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NOTES

AMAZON, OR THE MODERN PROMETHEUS: HOW THE KINDLE IS FIRING UP A READING REVOLUTION, AND WHY THE STATUS QUO IS RESISTING

Stanley Joseph Konoval

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NOTES

AMAZON, OR THE MODERN PROMETHEUS: HOW THE KINDLE IS FIRING UP A READING REVOLUTION, AND WHY THE STATUS QUO IS RESISTING

Stanley Joseph Konoval[*]

I. INTRODUCTION

It has been estimated that Amazon had, in recent history, 90% of the e-book market cornered (though more recent estimates put Amazon's e-book market share at approximately 60%).[1] In other words, Amazon is making a killing. However, killings do not happen without victims.[2] For

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[1] Andrew Albanese, *Judge Approves Final E-book Settlements*, PUBLISHERS WEEKLY, Dec. 6, 2013, *available at* http://www.publishersweekly.com/pw/by-topic/digital/content-and-e-books/article/60282-judge-approves-final-e-book-settlements-payments-to-begin-in-early-2014.html.

[2] For a particularly acerbic—and *not* unbiased—take on Amazon's business practices, see Kathleen Sharp, *Amazon's Bogus Anti-Apple Crusade*, SALON (Jan. 12, 2014), *available at* http://www.salon.com/2014/01/12/amazons_bogus_anti_apple_crusade/ ("You may remember that Amazon helped persuade the U.S. [DOJ] to sue Apple . . . claiming that Apple conspired with . . . publishers to fix the price of e-books . . . . Amazon, the web's biggest retailer, had been selling published books at a money-losing rate of $9.99. Why? To get us to buy its Kindle e-book reader, and to dominate the e-book market. . . . This meant that publishers—who had invested in the writing, production, promotion and distribution of these books—couldn't sell their wares at the recommended retail price of $14.99. Nor could brick-and-mortar stores match Amazon's money-losing discounts.").

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example, Barnes and Noble ("B&N") recently reported a 60% drop in its digital division.[3] According to a *Bloomberg Businessweek* contributor,

> [e]-book prices are a big reason why Barnes & Noble is losing this battle . . . Amazon often sells e-books at a loss, using low prices to lure customers into the Kindle ecosystem. It goes so far as to give many books away [by allowing its Amazon Prime members to borrow e-books for free]. . . ."[4]

As *Businessweek*—and B&N's revenue—attest to, "Barnes & Noble doesn't have the resources or the relationship with customers to match MatchBook and services like it."[5]

Amazon has not only put a sizeable dent in B&N's business; it has been hurting book publishers, as well, and the publishers have tried fighting back:

> According [to an antitrust complaint filed by the Department of Justice ("DOJ") against Apple and five New York book publishers], the five publishers and Apple were unhappy that competition among e-book sellers had reduced e-book prices and . . . retail profit margins. . . . To address these concerns . . . the companies worked together to enter into contracts that eliminated price competition among bookstores selling e-books, substantially increasing prices paid by consumers.[6]

On April 11, 2012, the DOJ and thirty-three U.S. states and territories filed suit against Apple and five of the six largest book publishers in America for colluding with each other to raise prices on e-books in direct response to what the publishers perceived as Amazon's undervaluing of e-books by pricing them at $9.99.[7] All five publishers settled.[8] Apple went to trial and lost, in the Southern District of New York, in July 2013.[9] The

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[3] Brad Stone, *Barnes & Noble's Nook Nightmare Stars Amazon and the DOJ*, BLOOMBERG BUSINESSWEEK (Jan. 9, 2014), http://www.businessweek.com/articles/2014-01-09/barnes-and-nobles-nook-sales-hurt-by-amazons-lower-e-book-prices.

[4] *Id*.

[5] *Id*. (MatchBook is a program recently unveiled by Amazon whereby publishers may elect to sale e-books to consumers for a reduced price (maximum of $2.99) when the consumer has made an eligible purchase of a hard copy of that same title).

[6] Press Release, Dep't of Justice, Justice Department Reaches Settlement with Penguin Group (USA) Inc. in E-Books Case (Dec. 18, 2012), http://www.justice.gov/atr/public/press_releases/2012/290409.pdf.

[7] United States v. Apple Inc., 952 F. Supp. 2d 638, 645–47 (S.D.N.Y. 2013).

[8] *Id*. at 645.

