each Publisher Defendant knew that, acting alone, it could not compel Amazon to raise e-book prices and that it was not in its economic self-interest to attempt unilaterally to raise retail e-book prices. Each Publisher Defendant relied on Amazon to market and distribute its e-books, and each Publisher Defendant believed Amazon would leverage its position as a large retailer to preserve its ability to compete and would resist any individual publisher's attempt to raise the prices at which Amazon sold that publisher's e-books. As one Publisher Defendant executive acknowledged Amazon's bargaining strength, "we've always known that unless other publishers follow us, there's no chance of success in getting Amazon to change its pricing practices." In the same email, the executive wrote, "without a critical mass behind us Amazon won't 'negotiate,' so we need to be more confident of how our fellow publishers will react...."

PENGUIN'S RESPONSE: Penguin admits it was concerned that the number of retailers was shrinking rapidly and that their share of sales were being largely absorbed by Amazon. Penguin also had extensive experience with Amazon that convinced Penguin that dealing with a new and credible retailer like Apple would probably provoke serious retaliation by

Amazon. Penguin otherwise denies the allegations regarding Penguin in paragraph 35. Penguin is without information or knowledge regarding the allegations contained in paragraph 35 about other publishers and therefore denies those allegations.

ALLEGATION 36. Each Publisher Defendant also recognized that it would lose sales if retail prices increased for only its e-books while the other Publisher Defendants' e-books remained competitively priced. In addition, higher prices for just one publisher's e-books would not change consumer perceptions enough to slow the erosion of consumer-perceived value of books that all the Publisher Defendants feared would result from Amazon's \$9.99 pricing policy.

PENGUIN'S RESPONSE: Penguin denies the allegations of paragraph 36 as they relate to Penguin and lacks sufficient information or knowledge regarding the state of mind of other publishers and therefore denies the allegations in paragraph 36.

#### DEFENDANTS' UNLAWFUL ACTIVITIES

ALLEGATION 37. Beginning no later than September 2008, the Publisher Defendants' senior executives engaged in a series of meetings, telephone conversations and other communications in which they jointly acknowledged to each other the threat posed by Amazon's pricing strategy and the need to work collectively to end that strategy. By the end of the summer of 2009, the Publisher Defendants had agreed to act collectively to force up Amazon's retail prices and thereafter considered and implemented various means to accomplish that goal, including moving under the guise of a joint venture. Ultimately, in late 2009, Apple and the Publisher Defendants settled on the strategy that worked—replacing the wholesale model with an agency model that gave the Publisher Defendants the power to raise retail e-book prices themselves.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 38. The evidence showing conspiracy is substantial and includes:

- Practices facilitating a horizontal conspiracy. The Publisher Defendants regularly communicated with each other in private conversations, both in person and on the telephone, and in e-mails to each other to exchange sensitive information and assurances of solidarity to advance the ends of the conspiracy.
- Direct evidence of a conspiracy. The Publisher Defendants directly discussed, agreed to, and encouraged each other to collective action to force Amazon to raise its retail e-book prices.
- Recognition of illicit nature of communications. Publisher Defendants took steps to conceal their communications with one another, including instructions to “double delete” e-mail and taking other measures to avoid leaving a paper trail.
- Acts contrary to economic interests. It would have been contrary to the economic interests of any Publisher Defendant acting alone to attempt to impose agency on all of its retailers and then raise its retail e-book prices. For example, Penguin Group CEO John Makinson reported to his parent company board of directors that “the industry needs to develop a common strategy” to address the threat “from digital companies whose objective may be to disintermediate traditional publishers altogether” because it “will not be possible for any individual publisher to mount an effective response,” and Penguin later admitted that it would have been economically disadvantaged if it “was the only publisher dealing with Apple under the new business model.”
- Motive to enter the conspiracy, including knowledge or assurances that competitors also will enter. The Publisher Defendants were motivated by a desire to maintain both the perceived value of their books and their own position in the industry. They received assurances from both each other and Apple that they all would move together to raise retail e-book prices. Apple was motivated to ensure that it would not face competition from Amazon’s low-price retail strategy.
- Abrupt, contemporaneous shift from past behavior. Prior to January 23, 2010, all Publisher Defendants sold their e-books under the traditional wholesale model; by January 25, 2010, all Publisher Defendants had irrevocably committed to transition all of their retailers to the agency model (and Apple had committed to sell e-books on a model inconsistent with the way it sells the vast bulk of the digital media it offers in its iTunes store). On April 3, 2010, as soon as the Apple Agency Agreements simultaneously

became effective, all Publisher Defendants immediately used their new retail pricing authority to raise the retail prices of their newly released and bestselling e-books to the common ostensible maximum prices contained in their Apple Agency Agreements.

PENGUIN'S RESPONSE:

Penguin denies that the conclusory statements contained in paragraph 38 are “evidence” of a conspiracy involving Penguin.

- Penguin specifically denies that Penguin communicated with other publishers to exchange sensitive information or otherwise facilitate the alleged conspiracy.
- Penguin specifically denies that it had any agreement with other publishers to force Amazon to raise its retail prices—an allegation that is completely conclusory.
- Penguin specifically denies that it took steps to conceal any communications, and is without knowledge as to these allegations regarding other publishers and therefore denies them.
- Penguin admits that it believed that Apple could not have a successful iBookstore without the participation of and supply of books from other publishers, because if the iBookstore's inventory was limited to only a small percentage of available eBooks, the iBookstore would almost certainly fail. Penguin did not want to sell its eBooks in a bookstore that was bound to fail; however, Penguin denies that it was against Penguin's economic self interest to take steps to expand its eBook distribution, regardless of what other publishers did. Further, Penguin specifically denies that the document selectively quoted above—excerpted out of context from a 2009 Penguin Strategic Plan prepared on August 4, 2009 John Makinson for the Pearson board—has anything to do with Penguin's agency agreement with Apple. To the contrary, the document concerned Penguin's participation in the lawful U.K. and U.S. eBook

publisher marketing joint ventures—“aNobii,” also referred to as “Project Z” ([www.anobii.com](http://www.anobii.com)), a U.K. joint venture, and “Project Muse” or “Bookish” ([www.bookish.com](http://www.bookish.com)), a U.S. joint venture. These joint ventures were and are legitimate competitor-collaborations among Penguin and other publishers – including Random House and Harper Collins with respect to aNobii, and Hachette and Simon & Schuster with respect to Bookish—and were conceived as a way for publishers to replicate online the “book finding” function that brick and mortar stores historically performed. The legality and propriety of these joint ventures, which Penguin was recruited to join *before* it made the decision to enter into an agency model with Apple, is not and has never been actually challenged (as neither forms part of the Counts in this Complaint or is mentioned in the requested relief). Conspicuously omitted from the Complaint’s selective quotation from the strategic plan is a sentence which makes it absolutely clear that the communications concerned Penguin’s participation in the Project Z and Bookish joint ventures:

Competition for the attention of readers will be most intense from digital companies whose objective may be to disintermediate traditional publishers altogether. This is not a new threat but we do appear to be on a collision course with Amazon, and possibly Google as well. It will not be possible for any individual publisher to mount an effective response, because of both the resources necessary and the risk of retribution, so the industry needs to develop a common strategy. ***This is the context for the development of the Project Z initiatives in London and New York.*** We shall be prepared to discuss these, and the London project in particular, when we meet next month but there will be significant costs and risks.

(Emphasis supplied.)

This document further bears the date of August 4, 2009, long before anyone outside of Apple ever heard of the iPad or iBookstore and hence long before any discussion with or concerning Apple or related to the agency model. Simply put, the three

sentences that the Complaint lifts from this document have nothing to do with Apple, the agency model, or pricing for that matter.

- Penguin denies that it was part of any agreement to raise retail prices for eBooks. As stated above, Penguin did not want to sell eBooks in the iBookstore unless the iBookstore was going to stock and distribute the type and variety of eBooks necessary to make it an attractive place for consumers to shop, which necessarily meant the participation of other publishers. Penguin sought assurances from Apple that Apple could deliver the breadth of participation Penguin felt was necessary for a successful eBook store.
- Penguin denies that its move to the agency model was an abrupt shift from past behavior. eBooks were in their relative infancy and Penguin had not made any decision that the business model for print books necessarily would be appropriate for eBooks. As the Government has alleged in its Complaint, there are differences between print book and eBooks, such as shipping costs, manufacturing costs, returns, risk of loss, etc. For a product so materially different, it would be surprising if Penguin had blindly followed its print book model. Penguin denies the remaining allegations in the last bullet point of paragraph 38.

E. *The Publisher Defendants Recognize a Common Threat*

ALLEGATION 39. Starting no later than September of 2008 and continuing for at least one year, the Publisher Defendants' CEOs (at times joined by one non-defendant publisher's CEO) met privately as a group approximately once per quarter. These meetings took place in private dining rooms of upscale Manhattan restaurants and were used to discuss confidential

business and competitive matters, including Amazon's e-book retailing practices. No legal counsel was present at any of these meetings.