[9] *Id*.

court found that all of the parties conspired to "raise, fix, and stabilize the retail price" of e-books in violation of the Sherman Antitrust Act.[10]

Yet, while litigation was ongoing, Random House, the largest publisher in America, and Penguin agreed to merge (announced on October 29, 2012),[11] received approval from the DOJ (February 14, 2013),[12] and completed the merger (July 1, 2013).[13] Though Random House was not a party to the DOJ's antitrust suit, it had, in only a matter of months after the illegal agreements were forged, signed essentially the same contract with Apple that the other publishers had signed.[14]

While Penguin's settlement agreement, the terms of which will be discussed below, will be binding upon the newly created company ("Penguin Random House"),[15] the DOJ's approval of the merger—with no conditions other than those imposed by Penguin's settlement agreement—occurred while the DOJ continued litigation against Apple. This seems to indicate some cognitive dissonance on the DOJ's part. While the publishers settled without admitting guilt, the DOJ, in arguing for its case against Apple, necessarily had to show that Apple colluded with the publishers to raise prices. In other words, at the same time the DOJ was considering and ultimately approving the Penguin-Random House merger, it was also arguing in court that Apple and Penguin (and other publishers) had conspired to engage in anti-competitive behavior. There seems to be something counterintuitive about the DOJ allowing a company to complete a merger while at the same time arguing that that company had recently engaged in anti-competitive behavior.

Why might the DOJ have approved the merger while continuing to litigate? The DOJ must have believed that the merger would not result in

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[10] *Id*.

[11] *Random House, Penguin Agree to Merge*, PUBLISHERS WEEKLY (Oct. 29, 2012), a*vailable at* http://www.publishersweekly.com/pw/by-topic/industry-news/industry-deals/article/54536-random-house-penguin-agree-to-merge.html.

[12] *DOJ Clears Random House, Penguin Merger*, PUBLISHERS WEEKLY (Feb. 14, 2013), *available at* http://www.publishersweekly.com/pw/by-topic/industry-news/industry-deals/article/55961-doj-clears-random-house-penguin-merger.html.

[13] *Random House, Penguin Merger Completed*, PUBLISHERS WEEKLY (July 1, 2013), *available at* http://www.publishersweekly.com/pw/by-topic/industry-news/industry-deals/article/58047-random-house-penguin-merger-completed.html.

[14] *Apple*, 952 F. Supp. 2d at 686.

[15] Press Release, Dep't of Justice, *supra* note 6.

anti-competitive effects. As will be discussed below, publishing is an industry which is undergoing radical change. This is due, in part, to advances in technology and to Amazon's trailblazing practices. Furthermore, publishers have already shown that they are more inclined to try strong-arm tactics to maintain the status-quo rather than innovate—which explains the DOJ's antitrust suit against Apple and the New York publishers. So, the questions we need to answer are: why exactly did the DOJ so quickly approve of the merger during this related litigation, and will the approval of the Penguin-Random House merger undermine the ability of Penguin's prior settlement to promote or protect consumer welfare?

Part II of this paper will elucidate the Southern District of New York's opinion in which Judge Cote found Apple guilty of anti-competitive behavior; the decision chronicles nicely the anxiety traditional New York book publishers have been feeling for years because of Amazon's ultra-competitive low-pricing and ground-breaking new programs (as exemplified by the new MatchBook program described above).[16] This elucidation of the New York publishers' anxiety and desperation, which manifested in the publishers' anti-competitive behavior, heightens the counterintuitive nature of the DOJ's approval of the Penguin-Random House merger. Part III will lay out some of the DOJ's criteria for evaluating mergers, as outlined in its latest Horizontal Merger Guidelines—there, I will also briefly discuss the antitrust policies of the Obama administration as explained by members of the administration. In Part IV, I will provide an analysis of the merger, using the Guidelines, which will go a long way toward explaining why the DOJ had few concerns about the competitive effects of the merger. This will resolve the apparent mystery of why the DOJ approved the merger with the *Apple* litigation ongoing. I will also briefly explain why, not just from the DOJ analysis, but from lay and industry perspectives as well, the Penguin-Random House merger seemed like it would benefit consumers—and why it may actually have the opposite effect. This uncertainty in possible outcomes suggests that the DOJ erred in providing the public no insight into its decision-making process. Greater transparency would have laid to rest not only the question of what effects this merger is expected to have on the industry; it also would have assured

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[16] *See supra* note 5 for details regarding Amazon's MatchBook program.

the public that the DOJ actually had thoroughly considered the nuances in a rapidly changing industry in evaluating likelihood of any unintended consequences.

II. Getting a Lay of the Land (i.e., Mapping Out the Dire Straits New York Publishers Have Found Themselves in)

Hachette Book Group, Inc., HarperCollins Publishers LLC, Holtzbrinck Publishers LLC ("Macmillan"), Penguin Group (USA), Inc., Simon & Schuster, Inc., and Random House are known as publishing's "Big Six."[17] The Big Six wanted to raise e-book prices for its New York Times Bestsellers above Amazon's standard $9.99.[18] Fortuitously for the publishers, Apple was planning on launching its first iPad, and it was hoping to have its iBookstore established in time for the launch.[19] Five of the Big Six (i.e., all of the publishers except for Random House)—referred to below as the "Big Five" and "Publisher Defendants" alternatively—met with Apple and realized they shared a goal: "[T]hat there be no price competition at the retail level. Apple did not want to compete with Amazon . . . on price; and the Publisher Defendants wanted to end Amazon's $9.99 pricing and increase significantly the prevailing price point for e-books."[20]