PENGUIN'S RESPONSE: Penguin generally denies the allegations contained in paragraph 39 other than admitting that Penguin Group CEO John Makinson, but not Penguin Group (USA) CEO David Shanks, attended a number of social gatherings at which some, but not all, of the other Publisher Defendant CEOs were present, as well as Random House's CEO. While, in addition to purely social matters, general book industry issues and trends were discussed at high-levels of generality, Makinson did so pursuant to antitrust legal advice and avoided competitively sensitive topics like terms of trade, prices, or confidential competitive matters. Certain potential joint venture proposals were also discussed. Penguin specifically denies that the purpose of any such gathering was to coordinate or fix prices or that any agreements to fix prices were reached at any such gathering.

ALLEGATION 40. In September 2008, Penguin Group CEO John Makinson was joined by Macmillan CEO John Sargent and the CEOs of the other four large publishers at a dinner meeting in "The Chefs Wine Cellar," a private room at Picholene. One of the CEOs reported that business matters were discussed.

PENGUIN'S RESPONSE: Penguin admits that Penguin Group CEO John Makinson attended a social dinner with colleagues in the publishing industry on September 15, 2008, 15 months before anyone in publishing ever heard of the iPad or iBookstore, to welcome the new CEO of Random House, Markus Dohle, who of course attended. Penguin is without information or knowledge about what other CEOs reported about the dinner and therefore otherwise denies the allegations in paragraph 40.



ALLEGATION 41. In January 2009, the CEO of one Publisher Defendant, a United States subsidiary of a European corporation, promised his corporate superior, the CEO of the parent company, that he would raise the future of e-books and Amazon's potential role in that future at an upcoming meeting of publisher CEOs. Later that month, at a dinner meeting hosted by Penguin Group CEO John Makinson, again in "The Chefs Wine Cellar" at Picholene, the same group of publisher CEOs met once more.

PENGUIN'S RESPONSE: Penguin admits that Penguin Group CEO John Makinson hosted a social dinner at Picholine on January 28, 2009, attended by the CEO of Random House, as well as the CEOs of Hachette, Harper Collins, and Simon & Schuster. Penguin does not believe MacMillan's CEO attended and therefore denies the allegation that the same group of CEOs attended. While, in addition to purely social matters, general book industry issues and trends were discussed at high-levels of generality, Makinson did so pursuant to antitrust legal advice and avoided competitively sensitive topics like terms of trade, prices, or confidential competitive matters. Certain potential joint venture proposals were also discussed. Penguin specifically denies that the purpose of any such gathering was to coordinate or fix prices or that any agreements to fix prices were reached at any such gathering. Penguin is without knowledge or information about the allegations in the first sentence of paragraph 41 and therefore denies them.

ALLEGATION 42. On or about June 16, 2009, Mr. Makinson again met privately with other Publisher Defendant CEOs and discussed, *inter alia*, the growth of e-books and Amazon's role in that growth.

PENGUIN'S RESPONSE: Penguin admits that Penguin Group CEO John Makinson on June 16, 2009 attended a social dinner at Picholine along with the CEO of Random House, as

well as the CEOs of Hachette, Harper Collins, and Simon & Schuster—but not the CEO of Macmillan. While, in addition to purely social matters, general book industry issues and trends were discussed at high-levels of generality, including the growth of eBooks and Amazon’s role therein, Makinson did so pursuant to antitrust legal advice and avoided competitively sensitive topics like terms of trade, prices, or confidential competitive matters. Certain potential joint venture proposals were also discussed. Penguin specifically denies that the purpose of any such gathering was to coordinate or fix prices or that any agreements to fix prices were reached at any such gathering.

ALLEGATION 43. On or about September 10, 2009, Mr. Makinson once again met privately with other Publisher Defendant CEOs and the CEO of one non-defendant publisher in a private room of a different Manhattan restaurant, Alto. They discussed the growth of e-books and complained about Amazon’s role in that growth.

PENGUIN’S RESPONSE: Penguin admits that Penguin Group CEO John Makinson attended a social dinner at Alto on September 10, 2009, attended by the CEO of Random House, as well as the CEOs of Hachette, Harper Collins, and Simon & Schuster—but not the CEO of Macmillan. While, in addition to purely social matters, general book industry issues and trends were discussed at high-levels of generality, including the growth of eBooks and Amazon’s role therein, Makinson did so pursuant to antitrust legal advice and avoided competitively sensitive topics like terms of trade, prices, or confidential competitive matters. Certain potential joint venture proposals were also discussed, including potential participation in a mobile telephone joint venture. Penguin specifically denies that the purpose of any such gathering was to coordinate or fix prices or that any agreements to fix prices were reached at any such gathering.

Penguin is without knowledge or information about the allegations in the first sentence of paragraph 41 and therefore denies them.

ALLEGATION 44. In addition to the CEO dinner meetings, Publisher Defendants' CEOs and other executives met in-person, one-on-one to communicate about e-books multiple times over the course of 2009 and into 2010. Similar meetings took place in Europe, including meetings in the fall of 2009 between executives of Macmillan parent company Verlagsgruppe Georg von Holtzbrinck GmbH and executives of another Publisher Defendant's parent company. Macmillan CEO John Sargent joined at least one of these parent company meetings.

PENGUIN'S RESPONSE: Penguin denies that John Makinson or David Shanks met in person, one-on-one with Publisher Defendant CEOs or other executives to communicate about eBooks in order to fix prices or otherwise diminish competition and therefore generally denies the allegations in paragraph 44. Penguin admits that it was recruited and ultimately joined two legitimate joint ventures—"aNobii" or "Project Z" in the U.K. ([www.anobii.com](http://www.anobii.com)) and "Bookish" or "Project Muse" in the U.S. ([bookish.com](http://bookish.com))— that would market and potentially sell eBooks, and met and communicated with the joint venturer publisher participants about the same. Penguin is without knowledge regarding other publishers' meetings with other people and therefore denies those allegations.

ALLEGATION 45. These private meetings provided the Publisher Defendants' CEOs the opportunity to discuss how they collectively could solve "the \$9.99 problem."

PENGUIN'S RESPONSE: Penguin denies that any of its executives' meeting with other publishers constituted an attempt to fix prices, and the only collective discussion about creating competition with respect to Amazon involved the creation of two legitimate joint

ventures—“aNobii” or “Project Z” in the U.K. ([www.anobii.com](http://www.anobii.com)) and “Bookish” or “Project Muse” in the U.S. ([bookish.com](http://bookish.com)).

F. *Publisher Defendants Conspire To Raise Retail E-book Prices Under the Guise of Joint Venture Discussions*

ALLEGATION 46. While each Publisher Defendant recognized that it could not solve “the \$9.99 problem” by itself, collectively the Publisher Defendants accounted for nearly half of Amazon’s e-book revenues, and by refusing to compete with one another for Amazon’s business, the Publisher Defendants could force Amazon to accept the Publisher Defendants’ new contract terms and to change its pricing practices.

PENGUIN’S RESPONSE: Penguin denies the allegations of paragraph 46 as they relate to Penguin and lacks sufficient information or knowledge regarding the state of mind of other publishers and therefore denies the allegations in paragraph 46.

ALLEGATION 47. The Publisher Defendants thus conspired to act collectively, initially in the guise of joint ventures. These ostensible joint ventures were not meant to enhance competition by bringing to market products or services that the publishers could not offer unilaterally, but rather were designed as anticompetitive measures to raise prices.

PENGUIN’S RESPONSE: Penguin denies that the eBook publisher joint ventures in which it is a participant—“aNobii” or “Project Z” in the U.K. ([www.anobii.com](http://www.anobii.com)) and “Bookish” or “Project Muse” in the U.S. ([bookish.com](http://bookish.com))—are anything other than legitimate joint ventures intended to enhance competition by providing innovative marketing combined with social media and an additional route to market for eBooks that Penguin could not otherwise offer effectively on its own. The publisher participants in these joint ventures—including Random House in the U.K., who is not alleged to be a “conspiring” publisher— have collectively invested several million dollars in them. Both aNobii and Bookish have independent CEOs, Boards of Directors,

legal counsel, staffs and operating budgets. Indeed, the controlling shareholder of aNobii is HMV, the U.K.'s leading entertainment brand—also not alleged to be a “co-conspirator” by the government.

ALLEGATION 48. All five Publisher Defendants agreed in 2009 at the latest to act collectively to raise retail prices for the most popular e-books above \$9.99. One CEO of a Publisher Defendant's parent company explained to his corporate superior in a July 29, 2009 e-mail message that “[i]n the USA and the UK, but also in Spain and France to a lesser degree, the ‘top publishers’ are in discussions to create an alternative platform to Amazon for e-books. The goal is less to compete with Amazon as to force it to accept a price level higher than 9.99 .... I am in NY this week to promote these ideas and the movement is positive with [the other four Publisher Defendants].” (Translated from French).

PENGUIN'S RESPONSE: Penguin denies that it agreed with other publishers to act collectively with other publishers to raise the retail prices for the most popular eBooks above \$9.99. Penguin is without knowledge as to the remaining allegations contained in paragraph 48 and therefore denies them.

ALLEGATION 49. Less than a week later, in an August 4, 2009 strategy memo for the board of directors of Penguin's ultimate parent company, Penguin Group CEO John Makinson conveyed the same message:

Competition for the attention of readers will be most intense from digital companies whose objective may be to disintermediate traditional publishers altogether. This is not a new threat but we do appear to be on a collision course with Amazon, and possibly Google as well. It will not be possible for any individual publisher to mount an effective response, because of both the resources necessary and the risk of retribution, so the industry needs to develop a common strategy. This is the context for the development of the Project Z initiatives [joint ventures] in London and New York.

PENGUIN’S RESPONSE: Penguin admits that Penguin Group CEO John Makinson drafted a document entitled “Penguin Three Year Plan 2009” to his board on August 4, 2009 relating the quoted language above. However, the language above, on its face, is clearly discussing the legitimate U.K and U.S. eBook joint ventures in which Penguin is a participant—“aNobii” ([www.anobii.com](http://www.anobii.com))( initially called “Project Z”) and “Bookish” (bookish.com). This document further bears the date of August 4, 2009, long before any discussion with or concerning Apple or related to the agency model. Simply put, the three sentences lifted from this document have nothing to do with Apple, the agency model, or pricing.

G. *Defendants Agree To Increase and Stabilize Retail E-book Prices by Collectively Adopting an Agency Model*

ALLEGATION 50. To raise e-book prices, the Publisher Defendants also began to consider in late 2009 selling e-books under an “agency model” that would take away Amazon’s ability to set low retail prices. As one CEO of a Publisher Defendant’s parent company explained in a December 6, 2009 e-mail message, “[o]ur goal is to force Amazon to return to acceptable sales prices through the establishment of agency contracts in the USA .... To succeed our colleagues must know that we entered the fray and follow us.” (Translated from French).

PENGUIN’S RESPONSE: Penguin generally denies the allegations contained in paragraph 50. Penguin began to consider the agency model seriously when, and only when, Apple proposed it to Penguin as a method of doing business for Apple’s proposed iBookstore. Indeed, on January 4, 2010 – i.e., several weeks after “late 2009” – Penguin sent to Apple a draft wholesale/retail agreement for the sale of Penguin eBooks in the iBookstore. Penguin is without knowledge as to the explanations of other publisher CEOs and therefore denies those allegations.

ALLEGATION 51. Apple’s entry into the e-book business provided a perfect opportunity for collective action to implement the agency model and use it to raise retail e-book

prices. Apple was in the process of developing a strategy to sell e-books on its new iPad device. Apple initially contemplated selling e-books through the existing wholesale model, which was similar to the manner in which Apple sold the vast majority of the digital media it offered in its iTunes store. On February 19, 2009, Apple Vice President of Internet Services Eddy Cue explained to Apple CEO Steve Jobs in an e-mail, “[a]t this point, it would be very easy for us to compete and I think trounce Amazon by opening up our own ebook store.” In addition to considering competitive entry at that time, though, Apple also contemplated illegally dividing the digital content world with Amazon, allowing each to “own the category” of its choice— audio/video to Apple and e-books to Amazon.

**PENGUIN’S RESPONSE:** Penguin generally denies the allegations contained in paragraph 51. Penguin admits that Apple approached Penguin in December 2009 to present the idea of opening an iBookstore to sell eBooks on its new iPad device, and Penguin was eager to do business with Apple to secure broader distribution for its eBooks and have the opportunity to create enhanced eBooks, which the iPad promised to be able to accommodate (and which Amazon’s Kindle could not). Penguin is without knowledge as to Apple’s statements or contemplations and therefore denies those allegations.

**ALLEGATION 52.** Apple soon concluded, though, that competition from other retailers – especially Amazon – would prevent Apple from earning its desired 30 percent margins on e-book sales. Ultimately, Apple, together with the Publisher Defendants, set in motion a plan that would compel all non-Apple e-book retailers also to sign onto agency or else, as Apple’s CEO put it, the Publisher Defendants all would say, “we’re not going to give you the books.”

PENGUIN'S RESPONSE: Penguin is without knowledge as to the allegations about conclusions drawn by Apple contained in paragraph 52 and therefore denies them. Penguin denies the remaining allegations contained in paragraph 52.

ALLEGATION 53. The executive in charge of Apple's inchoate e-books business, Eddy Cue, telephoned each Publisher Defendant and Random House on or around December 8, 2009 to schedule exploratory meetings in New York City on December 15 and December 16. Hachette and HarperCollins took the lead in working with Apple to capitalize on this golden opportunity for the Publisher Defendants to achieve their goal of raising and stabilizing retail e-book prices above \$9.99 by collectively imposing the agency model on the industry.

PENGUIN'S RESPONSE: Penguin admits that it was initially contacted in early December by Apple and met with Apple on December 15, 2009 to discuss the possibility of an iBookstore, and that this meeting was the first that Penguin learned of Apple's plans for an eReader application on its iPad device, but denies the remaining allegations contained in paragraph 53 as they pertain to Penguin. Penguin is without information regarding the allegations in paragraph 53 regarding other publishers and therefore denies them.

ALLEGATION 54. It appears that Hachette and HarperCollins communicated with each other about moving to an agency model during the brief window between Mr. Cue's first telephone calls to the Publisher Defendants and his visit to meet with their CEOs. On the morning of December 10, 2009, a HarperCollins executive added to his calendar an appointment to call a Hachette executive at 10:50 AM. At 11:01 AM, the Hachette executive returned the phone call, and the two spoke for six minutes. Then, less than a week later in New York, both Hachette and HarperCollins executives told Mr. Cue in their initial meetings with him that they



wanted to sell e-books under an agency model, a dramatic departure from the way books had been sold for over a century.

PENGUIN’S RESPONSE: Penguin is without knowledge as to the allegations about Hachette and HarperCollins contained in paragraph 54 and therefore denies them.

ALLEGATION 55. The other Publisher Defendants also made clear to Apple that they “certainly” did not want to continue “the existing way that they were doing business,” *i.e.*, with Amazon promoting their most popular e-books for \$9.99 under a wholesale model.

PENGUIN’S RESPONSE: Penguin admits that its discussed Amazon’s pricing of eBooks with Apple during the initial meeting between Penguin and Apple on December 15, 2009, insofar as it was an industry fact that Apple needed to be aware of in deciding whether to open an iBookstore, but Penguin denies the remaining allegations contained in paragraph 55.

ALLEGATION 56. Apple saw a way to turn the agency scheme into a highly profitable model for itself. Apple determined to give the Publisher Defendants what they wanted while shielding itself from retail price competition and realizing margins far in excess of what e-book retailers then averaged on each newly released or bestselling e-book sold. Apple realized that, as a result of the scheme, “the customer” would “pay[] a little more.”

PENGUIN’S RESPONSE: Penguin is without knowledge about the allegations regarding Apple contained in paragraph 56 and therefore denies them.

ALLEGATION 57. On December 16, 2009, the day after both companies’ initial meetings with Apple, Penguin Group CEO John Makinson had a breakfast meeting at a London hotel with the CEO of another Publisher Defendant’s parent company. Consistent with the Publisher Defendants’ other efforts to conceal their activities, Mr. Makinson’s breakfast

companion wrote to his U.S. subordinate that he would recount portions of his discussion with Mr. Makinson only by telephone.

PENGUIN'S RESPONSE: Penguin admits that Penguin Group CEO John Makinson attended a previously scheduled breakfast meeting with Hachette's CEO, Arnaud Nourry, on December 16, 2009 the purpose of which was to discuss participation in a publisher eBook joint venture. Penguin is without knowledge as to the allegations regarding Arnaud Nourry contained in paragraph 57 and therefore denies them.

ALLEGATION 58. By the time Apple arrived for a second round of meetings during the week of December 21, 2009, the agency model had become the focus of its discussions with all of the Publisher Defendants. In these discussions, Apple proposed that the Publisher Defendants require *all* retailers of their e-books to accept the agency model. Apple thereby sought to ensure that it would not have to compete on retail prices. The proposal appealed to the Publisher Defendants because wresting pricing control from Amazon and other e-book retailers would advance their collusive plan to raise retail e-book prices.

PENGUIN'S RESPONSE: Penguin denies the allegations contained in paragraph 58 insofar as they relate to Penguin. Penguin did not have further discussions with Apple regarding the business model under which the two might potentially operate until Penguin proposed a wholesale/retail distribution agreement with Apple on January 4, 2010. The next day, January 5, 2010, Apple unilaterally announced the agency model to Penguin as a take-it-or-leave-it deal term. Penguin is without knowledge as to the allegations regarding any other publisher contained in paragraph 58 and therefore denies them.

ALLEGATION 59. The Publisher Defendants acknowledged to Apple their common objective to end Amazon's \$9.99 pricing. As Mr. Cue reported in an e-mail message to Apple's

CEO Steve Jobs, the three publishers with whom he had met saw the “plus” of Apple’s position as “solv[ing the] Amazon problem.” The “negative” was that Apple’s proposed retail prices – topping out at \$12.99 for newly released and bestselling e-books – were a “little less than [the publishers] would like.” Likewise, Mr. Jobs later informed an executive of one of the Publisher Defendant’s corporate parents that “[a]ll major publishers” had told Apple that “Amazon’s \$9.99 price for new releases is eroding the value perception of their products in customer’s minds, and they do not want this practice to continue for new releases.”