There are two models by which the publishers can set prices for books: the wholesale model and the agency model. The wholesale model functions in that the publisher receives a designated "wholesale" price for each unit and the retailer, in this case Amazon, sets the retail price.[21] The agency model is where "the publisher sets the retail price and the retailer sells the e-book as [the publisher's] agent."[22] Because the publishers had been operating under the wholesale model, Amazon was able to sell the books for whatever price it wanted, thus the $9.99 price point for many books. The Big Six "feared [Amazon's pricing] would have a number of pernicious effects on their profits . . . [they] believed the low price point was eating into sales of their . . . hardcover books . . . and threatening the

[17] *Apple*, 952 F. Supp. 2d at 645, 647.
[18] *Id*. at 647.
[19] *Id*.
[20] *Id*.
[21] *Id*. at 648.
[22] *Id*.

viability of the brick-and-mortar stores in which hardcover books were displayed and sold."[23] The Big Six also feared that consumers would come to expect books to fall into the $9.99 price range, thus entrenching the price for the future.[24]

Apple was offering the Big Six the opportunity to move from a wholesale model to an agency model. But there was a catch: the Big Six's contract with Apple would not only guarantee Apple that it could match the lowest retail price of any of its competitors, it also would "impose[] a severe financial penalty upon the Publisher Defendants if they did not force Amazon . . . to change [its] business model[] and cede control over e-book pricing to the Publishers."[25] Apple made it clear that this was a watershed moment for the publishers.[26]

To put this in perspective: in 2009, Amazon was estimated to have 90% of the e-book market cornered.[27] Judge Cote provided an illustrative and concise summary of the Big Six's response to Amazon's dominance:

> Penguin told Amazon that "their $9.99 model" was "not a good sustainable one.". . . [Simon and Schuster] bluntly told Amazon that the $9.99 price point was "a mistake" and that [they] would "continue to be vocal because . . . it's terrible for business.". . . In . . . December 2009, Hachette [told Amazon] that Amazon's $9.99 pricing posed a "big problem" for the industry [and that Amazon should raise e-book prices by one or two dollars].[28]

The publishers had tried various methods to combat Amazon which proved fruitless (e.g., "windowing" whereby the publishers would release hardcovers before e-books in order to stimulate sales of the hardcovers).[29] However, it became clear to the Publisher Defendants that they needed to take Apple's offer.

Amazon was aware that the publishers were going to push for a change to an agency model; in response, Amazon created the Kindle Digital Platform in January 2010, which allowed Amazon to deal directly with authors—by allowing any and all authors to publish any new titles, or old

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[23] *Id*. at 649.
[24] *Id*.
[25] *Id*. at 648.
[26] *Id*.
[27] *Id*. at 649.
[28] *Id*. at 650.
[29] *Id*. at 651–53.

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titles which the authors had rights to, electronically with Amazon with no need for a publisher or an agent; this effectively eliminated the need for a middleman (i.e., publishers), which further enraged the Big Six.[30] The Big Five threatened to withhold their new release e-books from Amazon for seven months if Amazon would not acquiesce in changing to the agency model; Amazon replied by removing the publishers' books from its website, which created a storm of criticism against Amazon, who eventually relented and signed agency model agreements with the publishers.[31]

Each of the Big Five, when sued by the Department of Justice, settled. Representative of the settlements is this agreement pertaining to Penguin Group:

> WHEREAS . . . the United States of America filed its Complaint . . . alleging that Defendants conspired to raise retail prices of E-books in violation of Section 1 of the Sherman Act . . . and Plaintiff and Penguin . . . have consented to the entry of this Final Judgment . . . [which] does not constitute any admission by Penguin that the law has been violated or of any issue of fact or law . . . are true . . . Penguin agrees to be bound by the provisions of this Final Judgment. . . .
>
> *Within seven days . . . Penguin shall terminate any agreement with Apple relating to the Sale of E-books . . . .*
>
> *The failure of the Department of Justice to* request additional information or to *bring an action under the antitrust laws to challenge the formation . . . of [a] joint venture shall neither give rise to any inference of lawfulness* nor limit . . . the right of the United States to investigate . . . activities of the joint venture. . . .
>
> *For two years, Penguin shall not restrict, limit, or impede an E-book Retailer's ability to set, alter, or reduce the Retail Price of any E-book or to offer price discounts or any other form of promotions . . . .*[32]

This is the state of things. Amazon is back in business with a diminished, but healthy, market share of 60% of e-book sales.[33] The Big Six is now five, and because of their settlements with the DOJ, each of them has had to relinquish its profitable (if coerced) agency agreement with Amazon, putting them essentially back where they started—except that they are no