**PENGUIN’S RESPONSE:** Penguin denies that it acknowledged to Apple that the publishers had a common objective to end Amazon’s \$9.99 pricing and is otherwise without knowledge as to the allegations regarding Apple other than that Penguin did not participate in a “second round of meetings” with Apple in December, and was not the Publisher to which Mr. Jobs communicated, and therefore denies the allegations contained in paragraph 59.

**ALLEGATION 60.** As perhaps the only company that could facilitate their goal of raising retail e- book prices across the industry, Apple knew that it had significant leverage in negotiations with Publisher Defendants. Apple exercised this leverage to demand a thirty percent commission—a margin significantly above the prevailing competitive margins for e-book retailers. The Publisher Defendants worried that the combination of paying Apple a higher commission than they would have liked and pricing their e-books lower than they wanted might be too much to bear in exchange for Apple’s facilitation of their agreement to raise retail e-book prices. Ultimately, though, they convinced Apple to allow them to raise prices high enough to make the deal palatable to them.

**PENGUIN’S RESPONSE:** Penguin admits that Apple—with access to hundreds of millions of potential eBook buyers through iTunes and the drawing power of its hotly anticipated

iPad—had significant leverage in its negotiations with Penguin. Thus, and among other terms, Apple negotiated a 30% commission, which Penguin understands to be the same commission Apple received under its agency agreements with regard to the sale of Apps for the iPhone. Penguin denies that there were any extant “competitive” margins prior to Apple opening an iBookstore. Penguin admits that it negotiated business terms with Apple that Penguin estimated would be profitable for Penguin based upon the assumption that the entry of Apple and the institution of the agency model would expand distribution and increase Penguin’s overall sales of eBooks significantly, as demonstrated by Penguin’s internal business planning documents. Penguin denies the remaining allegations contained in paragraph 60 with respect to Penguin, and is without knowledge as to the allegations regarding any other publisher contained in paragraph 60 and therefore denies them.

ALLEGATION 61. As it negotiated with the Publisher Defendants in December 2009 and January 2010, Apple kept each Publisher Defendant informed of the status of its negotiations with the other Publisher Defendants. Apple also assured the Publisher Defendants that its proposals were the same to each and that no deal Apple agreed to with one publisher would be materially different from any deal it agreed to with another publisher. Apple thus knowingly served as a critical conspiracy participant by allowing the Publisher Defendants to signal to one another both (a) which agency terms would comprise an acceptable means of achieving their ultimate goal of raising and stabilizing retail e-book prices, and (b) that they could lock themselves into this particular means of collectively achieving that goal by all signing their Apple Agency Agreement.

PENGUIN’S RESPONSE: Penguin generally denies the allegations contained in paragraph 61 but admits that Apple made it clear to Penguin that Apple, for its own reasons, did

not want to have materially different agreements with its book publisher partners. Penguin further denies that Apple informed Penguin of the status of its negotiations with other publishers, other than telling Penguin at times that it had agreed to terms with some number of unidentified other publishers. Penguin is without knowledge as to the allegations regarding any other entity contained in paragraph 61 and therefore denies them.

ALLEGATION 62. Apple's Mr. Cue e-mailed each Publisher Defendant between January 4, 2010, and January 6, 2010 an outline of what he tabbed [sic] "the best approach for e-books." He reassured Penguin USA CEO David Shanks and other Publisher Defendant CEOs that Apple adopted the approach "[a]fter talking to all the other publishers." Mr. Cue sent substantively identical e-mail messages and proposals to each Publisher Defendant.

PENGUIN'S RESPONSE: Penguin admits that Apple's Eddy Cue emailed Penguin on January 5, 2010 outlining the terms it was willing to use to open an iBookstore and that email includes the statement: "After talking to all the other publishers and seeing the overall book environment, here is what I think is the best approach for ebooks." Penguin denies that the Apple statement was a "reassurance" to David Shanks and denies knowledge of whether it was a "reassurance" to any other publisher.

ALLEGATION 63. The outlined proposal that Apple circulated after consulting with each Publisher Defendant contained several key features. First, as Hachette and HarperCollins had initially suggested to Apple, the publisher would be the principal and Apple would be the agent for e-book sales. Consumer pricing authority would be transferred from retailers to publishers. Second, Apple's proposal mandated that every other retailer of each publisher's e-books – Apple's direct competitors – be forced to accept the agency model as well. As Mr. Cue wrote, "all resellers of new titles need to be in agency model." Third, Apple would receive a 30

percent commission for each e-book sale. And fourth, each Publisher Defendant would have identical pricing tiers for e-books sold through Apple's iBookstore.

PENGUIN'S RESPONSE: Penguin admits that Eddy Cue's email to Penguin dated January 5, 2010 outlined what Eddy Cue believed was "the best approach for ebooks." Penguin is without knowledge of what, if anything, Hachette and HarperCollins initially suggested to Apple and therefore denies those allegations, and Penguin specifically denies that Penguin suggested the agency model to Apple, as it in fact had done the opposite by transmitting a draft wholesale/retail contract to Apple on January 4, 2010—the day before. Penguin admits that Eddy Cue's email on January 5, 2010 informed Penguin that it would only go forward using the agency model ("Just like the App Store, we are proposing a principal-agency model with you, where you would be the principal and iTunes would sell your product as your agent for your account. In exchange for acting as your agent, iTunes would get a 30% commission for each transaction"), and that it would insist upon pricing tiers in order to keep eBook prices low ("On pricing, you would be free to determine whether to distribute any particular publication through iTunes (of course if another eBook distributor was able to sell a book then we would as well); and you would be free to establish the price that eBook would be sold. So that we could efficiently manage our agency role, we propose a corresponding range of prices for books at various stages in a book's publication and distribution evolution."). Eddy Cue also wrote: "There are several things we have to accomplish in order to sell eBooks at realistic prices: books need to be cheaper to buy than physical; you should make less per book since significant costs have been eliminated but still have a healthy, profitable sale; all resellers of new titles need to be in agency model." Penguin specifically denies that Eddy Cue's January 5, 2010 suggested that Penguin would have identical pricing tiers as other publishers. Penguin is without knowledge as

to the allegations contained in paragraph 63 regarding any other publisher and therefore denies them.

ALLEGATION 64. On January 11, 2010, Apple e-mailed its proposed e-book distribution agreement to all the Publisher Defendants. As with the outlined proposals Apple sent earlier in January, the proposed e-book distribution agreements were substantially the same. Also on January 11, 2010, Apple separately e-mailed to Penguin and two other Publisher Defendants charts showing how the Publisher Defendant's bestselling e-books would be priced at \$12.99 – the ostensible maximum price under Apple's then-current price tier proposal – in the iBookstore.

PENGUIN'S RESPONSE: Penguin admits that Apple sent its initial draft of an agency distribution agreement for eBooks to Penguin on January 11, 2010, Penguin is without knowledge as to any proposals sent by Apple to other publishers and therefore denies those allegations. Penguin admits that Apple also sent Penguin a chart explaining its price tiers that Apple had proposed in its initial draft agency contract. Penguin denies the remaining allegations contained in paragraph 64. Penguin is without knowledge as to the allegations contained in paragraph 64 regarding any other publisher and therefore denies them.

ALLEGATION 65. The proposed e-book distribution agreement mainly incorporated the principles Apple set out in its e-mail messages of January 4 through January 6, with two notable changes. First, Apple demanded that the Publisher Defendants provide Apple their complete e-book catalogs and that they not delay the electronic release of any title behind its print release. Second, and more important, Apple replaced the express requirement that each publisher adopt the agency model with each of its retailers with an unusual most favored nation ("MFN") pricing provision. That provision was not structured like a standard MFN in favor of a retailer, ensuring Apple that it would receive the best available wholesale price. Nor did the MFN

ensure Apple that the Publisher Defendants would not set a higher retail price on the iBookstore than they set on other websites where they controlled retail prices. Instead, the MFN here required each publisher to guarantee that it would lower the retail price of each e-book in Apple's iBookstore to match the lowest price offered by any other retailer, even if the Publisher Defendant did not control that other retailer's ultimate consumer price. That is, instead of an MFN designed to protect Apple's ability to compete, this MFN was designed to protect Apple from having to compete on price at all, while still maintaining Apple's 30 percent margin.

PENGUIN'S RESPONSE: Penguin admits that Apple's initial draft agency contract circulated to Penguin included what might be characterized as "most favored nation" provision regarding eBook content, and what the government characterizes as a "most favored nation" provision regarding retail prices. Contrary to the allegations in paragraph 65, the provision with regard to pricing ensured that the prices set by Penguin for Penguin titles sold in the iBookstore would be competitive with any price for the same title offered anywhere else. This provision did not diminish Apple's incentives to compete; to the contrary, it allowed Apple to match the lowest eBook prices in the marketplace and thus to ensure that the iBookstore could be the most attractive location to buy eBooks. Penguin denies the remaining allegations contained in paragraph 65.