[30] *Id*. at 649, 671.
[31] *Id*. at 679–81.
[32] United States v. Apple, Inc., 2013 U.S. Dist. LEXIS 128364 at *3–4, *13, *15–16 (S.D.N.Y. May 17, 2013) (emphasis added).
[33] Albanese, *supra* note 1.

longer free to play hardball with Amazon for years because of the settlement agreements. As the excerpt from the settlement agreement above shows, the Publisher Defendants have no say for two years over Amazon's pricing of e-books (as opposed to what had previously been the case: publishers had at least the *possibility* of playing hardball with Amazon, but had been afraid to do so because Amazon could retaliate). Essentially, the publishers are worse off now than they were before they had tried to strong-arm Amazon. Specifically, Penguin Random House is worse off in the sense that it has a more limited say over pricing. However, it is better off in the sense that it will have the combined market share and resources of two of the former Big Six.

Elucidation of the DOJ's prompt approval of this merger raises two questions: (1) by what criteria did the DOJ evaluate this merger?; and (2) was the DOJ right to approve the merger?

III. Laying Out Some of the DOJ's Criteria for Evaluating Mergers

One simple—and cynical—explanation for the DOJ's quick approval of the merger, without conditions,[34] is that the DOJ just is not interested in aggressively pursuing antitrust cases. This explanation may be implied by law review articles with titles such as *Antitrust Enforcement Under the Obama Administration: Change? Really?*[35] that express disappointment that the Obama administration is not making "dramatic changes in antitrust enforcement levels."[36] A quick glance at the statistics reveals that cynicism is probably unjustified: "Challenges to U.S. mergers and acquisitions are up . . . [the DOJ and Federal Trade Commission ("FTC")] challenged 44 deals during the 2012 fiscal year . . . a 19 percent jump from challenges during . . . 2011 . . . Steven Salop, a law professor at Georgetown university . . . [said] the increase . . . demonstrates the Obama administration's greater emphasis on antitrust enforcement and litigation."[37] And even the

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[34] *DOJ Clears Random House, Penguin Merger*, *supra* note 12.

[35] Sanford M. Litvack et al., *Antitrust Enforcement Under the Obama Administration: Change? Really?*, 12 SEDONA CONF. J. 227 (2011).

[36] *Id.*

[37] Ashley Post, *Merger challenges were up in 2012 fiscal* year, INSIDE COUNSEL (May 1, 2013), *available at* http://www.insidecounsel.com/2013/05/01/merger-challenges-were-up-in-2012-fiscal-year.

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suggestively titled law review article above concluded, "While the antitrust agencies under Obama plainly are intent on enforcing the antitrust laws more aggressively than the prior Administration, the increase has, to date, been modest."[38] In other words, the authors were criticizing the Obama Administration for not providing "major change" from the Bush Administration; but they would reject the proposition that the DOJ is soft on antitrust enforcement.[39] Working under the assumption that the DOJ and FTC are intent on preventing anti-competitive mergers, how are they determining when action is or is not appropriate?

In 2010, the DOJ and FTC released new horizontal merger guidelines that "outline how the federal antitrust agencies evaluate the likely competitive impact of mergers and whether those mergers comply with U.S. antitrust law."[40] (A horizontal merger is a merger between actual or potential competitors.[41] Seeing as how the Big Six, though united in their opposition to Amazon, are still competitors whose products compete for consumers' dollars, the merger between Penguin and Random House is a horizontal merger.) The "primary goal" of the new guidelines is to help "identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that either are competitively beneficial or likely will have no competitive impact on the marketplace."[42] We can do a bit of quasi *a priori* reasoning from just these revelations, plus what facts we already know. Let us begin with the facts: the DOJ approved the Penguin-Random House merger without conditions—and we also know that the Penguin settlement applies to Penguin Random House. If the basic policy considerations behind the 2010 Horizontal Merger Guidelines include not just challenging harmful mergers, but also getting out of the way of mergers that seem beneficial, then the speed with which the DOJ got

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[38] Litvack et al., *supra* note 35, at 247.

[39] *Id.* at 250.

[40] Press Release, Dep't of Justice, Department of Justice and Federal Trade Commission Issue Revised Horizontal Merger Guidelines, 1 (Aug. 19, 2010), http://www.justice.gov/atr/public/press_releases/2010/261642.pdf.

[41] DEP'T OF JUSTICE & FED. TRADE COMM'N, FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES, 1 (Aug. 19, 2010) [hereinafter HORIZONTAL MERGER GUIDELINES 2010], http://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

[42] Press Release, Dep't of Justice, *supra* note 40, at 1.

out of the way,[43] in addition to the fact that they did not impose conditions on the merger, suggest that the DOJ believed this merger would be beneficial, or at worst, have a negligible effect on the market.

To better understand how the DOJ came to such a conclusion, we can start with basic, and broad, assumptions underlying the DOJ's approach to mergers. According to Assistant U.S. Attorney Christine A. Varney of the DOJ's Antitrust Division speaking empirically based on ten-year department statistics, "The vast majority of mergers are procompetitive and enhance consumer welfare or are competitively benign."[44] Mergers of course can detrimentally affect consumers, which Ms. Varney stated "can take many forms, including higher prices, slower innovation, lower quality, and reduced product variety. In some cases, a transaction's effects may take the form of reduced incentives to innovate, to cut prices, or to expand consumer choice through product variety."[45]

The 2010 Horizontal Merger Guidelines begin with a citation to Section 7 of the Clayton Act[46]: the Act "prohibits mergers if 'in any line of commerce . . . the effect . . . may be substantially to lessen competition, or to tend to create a monopoly.'"[47] Negative impacts on the consumers may occur as a result of "unilateral" or "coordinated" effects (where the former is due to the detrimental conduct of one firm in particular and the latter is due to coordinated behavior among rivals).[48] Mergers, the Guidelines indicate, should not be allowed to entrench or enhance market power, meaning that the merger should not "encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives."[49] In other words, the Guidelines state that the agencies should be on the lookout for mergers that are likely to negatively impact consumers in some way, including, but not limited to, raised prices—"Enhanced market power can

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[43] Four months from announcement of the merger to approval of the merger, as we will recall, was during a relevant antitrust suit. *See supra* Part I.

[44] CHRISTINE A. VARNEY, ATT'Y GEN. ANTITRUST DIV., DEP'T OF JUSTICE, MERGER GUIDELINES WORKSHOPS, 1 (Sept. 22, 2009), http://www.justice.gov/atr/public/speeches/250238.pdf.

[45] *Id*. at 2.

[46] 15 U.S.C. § 18 (2012).

[47] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 1.

[48] *Id*. at 2.

[49] *Id*.

also be manifested in non-price terms and conditions . . . including reduced product quality, reduced product variety, reduced service, or diminished innovation [which may] coexist with price effects or arise in their absence."[50]

While a complete survey of the Horizontal Merger Guidelines is beyond the scope of this note, it will be useful to outline some of the considerations which seem particularly relevant to this merger: (1) market shares and market concentration; (2) unilateral effects; (3) coordinated effects; and (4) efficiencies.[51]

Before delving into the first criterion, market shares and market concentration, it is important to note a few things about "market definition," which is what "helps specify the line of commerce and section of the country in which the competitive concern arises."[52] Interestingly enough, the Guidelines state that the "Agencies analysis need not start with market

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[50] *Id*.

[51] For the sake of concision and relevance, not all of the factors the Agencies might consider can be considered thoroughly in this note. However, I will briefly synopsize the other criteria the Agencies may look to, which include: Powerful buyers, entry, failure and exiting assets, mergers of competing buyers, and partial acquisitions.

The Agencies define *powerful buyers* as those buyers who are "able to negotiate favorable terms with their suppliers . . . . The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices." *Id*. at 27. This factor will be deeply entangled with the issue of Amazon's involvement in the publishing industry. See *infra*, Part IV for further discussion of the possible, but uncertain, effects this merger can have on Amazon.

Entry concerns whether potential competitors have the ability to enter the market and "deter or counteract any competitive effects of concern so the merger will not substantially harm customers." HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 28. The Agencies will attempt to determine whether competitors are likely to enter the market in time to have a sufficient counteracting effect on anti-competitive concerns. Barriers to entry for online independent publishers are low, on account of programs like Amazon's KDP. There may be some debate about whether the entry barriers are low for physical book publishers; however, the proliferation of print-on-demand services for independent authors and publishers probably goes a long way toward allaying this concern.

Failure and exiting assets pertains to mergers involving firms which are literally unable to meet their financial obligations and are incapable of reorganizing by filing Chapter 11 bankruptcy, and have been unable to "elicit reasonable alternative offers that . . . pose a less severe danger to competition than . . . the proposed merger." *Id*. at 32. This factor is irrelevant in this case.

Mergers of competing buyers is essentially the same "framework [under discussion, except it is aimed toward evaluating] whether a merger is likely to enhance market power on the buying side of the market." *Id*. There appear to be neither controversy nor concern relevant to this factor.

Partial acquisitions involve one firm's "partial acquisition of a competitor." *Id*. at 33. This factor is irrelevant in this case.