ALLEGATION 66. The purpose of these provisions was to work in concert to enforce the Defendants' agreement to raise and stabilize retail e-book prices. Apple and the Publisher Defendants recognized that coupling Apple's right to all of their e-books with its right to demand that those e-books not be priced higher on the iBookstore than on any other website effectively required that each Publisher Defendant take away retail pricing control from all other e-book retailers, including stripping them of any ability to discount or otherwise price promote e-books



out of the retailer's own margins. Otherwise, the retail price MFN would cause Apple's iBookstore prices to drop to match the best available retail price of each e-book, and the Publisher Defendants would receive only 70 percent of those reduced retail prices. Price competition by other retailers, if allowed to continue, thus likely would reduce e-book revenues to levels the Publisher Defendants could not control or predict.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 67. In negotiating the retail price MFN with Apple, "some of [the Publisher Defendants]" asserted that Apple did not need the provision "because they would be moving to an agency model with [the other e-book retailers,]" regardless. Ultimately, though, all Defendants agreed to include the MFN commitment mechanism.

PENGUIN'S RESPONSE: Penguin admits that its agency contract with Apple contains several clauses that might be characterized as "most favored nation" provisions. Penguin also notes that its agency contract with Amazon *also* contains several clauses that might be characterized as "most favored nation" provisions. Both sets of commitments by Penguin were intended to keep Penguin's agents' offerings competitive with each other. Penguin denies the remaining allegations contained in paragraph 67 with respect to Penguin, and is without knowledge as to the allegations regarding any other entity contained in paragraph 67, and therefore denies them.

ALLEGATION 68. On January 16, 2010, Apple, via Mr. Cue, offered revised terms to the Publisher Defendants that again were identical in substance. Apple modified its earlier proposal in two significant ways. First, in response to publisher requests, it added new maximum pricing tiers that increased permissible e-book prices to \$16.99 or \$19.99, depending on the book's hardcover list price. Second, Apple's new proposal mitigated these price increases

somewhat by adding special pricing tiers for e-book versions of books on the *New York Times* fiction and non-fiction bestseller lists. For e-book versions of bestsellers bearing list prices of \$30 or less, Publisher Defendants could set a price up to \$12.99; for bestsellers bearing list prices between \$30 and \$35, the e-book price cap would be \$14.99. In conjunction with the revised proposal, Mr. Cue set up meetings for the next week to finalize agreements with the Publisher Defendants.

PENGUIN'S RESPONSE: Penguin admits that Apple's Eddie Cue sent an electronic mail message with revised, proposed deal terms to Penguin on or around January 16, 2010, which among other items, included price ceilings that were different from the price tiers Apple had first proposed and a requirement that the price ceiling applied to titles listed on the New York Times Best Seller list be lowered. Penguin is otherwise without knowledge of Apple's negotiations with other publishers and therefore denies those allegations. Penguin further admits that Apple arranged to meet with Penguin on or around January 20, 2010 to discuss Apple opening an online bookstore and Penguin's possible participation. Penguin is without knowledge as to the allegations contained in paragraph 68 regarding any other entity and therefore denies them.

ALLEGATION 69. Each Publisher Defendant required assurances that it would not be the only publisher to sign an agreement with Apple that would compel it either to take pricing authority from Amazon or to pull its e-books from Amazon. The Publisher Defendants continued to fear that Amazon would act to protect its ability to price e-books at \$9.99 or less if any one of them acted alone. Individual Publisher Defendants also feared punishment in the marketplace if only its e-books suddenly became more expensive at retail while other publishers continued to allow retailers to compete on price. As Mr. Cue noted, "all of them were very concerned about

being the only ones to sign a deal with us.” Penguin explicitly communicated to Apple that it would sign an e-book distribution agreement with Apple only if at least three of the other “major[]” publishers did as well. Apple supplied the needed assurances.

**PENGUIN’S RESPONSE:** Penguin admits that it sought an assurance from Apple, prior to entering a business relationship with Apple to sell eBooks, that a number of publishers would be selling their eBooks in the iBookstore because Penguin wanted to sell its eBooks on a platform that would attract the greatest number of customers—which would necessarily require the participation of other eBook publishers in providing titles to the bookstore. Also, because a switch to agency selling involved costs and some business disruption (e.g., occasioned by systems changes), Penguin wanted to be assured that Apple was committed to a full-scale, viable iBookstore, which meant a store selling a large variety of eBook titles being published. In addition to ensuring the viability of the iBookstore, Penguin was also worried about preserving its existing distribution—which could have been harmed, for example, if Amazon punitively refused to sell Penguin titles on its website in retaliation for Penguin entering a business relationship with a new competitor. Penguin denies the remaining allegations contained in paragraph 69 with respect to Penguin, and is without knowledge as to the allegations contained in paragraph 69 regarding any other entity, and therefore denies them.

**ALLEGATION 70.** While the Publisher Defendants were discussing e-book distribution terms with Apple during the week of January 18, 2010, Amazon met in New York City with a number of prominent authors and agents to unveil a new program under which copyright holders could take their e-books directly to Amazon – cutting out the publisher – and Amazon would pay royalties of up to 70 percent, far in excess of what publishers offered. This announcement further highlighted the direct competitive threat Amazon posed to the Publisher

Defendants' business model. The Publisher Defendants reacted immediately. For example, Penguin USA CEO David Shanks reported being "really angry" after "hav[ing] read [Amazon's] announcement." After thinking about it for a day, Mr. Shanks concluded, "[o]n Apple I am now more convinced that we need a viable alternative to Amazon or this nonsense will continue and get much worse." Another decisionmaker stated he was "p\*\*\*\*d" at Amazon for starting to compete directly against the publishers and expressed his desire "to screw Amazon."

PENGUIN'S RESPONSE: Penguin admits that it became publicly known on or around January 18, 2010 that Amazon was attempting to negotiate deals with literary agents directly, and that Penguin Group (USA) CEO David Shanks and others were disappointed to learn that Penguin's business partner was attempting to disrupt Penguin's business relationships with literary agents. Penguin denies the remaining allegations contained in paragraph 70 with respect to Penguin, and is without knowledge as to the allegations contained in paragraph 70 regarding any other publisher and therefore denies them.

ALLEGATION 71. To persuade one of the Publisher Defendants to stay with the others and sign an agreement, Apple CEO Steve Jobs wrote to an executive of the Publisher Defendant's corporate parent that the publisher had only two choices apart from signing the Apple Agency Agreement: (i) accept the status quo ("Keep going with Amazon at \$9.99"); or (ii) continue with a losing policy of delaying the release of electronic versions of new titles ("Hold back your books from Amazon"). According to Jobs, the Apple deal offered the Publisher Defendants a superior alternative path to the higher retail e-book prices they sought: "Throw 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."

PENGUIN’S RESPONSE: Penguin is without knowledge as to the allegations contained in paragraph 71 and therefore denies them.

ALLEGATION 72. In addition to passing information through Apple and during their private dinners and other in-person meetings, the Publisher Defendants frequently communicated by telephone to exchange assurances of common action in attempting to raise the retail price of e-books. These telephone communications increased significantly during the two-month period in which the Publisher Defendants considered and entered the Apple Agency Agreements. During December 2009 and January 2010, the Publisher Defendants’ U.S. CEOs placed at least 56 phone calls to one another. Each CEO, including Penguin’s Shanks and Macmillan’s Sargent, placed at least seven such phone calls.

PENGUIN’S RESPONSE: Penguin admits that during December 2009 and January 2010, Penguin Group (USA) CEO David Shanks communicated by telephone a handful of times with the CEOs of Hachette and Simon & Schuster, with whom he serves on the Board of Directors of the publisher eBook joint venture “Bookish” (bookish.com) (also known as “Project Muse”) as Penguin during that time period agreed to participate as a founding member of the joint venture and the Bookish board was in the process of searching for a CEO and engaged in other formative matters. Penguin denies the remaining allegations contained in paragraph 72 related to Penguin and is otherwise without knowledge as to the allegations concerning other publishers and therefore denies them.

ALLEGATION 73. The timing, frequency, duration, and content of the Publisher Defendant CEOs’ phone calls demonstrate that the Publisher Defendants used them to seek and exchange assurances of common strategies and business plans regarding the Apple Agency Agreements. For example, in addition to the telephone calls already described in this complaint:

- Near the time Apple first presented the agency model, one Publisher Defendant’s CEO used a telephone call – ostensibly made to discuss a marketing joint venture – to tell Penguin USA CEO David Shanks that “everyone is in the same place with Apple.”
- After receiving Apple’s January 16, 2010 revised proposal, executives of several Publisher Defendants responded to the revised proposal and meetings by, again, seeking and exchanging confidential information. For example, on Sunday, January 17, one Publisher Defendant’s CEO used his mobile phone to call another Publisher Defendant’s CEO and talk for approximately ten minutes. And on the morning of January 19, Penguin USA CEO David Shanks had an extended telephone conversation with the CEO of another Publisher Defendant.
- On January 21, 2010, the CEO of one Publisher Defendant’s parent company instructed his U.S. subordinate via e-mail to find out Apple’s progress in agency negotiations with other publishers. Four minutes after that e-mail was sent, the U.S. executive called another Publisher Defendant’s CEO, and the two spoke for over eleven minutes.
- On January 22, 2010, at 9:30 a.m., Apple’s Cue met with one Publisher Defendant’s CEO to make what Cue hoped would be a “final go/no-go decision” about whether the Publisher Defendant would sign an agreement with Apple. Less than an hour later, the Publisher Defendant’s CEO made phone calls, two minutes apart, to two other Publisher Defendants’ CEOs, including Macmillan’s Sargent. The CEO who placed the calls admitted under oath to placing them specifically to learn if the other two Publisher Defendants would sign with Apple prior to Apple’s iPad launch.
- On the evening of Saturday, January 23, 2010, Apple’s Cue e-mailed his boss, Steve Jobs, and noted that Penguin USA CEO David Shanks “want[ed] an assurance that he is 1 of 4 before signing.” The following Monday morning, at 9:46 a.m., Mr. Shanks called another Publisher Defendant’s CEO and the two talked for approximately four minutes. Both Penguin and the other Publisher Defendant signed their Apple Agency Agreements later that day.

PENGUIN’S RESPONSE: Penguin denies that its executives engaged in any conversations with other publishers that sought “assurances of common strategies and business plans” regarding Apple. At the time Apple presented the possibility of an iBookstore to Penguin,

Penguin was in the midst of forming a U.S. based joint publisher venture to market eBooks with Simon & Schuster and Hachette—“Project Muse” or “Bookish” (bookish.com)—and was necessarily in conversation with executives at those publishers related to the joint venture.

Specifically, with regard to the allegations in the bullet points, Penguin admits that

- On or around the time Apple first presented its agency-model concept to publishers, David Shanks recalls a joint venture related telephone call with David Young (a fellow Board Member of Bookish) in which Mr. Young made a casual comment that everyone was in the same place with Apple.
- On January 19, David Shanks had an eleven-minute, Bookish-related telephone call with Carolyn Reidy (a fellow Board member of Bookish). Penguin denies that this telephone call was in furtherance of a publisher conspiracy.
- David Shanks sent Apple’s Eddie Cue an email on January 22, 2010 in which he told Apple: You must have the fourth major or we can’t be in the announcement [of the release of the iPad and the opening of the iBookstore]. Penguin denies that this statement shows Penguin was part of a publisher conspiracy; otherwise it would not have to have asked Apple for confirmation.
- Penguin call records show David Shanks had a four minute telephone call with Carolyn Reidy the morning of January 25, 2010. Penguin’s internal electronic communications further show that Penguin subsequently decided not to agree to the agency terms as proposed by Apple, and not be part of opening the iBookstore. Only after negotiating new and different deal terms—which Penguin believes are unique to it and its business model—did Penguin change course and enter into an agency agreement with Apple.

Penguin otherwise is without knowledge as to any publisher communications not involving Penguin and therefore denies those allegations contained in paragraph 73.

ALLEGATION 74. On January 24, 2010, Hachette signed an e-book distribution agreement with Apple. Over the next two days, Simon & Schuster, Macmillan, Penguin, and HarperCollins all followed suit and signed e-book distribution agreements with Apple. Within these three days, the Publisher Defendants agreed with Apple to abandon the longstanding wholesale model for selling e-books. The Apple Agency Agreements took effect simultaneously on April 3, 2010 with the release of Apple's new iPad.

PENGUIN'S RESPONSE: Penguin admits that Penguin signed an agency agreement with Apple on January 25, 2010. Penguin is without knowledge regarding any other publisher's distribution agreement with Apple and therefore denies those allegations. Penguin denies the remaining allegations contained in paragraph 75.

ALLEGATION 75. The final version of the pricing tiers in the Apple Agency Agreements contained the \$12.99 and \$14.99 price points for bestsellers, discussed earlier, and also established prices for all other newly released titles based on the hardcover list price of the same title. Although couched as maximum retail prices, the price tiers in fact established the retail e-book prices to be charged by Publisher Defendants.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 76. By entering the Apple Agency Agreements, each Publisher Defendant effectively agreed to require all of their e-book retailers to accept the agency model. Both Apple and the Publisher Defendants understood the Agreements would compel the Publisher Defendants to take pricing authority from all non-Apple e-book retailers. A February 10, 2010 presentation by one Publisher Defendant applauded this result (emphasis in original):



“The Apple agency model deal means that we will have to shift to an agency model with Amazon which [will] strengthen our control over pricing.”

PENGUIN’S RESPONSE: Penguin denies the allegations in paragraph 76 as they relate to Penguin and is without knowledge as to the understandings of Apple or other publishers or the content of the referenced February 10, 2010 presentation and therefore denies those allegations.

ALLEGATION 77. Apple understood that the final Apple Agency Agreements ensured that the Publisher Defendants would raise their retail e-book prices to the ostensible limits set by the Apple price tiers not only in Apple’s forthcoming iBookstore, but on Amazon.com and all other consumer sites as well. When asked by a *Wall Street Journal* reporter at the January 27, 2010 iPad unveiling event, “Why should she buy a book for... \$14.99 from your device when she could buy one for \$9.99 from Amazon on the Kindle or from Barnes & Noble on the Nook?” Apple CEO Steve Jobs responded, “that won’t be the case ... the prices will be the same.”

PENGUIN’S RESPONSE: Penguin is without knowledge as to Apple’s understanding about its agency agreement with Penguin or anyone else and therefore denies the allegations contained in paragraph 78.

ALLEGATION 78. Apple understood that the retail price MFN was the key commitment mechanism to keep the Publisher Defendants advancing their conspiracy in lockstep. Regarding the effect of the MFN, Apple executive Pete Alcorn remarked in the context of the European roll-out of the agency model in the spring of 2010:

I told [Apple executive Keith Moerer] that I think he and Eddy [Cue] made it at least halfway to changing the industry permanently, and we should keep the pads on and keep fighting for it. I might regret that later, but right now I feel like it’s a giant win to keep pushing the MFN and forcing people off the [A]mazon model and onto ours. If anything, the place to give is the pricing – long run, the mfn is

more important. The interesting insight in the meeting was Eddy's explanation that it doesn't have to be that broad – any decent MFN forces the model.

PENGUIN'S RESPONSE: Penguin is without knowledge as to Apple's understanding about its agency agreement with Penguin or anyone else and therefore denies the allegations contained in paragraph 78.

ALLEGATION 79. Within the four months following the signing of the Apple Agency Agreements, and over Amazon's objections, each Publisher Defendant had transformed its business relationship with all of the major e-book retailers from a wholesale model to an agency model and imposed flat prohibitions against e-book discounting or other price competition on all non- Apple e-book retailers.

PENGUIN'S RESPONSE: Penguin admits that by May 26, 2010, it had negotiated agency agreements with all of its principal distribution partners, including Amazon, and that with the exception of Amazon, every potential agent welcomed the prospect of moving to the agency model during Penguin's negotiations. Penguin admits that under each of its agency agreements, including its agency agreement with Apple, Penguin has sole discretion to set the prices at which it would offer to sell Penguin titles.

ALLEGATION 80. For example, after it signed its Apple Agency Agreement, Macmillan presented Amazon a choice: adopt the agency model or lose the ability to sell e-book versions of new hardcover titles for the first seven months of their release. Amazon rejected Macmillan's ultimatum and sought to preserve its ability to sell e-book versions of newly released hardcover titles for \$9.99. To resist Macmillan's efforts to force it to accept either the agency model or delayed electronic availability, Amazon effectively stopped selling Macmillan's print books and e-books.

PENGUIN’S RESPONSE: Penguin admits that Amazon publicly retaliated against Macmillan in January 2010 by removing the “buy” buttons from Macmillan book titles after Macmillan purportedly proposed the agency model to Amazon. Penguin is without knowledge regarding the other allegations contained in paragraph 80 and therefore denies them.

ALLEGATION 81. When Amazon stopped selling Macmillan titles, other Publisher Defendants did not view the situation as an opportunity to gain market share from a weakened competitor. Instead, they rallied to support Macmillan. For example, the CEO of one Publisher Defendant’s parent company instructed the Publisher Defendant’s CEO that “[Macmillan CEO] John Sargent needs our help!” The parent company CEO explained, “M[acm]illan have been brave, but they are small. We need to move the lines. And I am thrilled to know how A[mazon] will react against 3 or 4 of the big guys.”

PENGUIN’S RESPONSE: Penguin admits its executives were supportive of Macmillan given that Amazon could just have easily retaliated against Penguin. Penguin otherwise denies the allegations in paragraph 81 as they related to penguin. Penguin is without knowledge regarding the remaining allegations contained in paragraph 81 and therefore denies them.

ALLEGATION 82. The CEO of one Publisher Defendant’s parent company assured Macmillan CEO John Sargent of his company’s support in a January 31, 2010 email: “I can ensure you that you are not going to find your company alone in the battle.” The same parent company CEO also assured the head of Macmillan’s corporate parent in a February 1 email that “others will enter the battle field!” Overall, Macmillan received “hugely supportive” correspondence from the publishing industry during Macmillan’s effort to force Amazon to accept the agency model.

PENGUIN’S RESPONSE: Penguin admits it was highly publicized that many people in the book industry expressed disagreement with Amazon’s actions and believed those actions were anticompetitive but is otherwise without knowledge regarding the allegations contained in paragraph 82 and therefore denies them.