[52] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 7.

definition" and that analysis may indeed "suggest[] alternative and reasonably plausible candidate markets."[53] This implies that "market" is somewhat of a fluid concept. However, a basic definition will be helpful in laying the conceptual foundation for what is to follow. "Market" may be defined in various ways; for the sake of simplicity, however, a broad definition will suffice: "market" is the concept which encompasses the production, demand, and revenue resulting from the sales of specific types of goods, the interchangeability of such goods determining the extent of a firm's power over the pricing of these goods.[54] "Market" is a matter of definition, which means that the relevant market can be determined in various ways—the DOJ recognizes this: "The Agencies implement . . . principles of market definition flexibly when evaluating different possible candidate markets . . . [some market definitions] are not always intuitive and may not align with how industry members use the term 'market.'"[55]

Market share is defined as "The percentage of the market for a product that a firm supplies, usually calculated by dividing the firm's output by the total market output. In antitrust law, market share is used to measure a firm's market power."[56] The Horizontal Guidelines state that the agencies "normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data . . . [and] also . . . for other market participants if this can be done to reliably reflect their competitive significance."[57] The agencies recognize that looking at past market shares may be somewhat of an inaccurate predictor of future competitiveness (e.g., in situations in which firms are anticipated to have exclusive access to new technology, which would presumably increase those firms' competitiveness above what past market share would indicate).[58] Market share, as measured by revenue, is an important metric

[53] *Id*.

[54] *See* BLACK'S LAW DICTIONARY 1055 (9th ed. 2009) definition for "market": "A place of commercial activity in which goods or services are bought and sold. . . A geographic area or demographic segment considered as a place of demand for particular goods or services." And in an antitrust context, *Black's Law Dictionary* states further that a "product market" is, "[t]he part of a relevant market that applies to a firm's particular product by identifying all reasonable substitutes for the product and by determining whether these substitutes limit the firm's ability to affect prices."

[55] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 8.

[56] BLACK'S LAW DICTIONARY 1058 (9th ed. 2009), "Market share."

[57] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 16 (emphasis added).

[58] *Id*.

because it reflects "the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers."[59]

Market concentration is one way the Agencies can measure the anti-competitive effects of a merger. Market concentration may be measured by calculating the "Herfindahl-Hirschman Index" ("HHI").[60] HHI is calculated by taking the market shares of each of the firms within the market and summing the square of each market share: "The HHI ranges from 10,000 (in the case of pure monopoly) to a number approaching zero (in the case of an atomistic market)."[61] The Agencies look not only to the post-merger HHI, but the change in HHI from pre- to post-merger. The Agencies employ the following categories of markets: *Unconcentrated Markets*: HHI below 1500; *Moderately Concentrated Markets*: HHI between 1500 and 2500; and *Highly Concentrated Markets*: HHI above 2500.[62] As the DOJ states: "The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns. . . ."[63]

Unilateral effects are effects wrought upon the market directly by the newly merged firm. A merged firm may be capable of various flavors of anticompetitive behavior: a merged firm may be able to "diminish competition by enabling the merged firm to profit by unilaterally raising the price of . . . products above the pre-merger level."[64] Another important unilateral effect concerns the merger's impact on innovation; this also can take a couple of forms including "reduced incentive to continue with an existing product-development or reduced incentive to initiate development of new products."[65]

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[59] *Id*. at 17.

[60] *Id*. at 18.

[61] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 18 n.9.

[62] *Id*. at 19.

[63] *Id*. However, market concentration is evaluated with reference to the relationship between a firm's pricing of goods and its market share: if a firm increases prices, relative to its competitors, and it retains its market share, then "that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger." *Id*. at 18. However, if there is a highly concentrated market and the market shares fluctuate "substantially over short periods of time in response to changes in competitive offerings" then the market is considered to be "very competitive." *Id*.

[64] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 20.

[65] *Id*. at 23.

Coordinated effects are those effects which involve coordinated conduct between competitors which may occur as a result of a merger.[66] Coordinated effects can include explicitly negotiated or implied terms between competitors pertaining to how they will compete against one another.[67] Government agencies "examine whether a merger is likely to . . . [encourage] substantially more coordinated interaction."[68] As the Guidelines point out, the DOJ may file suit to prevent mergers if there is a danger of substantial anti-competitive effects resulting from coordinated effects "even without specific evidence showing precisely how the coordination likely would take place."[69] Three criteria need to be met in order for the Agencies to challenge mergers: (1) significantly increased coordinated behavior resulting in a highly concentrated market; (2) market vulnerability to coordinated conduct; (3) the Agencies credibly believe that the merger would enhance market vulnerability.[70]

Mergers may have positive impacts on *efficiencies* in that mergers may "enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products."[71] Examples of increased efficiency, the Guidelines say, include combined assets and new or improved products, even if there is no immediate or direct reflection in price.[72] Ability to "conduct research or development more effectively" is also a factor to be considered, though it may have little to no impact on pricing in the short-term.[73]

A brief application of these criteria to the Penguin-Random House merger will presumably shed some light on why the DOJ chose not to challenge the merger.

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[66] *Id*. at 24.
[67] *Id*.
[68] *Id*. at 25.
[69] *Id*.
[70] *Id*. Considering the *Apple* suit discussed above, in which the DOJ argued that the publishers colluded with Apple to raise prices, one should pay special attention to the Guidelines' statement that "The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market. . . ." *Id*.
[71] *Id*. at 29.
[72] HORIZONTAL MERGER GUIDELINES 2010, *supra* note 41, at 29.
[73] *Id*. at 31.