ALLEGATION 83. As its battle with Amazon continued, Macmillan knew that, because the other Publisher Defendants, via the Apple Agency Agreements, had locked themselves into forcing agency on Amazon to advance their conspiratorial goals, Amazon soon would face similar edicts from a united front of Publisher Defendants. And Amazon could not delist the books of all five Publisher Defendants because they together accounted for nearly half of Amazon’s e-book business. Macmillan CEO John Sargent explained the company’s reasoning: “we believed whatever was happening, whatever Amazon was doing here, they were going to face – they’re going to have more of the same in the future one way or another.” Another Publisher Defendant similarly recognized that Macmillan was not acting unilaterally but rather was “leading the charge on moving Amazon to the agency model.”

PENGUIN’S RESPONSE: Penguin is without knowledge regarding the allegations contained in paragraph 83 and therefore denies them.

ALLEGATION 84. Amazon quickly 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. Just two days after it stopped selling Macmillan titles, Amazon capitulated and publicly announced that it had no choice but to accept the agency model, and it soon resumed selling Macmillan’s e-book and print book titles.

PENGUIN’S RESPONSE: Penguin admits that Amazon publicly announced in February 2010 that it was accepting Macmillan’s proposal of an agency agreement and reinstated the “buy” buttons for Macmillan titles on its website. Penguin is without knowledge regarding the remaining allegations contained in paragraph 84 and therefore denies them.

H. *Defendants Further the Conspiracy by Pressuring Another Publisher To Adopt the Agency Model*

ALLEGATION 85. When a company takes a pro-competitive action by introducing a new product, lowering its prices, or even adopting a new business model that helps it sell more product at better prices, it typically does not want its competitors to copy its action, but prefers to maintain a first-mover or competitive advantage. In contrast, when companies jointly take collusive action, such as instituting a coordinated price increase, they typically want the rest of their competitors to join them in that action. Because collusive actions are not pro-competitive or consumer friendly, any competitor that does not go along with the conspirators can take more consumer friendly actions and see its market share rise at the expense of the conspirators. Here, the Defendants acted consistently with a collusive arrangement, and inconsistently with a pro-competitive arrangement, as they sought to pressure another publisher (whose market share was growing at the Publisher Defendants’ expense after the Apple Agency Contracts became effective) to join them.

PENGUIN’S RESPONSE: The first two sentences of paragraph 85 are hypothetical speculation or abstract economic propositions and not factual allegations and therefore no response is required. Otherwise the allegations contained in paragraph 85 are denied.

ALLEGATION 86. Penguin appears to have taken the lead in these efforts. Its U.S. CEO, David Shanks, twice directly told the executives of the holdout major publisher about his displeasure with their decision to continue selling e-books on the wholesale model. Mr. Shanks

tried to justify the actions of the conspiracy as an effort to save brick-and-mortar bookstores and criticized the other publisher for “not helping” the group. The executives of the other publisher responded to Mr. Shanks’s complaints by explaining their objections to the agency model.

PENGUIN’S RESPONSE: Penguin denies that it “took the lead” in pressuring Random House to move to the agency model. Penguin admits that David Shanks had a conversation with Madeline McIntosh of Random House in late 2010, and that, on Markus Dohle’s invitation, David Shanks had lunch with Dohle in late 2010, and discussed the fate of bricks-and-mortar bookstores with each, but otherwise denies the allegations contained in paragraph 86. As David Shanks has testified about his conversation with Markus Dohle of Random House:

Random House is the largest publisher so if it was important that publishers have book stores, the largest publisher needs to help to assure that there are book stores because they are the largest so [I asked] what are you going to do to stop the demise of book stores and we never talked about pricing or doing anything else, it was just that my opinion, my personal opinion that he had an obligation to the industry to do something to help the industry. Never talked about what that would be, but to do something to make sure that there will be book stores for a while.

ALLEGATION 87. Mr. Shanks also encouraged a large print book and e-book retailer to punish the other publisher for not joining Defendants’ conspiracy. In March 2010, Mr. Shanks sent an e-mail message to an executive of the retailer complaining that the publisher “has chosen to stay on their current model and will allow retailers to sell at whatever price they wish.” Mr. Shanks argued that “[s]ince Penguin is looking out for [your] welfare at what appears to be great costs to us, I would hope that [you] would be equally brutal to Publishers who have thrown in with your competition with obvious disdain for your welfare.... I hope you make [the publisher] hurt like Amazon is doing to [the Publisher Defendants].”

PENGUIN'S RESPONSE: Penguin admits that Penguin Group (USA) CEO David Shanks sent an email to Steve Riggio, the [President] of Barnes & Noble, on March 4, 2010 that said:

Hi Steve. I wanted to share something that has me concerned. You know that we are working with your guys to come up with a formula where all of our accounts will be able to have the same prices on our ebooks. It will level the playing field for Penguin books and hopefully allow us to sell both paper and ebook product. The one discouraging thing as you no doubt know is that Random House has chosen to stay on their current model and allow retailers to sell at whatever price they wish. **That is their prerogative.** When you go on the Kindle website it could be the Random House home page. Amazon is showing us what they do to people who do not do what they want. As Penguin is looking out for B&N at what appears to be great cost to us, I would hope that B&N would be equally brutal to Publishers who have thrown in with your competition with obvious disdain for your welfare. You told me once that you were nice and Amazon played hardball and they were winning. I hope you make random House hurt like Amazon is doing to people who are looking out for the overall welfare of the publishing industry. I hope you can see how strongly I feel about this. They should not be allowed to be selfish and win. Thanks for listening. I hope to see you soon. (emphasis added)

The email speaks for itself. Penguin otherwise denies the allegations contained in paragraph 87.

ALLEGATION 88. When the third-party retailer continued to promote the non-defendant publisher's books, Mr. Shanks applied more pressure. In a June 22, 2010 email to the retailer's CEO, Mr. Shanks claimed to be "baffled" as to why the retailer would promote that publisher's books instead of just those published by "people who stood up for you."

PENGUIN'S RESPONSE: Penguin admits that on June 22, 2010, after Barnes & Noble took out a full page advertisement in the *New York Times* promoting the Nook, a Penguin employee emailed his contact at Barnes & Noble and commented:

Not to be a nudge but the ad prominently show 5 titles, 3 of which were Random House. I don't understand why you would advertise a publisher who has not gone to an agency model. B&N actually loses money on each sale of these books at the \$9.99 so advertising them rather than so many other great profitable books makes no sense to me. Penguin went to an agency model to help support booksellers like B&N where the retailer can raise the price and perceived value of a book and make the retailer a profit. To have B&N support the one publisher who didn't do that in this ad makes us feel like our efforts to make our industry stronger are not appreciated by the biggest book account in the country.

Penguin admits that Penguin Group (USA) CEO David Shanks forwarded this email to William Lynch, the CEO of Barnes & Noble, and said "I am still baffled why you would push RH books over people who stood up for you." The email otherwise speaks for itself. Penguin otherwise denies the allegations contained in paragraph 88.

ALLEGATION 89. Throughout the summer of 2010, Apple also cajoled the holdout publisher to adopt agency terms in line with those of the Publisher Defendants, including on a phone call between Apple CEO Steve Jobs and the holdout publisher's CEO. Apple flatly refused to sell the holdout publisher's e-books unless and until it agreed to an agency relationship substantially similar to the arrangement between Apple and the Publisher Defendants defined by the Apple Agency Agreements.

PENGUIN'S RESPONSE: Penguin is without knowledge regarding the allegations contained in paragraph 90 and therefore denies them.

I. *Conspiracy Succeeds at Raising and Stabilizing Consumer E-book Prices*

ALLEGATION 90. The ostensible maximum prices included in the Apple Agency Agreements' price schedule represent, in practice, actual e-book prices. Indeed, at the time the Publisher Defendants snatched retail pricing authority away from Amazon and other e-book retailers, not one of them had built an internal retail pricing apparatus sufficient to do anything



other than set retail prices at the Apple Agency Agreements' ostensible caps. Once their agency agreements took effect, the Publisher Defendants raised e-book prices at all retail outlets to the maximum price level within each tier. Even today, two years after the Publisher Defendants began setting e-book retail prices according to the Apple price tiers, they still set the retail prices for the electronic versions of all or nearly all of their bestselling hardcover titles at the ostensible maximum price allowed by those price tiers.

PENGUIN'S RESPONSE: Penguin denies the allegations in paragraph 90 to the extent they relate to Penguin. Penguin lacks information or knowledge with regard to the allegations concerning other publishers and therefore denies them.