IV. WHY THE PENGUIN-RANDOM HOUSE MERGER SEEMS LIKE A GOOD IDEA—AND WHY IT MAY BE A BAD ONE

Recall the Horizontal Guidelines criteria discussed above: (1) market shares and market concentration; (2) unilateral effects; (3) coordinated effects; and (4) efficiencies. The chairman and chief executive of one of the Random House's parent companies, Bertelsmann, said the merger "will enable investments worldwide in new digital publishing models, in new distribution paths, products and services and in the major growth markets."[74] Though we can hardly expect objectivity from a Random House executive, it is not implausible to assume that Penguin Random House will have a greater ability to increase efficiency—this does not seem controversial. So, let us assume *arguendo* that the companies are correct that as a larger entity they will be able to invest in research and development, combine assets, and make their operations overall leaner and more *efficient*. Let us also assume *arguendo* that we have no need to worry about *coordinated effects* (in particular price fixing), courtesy of the DOJ's settlement with the New York publishers which prevents the publishers from having any say whatsoever, for two years, over retail pricing of e-books. That leaves us market shares, market concentration, and unilateral effects to concern ourselves with.

Regarding *market shares* and *market concentration*, note that it is possible—likely even—that the DOJ did not concretely define the market, meaning that it probably did not conclusively determine whether paperback books, audio books, e-books, hardcover books, etc. all belonged to the same market.[75] Also bear in mind that in 2012, Penguin's U.S. overall market

[74] Press Release, Penguin Group USA LLC, Penguin and Random House to Combine Creating the World's Leading Trade Publisher; Penguin Random House, *available at* http://www.penguin.com/static/pages/aboutus/pressrelease/penguin_random_house_102912.php.

[75] Note that Penguin and Random House, in presenting their views to the European authorities, urged the EU to consider various types of media to constitute a single market; and the EU actually decided not to definitively answer the question, but rather it proceeded under findings that, in regard to the various types of media, there would be no anticompetitive effects. Bertelsmann v. Penguin Random House, No. COMP/M.6789, EUR-Lex 32013M6789, at *25, *30 (Eur. Comm'n Apr. 5, 2013).

If in standard publishing contracts, e-book rights are bundled with physical book rights, then the publishers' market share in the two media should be coextensive. However, it is not at all clear that this is going to be a reliable presumption going forward. For example, authors may insist, going forward, on unbundling rights to e-books from rights to physical books in contractual negotiations; in which case, a

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share was 10.45% and Random House's was 17.28%.[76] Using these numbers, the pre-merger HHI was 615.86.[77] The post-merger HHI would be 977.01.[78] Recall that, under the DOJ's classification, an HHI of under 1500 signals an unconcentrated market; and the lower the HHI, the lower the Agencies' competitive concerns. Because the HHI is well under 1500, the Agencies likely concluded that this merger was far from being a competitive concern, despite whatever misgivings it otherwise would have on account of the concurrent antitrust suit against Apple.

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publisher's market share of physical and electronic books may vary substantially. More, there is the issue of substitutiality: are e-books substitutions for physical books or supplements? Programs such as Amazon's MatchBook endeavor to entice customers to buy *both* physical and electronic books. See also *infra* note 96 on the non-substitutiality of electronic and physical books. This suggests that physical and electronic books ought to be considered to be separate markets. This would have the added benefit of increasing scrutiny on the e-book market, rather than having it swept under the rug by collapsing it into a broader "books" market. This situation is complex, and there is no indication that the DOJ has given the appropriate attention to these nuances. Note that even if e-books are considered to constitute a separate market, that market may currently be so small that its import is accordingly marginal. However, the market may continue to grow, making inattentiveness to this market shortsighted.

And even if publishers' rights to the two media are coextensive, all of the difficulties discussed in this note, pertaining specifically to e-books, suggest that the DOJ needs to give serious consideration to how it defines market going forward. Is this turbulence in the publishing industry, pertaining to e-books, more than a blip on the competitive effects analysis if e-books are considered separately from the physical book market?

[76] Tom Tivnan, *Scholastic Cracks US Six*, THE BOOKSELLER, May 25, 2012. Numbers are based on 19 weeks up to May 13, 2012. Mr. Tivnan sourced his statistics from Nielsen Bookscan. Market share for the top ten publishing groups in the United States are as follows:

1. Random House: 17.28%
2. Penguin USA: 10.45%
3. HarperCollins: 8.25%
4. Simon & Schuster: 7.13%
5. Scholastic: 5.99%
6. Hachette Book Group: 4.99%
7. Macmillan: 4.66%
8. John Wiley: 2.05%
9. Harlequin Books: 1.50%
10. National Book Network: .46%

[77] *See infra* Figure 1, which is based on the data in *supra* note 76.

[78] Again, *see infra* Figure 1, which is based on the data in *supra* note 76.