ALLEGATION 91. The Publisher Defendants' collective adoption of the Apple Agency Agreements allowed them (facilitated by Apple) to raise, fix, and stabilize retail e-book prices in three steps: (a) they took away retail pricing authority from retailers; (b) they then set retail e-book prices according to the Apple price tiers; and (c) they then exported the agency model and higher retail prices to the rest of the industry, in part to comply with the retail price MFN included in each Apple Agency Agreement.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 92. Defendants' conspiracy and agreement to raise and stabilize retail e-book prices by collectively adopting the agency model and Apple price tiers led to an increase in the retail prices of newly released and bestselling e-books. Prior to the Defendants' conspiracy, consumers benefited from price competition that led to \$9.99 prices for newly released and bestselling e-books. Almost immediately after Apple launched its iBookstore in April 2010 and the Publisher Defendants imposed agency model pricing on all retailers, the Publisher

Defendants' e-book prices for most newly released and bestselling e-books rose to either \$12.99 or \$14.99.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 93. Defendants' conspiracy and agreement to raise and stabilize retail e-book prices by collectively adopting the agency model and Apple price tiers for their newly released and bestselling e-books also led to an increase in average retail prices of the balance of Publisher Defendants' e-book catalogs, their so-called "backlists." Now that the Publisher Defendants control the retail prices of e-books – but Amazon maintains control of its print book retail prices – Publisher Defendants' e-book prices sometimes are higher than Amazon's prices for print versions of the same titles.

PENGUIN'S RESPONSE: Penguin admits that from time to time, for certain titles and for certain time periods, Amazon has instituted a practice of loss-leading on certain print books, pursuant to which Amazon chooses to price those print book lower than the same eBook title sold by Penguin. Penguin otherwise denies the allegations contained in paragraph 93.

## VI. VIOLATION ALLEGED

ALLEGATION 94. Beginning no later than 2009, and continuing to date, Defendants and their coconspirators have engaged in a conspiracy and agreement in unreasonable restraint of interstate trade and commerce, constituting a violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. This offense is likely to continue and recur unless the relief requested is granted.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 95. The conspiracy and agreement consists of an understanding and concert of action among Defendants and their co-conspirators to raise, fix, and stabilize retail e-book prices, to end price competition among e-book retailers, and to limit retail price

competition among the Publisher Defendants, ultimately effectuated by collectively adopting and adhering to functionally identical methods of selling e-books and price schedules.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 96. For the purpose of forming and effectuating this agreement and conspiracy, some or all Defendants did the following things, among others:

- a. Shared their business information, plans, and strategies in order to formulate ways to raise retail e-book prices;
- b. Assured each other of support in attempting to raise retail e-book prices;
- c. Employed ostensible joint venture meetings to disguise their attempts to raise retail e-book prices;
- d. Fixed the method of and formulas for setting retail e-book prices;
- e. Fixed tiers for retail e-book prices;
- f. Eliminated the ability of e-book retailers to fund retail e-book price decreases out of their own margins; and
- g. Raised the retail prices of their newly released and bestselling e-books to the agreed prices – the ostensible price caps – contained in the pricing schedule of their Apple Agency Agreements.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 97. Defendants' conspiracy and agreement, in which the Publisher Defendants and Apple agreed to raise, fix, and stabilize retail e-book prices, to end price

competition among e- book retailers, and to limit retail price competition among the Publisher Defendants by fixing retail e-book prices, constitutes a *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 98. Moreover, Defendants' conspiracy and agreement has resulted in obvious and demonstrable anticompetitive effects on consumers in the trade e-books market by depriving consumers of the benefits of competition among e-book retailers as to both retail prices and retail innovations (such as e-book clubs and subscription plans), such that it constitutes an unreasonable restraint on trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 99. Where, as here, defendants have engaged in a *per se* violation of Section 1 of the Sherman Act, no allegations with respect to the relevant product market, geographic market, or market power are required. To the extent such allegations may otherwise be necessary, the relevant product market for the purposes of this action is trade e-books. The anticompetitive acts at issue in this case directly affect the sale of trade e-books to consumers. No reasonable substitute exists for e-books. There are no technological alternatives to e-books, thousands of which can be stored on a single small device. E-books can be stored and read on electronic devices, while print books cannot. E-books can be located, purchased, and downloaded anywhere a customer has an internet connection, while print books cannot. Industry firms also view e-books as a separate market segment from print books, and the Publisher Defendants were able to impose and sustain a significant retail price increase for their trade e-books.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 100. The relevant geographic market is the United States. The rights to license e- books are granted on territorial bases, with the United States typically forming its own territory. E-book retailers typically present a unique storefront to U.S. consumers, often with e-books bearing different retail prices than the same titles would command on the same retailer's foreign websites.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 101. The Publisher Defendants possess market power in the market for trade e-books. The Publisher Defendants successfully imposed and sustained a significant retail price increase for their trade e-books. Collectively, they create and distribute a wide variety of popular e- books, regularly comprising over half of the *New York Times* fiction and non-fiction bestseller lists. Collectively, they provide a critical input to any firm selling trade e-books to consumers. Any retailer selling trade e-books to consumers would not be able to forgo profitably the sale of the Publisher Defendants' e-books.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 102. Defendants' agreement and conspiracy has had and will continue to have anticompetitive effects, including:

- a. Increasing the retail prices of trade e-books;
- b. Eliminating competition on price among e-book retailers;
- c. Restraining competition on retail price among the Publisher Defendants;
- d. Restraining competition among the Publisher Defendants for favorable relationships with e-book retailers;

- e. Constraining innovation among e-book retailers;
- f. Entrenching incumbent publishers' favorable position in the sale and distribution of print books by slowing the migration from print books to e-books;
- g. Making more likely express or tacit collusion among publishers; and
- h. Reducing competitive pressure on print book prices.

PENGUIN'S RESPONSE: Denied.

ALLEGATION 103. Defendants' agreement and conspiracy is not reasonably necessary to accomplish any procompetitive objective, or, alternatively, its scope is broader than necessary to accomplish any such objective.

PENGUIN'S RESPONSE: Denied.

## VII. REQUEST FOR RELIEF

ALLEGATION 104. To remedy these illegal acts, the United States requests that the Court:

- a. Adjudge and decree that Defendants entered into an unlawful contract, combination, or conspiracy in unreasonable restraint of interstate trade and commerce in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1;
- b. Enjoin the Defendants, their officers, agents, servants, employees and attorneys and their successors and all other persons acting or claiming to act in active concert or participation with one or more of them, from continuing,

maintaining, or renewing in any manner, directly or indirectly, the conduct alleged herein or from engaging in any other conduct, combination, conspiracy, agreement, understanding, plan, program, or other arrangement having the same effect as the alleged violation or that otherwise violates Section 1 of the Sherman Act, 15 U.S.C. § 1, through fixing the method and manner in which they sell e-books, or otherwise agreeing to set the price or release date for e-books, or collective negotiation of e-book agreements, or otherwise collectively restraining retail price competition for e-books;

c. Prohibit the collusive setting of price tiers that can de facto fix prices;

d. Declare null and void the Apple Agency Agreements and any agreement between a Publisher Defendant and an e-book retailer that restricts, limits, or impedes the e-book retailer's ability to set, alter, or reduce the retail price of any e-book or to offer price or other promotions to encourage consumers to purchase any e-book, or contains a retail price MFN;

e. Reform the agreements between Apple and Publisher Defendants to strike the retail price MFN clauses as void and unenforceable; and

f. Award to Plaintiff its costs of this action and such other and further relief as may be appropriate and as the Court may deem just and proper.

PENGUIN'S RESPONSE: No response is required and paragraph 104 is therefore denied.

To the extent the Complaint sets forth any allegation to which Penguin has not responded, such allegation is denied.

### **AFFIRMATIVE AND OTHER DEFENSES**

#### **FIRST DEFENSE**

The Complaint fails to state a claim against Penguin upon which relief can be granted.

#### **SECOND DEFENSE**

Plaintiff's claims against Penguin are barred because Penguin was not part of any contract, combination, or conspiracy in restraint of trade.

#### **THIRD DEFENSE**

Plaintiff's claims against Penguin are barred because Penguin's alleged actions did not result in any harm to competition.

#### **FOURTH DEFENSE**

Plaintiff's claims against Penguin fail under the rule of reason because the procompetitive justifications for Penguin's alleged actions outweigh any alleged resulting harm to competition.

#### **FIFTH DEFENSE**

Plaintiff's claims against Penguin are barred by the doctrine of unclean hands.

#### **SIXTH DEFENSE**

Plaintiff's claims against Penguin are barred by the doctrine of laches.



**SEVENTH DEFENSE**

Plaintiff's claims against Penguin are barred because the principal/agent relationship does not form an "agreement" as defined by Section 1 of the Sherman Act.

**EIGHTH DEFENSE**

Plaintiff has failed to join all parties necessary for a just and appropriate adjudication of its claims.

**NINTH DEFENSE**

Penguin's actions were undertaken in good faith to promote legitimate business purposes and in order to and did have the effect of promoting competition.

**TENTH DEFENSE**

Penguin reserves the right to amend this Answer, and to assert additional defenses, cross-claims, and third party claims in this action when and if they become appropriate.

Dated: May 29, 2012

Respectfully submitted,

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*Attorneys for Penguin Group (USA), Inc. and The Penguin Group, a Division of Pearson plc.*

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that on May 29, 2012, I electronically filed the foregoing document using the CM/ECF system which will send notification of such filing to the e-mail addresses registered in the CM/ECF system, as denoted on the Electronic Mail Notice List.

DATED: May 29, 2012

\_\_\_\_\_  
/s/  
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