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Pre-merger HHI		Post-merger HHI	
Random House	17.28^2 +	Penguin Random House	27.73^2 +
Penguin USA	10.45^2 +	Harper Collins	8.25^2 +
Harper Collins	8.25^2 +	Simon & Schuster	7.13^2 +
Simon & Schuster	7.13^2 +	Scholastic	5.99^2 +
Scholastic	5.99^2 +	Hachette	4.99^2 +
Hachette	4.99^2 +	Macmillan	4.66^2 +
Macmillan	4.66^2 +	John Wiley	2.05^2 +
John Wiley	2.05^2 +	Harlequin Books	1.50^2 +
Harlequin Books	1.50^2 +	National Book Network	$.46^2$
National Book Network	$.46^2$		
	615.8602		**977.0122**

Figure 1

Recall that *unilateral effects* are those effects on a market caused by a merged firm. A merged firm may have effects on a market, which are actually pro-competitive. We can imagine what such a gloss might look like in this case. In order for the New York publishers to deal with Amazon effectively, the publishers need to combine their resources. Recent history supports the idea that these publishers, with the leverage they currently have, are ill-equipped to handle Amazon. The publishing industry is sailing into uncharted waters largely because of e-books. The root cause of the *Apple* antitrust suit discussed above was the Big Six's worries that Amazon's way of doing business under the old wholesale model was putting pressure on the bottom lines of these companies—but none of the companies, alone, were powerful enough to force Amazon to agree to a different pricing model, which would be more favorable to the publishers. Thus, they colluded with Apple in order to raise prices. The implication here seems to be, then, that if these publishing houses are to thrive in this new era of publishing which—though not yet dominated by e-books—is significantly intertwined with the issue of revenue gained from e-books, then the publishers are going to need some way of gaining some bargaining power in order to deal effectively with Amazon; the "idea was that the combined entity would be better positioned in the digital market to combat companies like Amazon, whose aggressive pricing was putting pressure on big publishers."[79] The conventional wisdom seems to be that Penguin Random House "represents the publishing world's challenge to Amazon. . . ."[80]

So, the conventional take on why the DOJ allowed the merger to go forward so easily is that the numbers suggested there were no competitive concerns, and the DOJ likely reasoned that the traditional publishing companies were in need of more leverage in order for the publishing industry to bargain more effectively with Amazon, thus giving the publishing industry a way to try to preserve itself. This conventional explanation is not as easy to swallow on second glance. As noted above, Penguin's settlement agreement is applicable to Penguin Random House.[81] And part of what is required of Penguin is that it eliminates any agreements it made with e-book retailers which limited the retailers' ability to set the prices.[82] This restriction is binding for two years.[83] According to an industry insider, "The Justice Department came in at a time when agency pricing was weakening Amazon's hold and dispersing the e-book market . . . . By eliminating fixed prices for e-books, they have handed the advantage back to Amazon. Now everyone else is losing share."[84] One independent publisher had this to say about the merger: "Like a lot of people, I at first thought the merger was a good thing in the fight against Amazon. Finally, a company with enough clout to stand up to Amazon's thuggishness . . . . Until a book industry insider pointed out to me . . . that Random House is going to tell Penguin to settle the case with the DOJ . . . . And it *is* good for

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[79] Leslie Kaufman, *Justice Department Approves Random House-Penguin Merger*, N.Y. TIMES, Feb. 14, 2013, *available at* http://mediacoder.blogs.nytimes.com/2013/02/14/justice-department-approves-random-house-penguin-merger/.

[80] David Wagner, *Could the Penguin-Random House Merger Actually Help Amazon?*, THE ATLANTIC WIRE (Feb. 15, 2013), http://www.thewire.com/business/2013/02/penguin-random-house-merger-amazon/62193/.

[81] *See generally supra* Part I.

[82] *Apple, Inc.*, 2013 U.S. Dist. LEXIS 128364, at *13.

[83] *Id*. at *16.

[84] Stone, *supra* note 3.

Amazon."[85] In other words, there seems to be some real doubt that this merger was in the best interests of competition. Because the Penguin-Random House merger was granted clearance by the DOJ on condition that the Penguin antitrust settlement apply to the new entity, it appears that Amazon has gained the upper hand, which arguably gives Amazon further opportunity to entrench and enlarge its market share.

This preceding discussion appears to vilify Amazon—it suggests that a big problem with this merger is that it will further entrench Amazon's pricing power over e-books. But a closer examination of the quotes above—which are all negative toward Amazon—reveals that they are all coming from the perspective of industry insiders who bemoan Amazon's effects not on consumers but on the publishing industry. A commentator likened the Penguin Random House merger to "a financial version of a couple having a baby to save a marriage . . . [because] [e]ver since Amazon began ripping apart the book business, the largest houses have been looking for a way to fight back . . . they [seem to] have chosen an old-fashioned strategy: Size."[86] This commentator questioned whether the merger might not in fact be bad for the economy, i.e., if the combined entity would innovate or, rather, abuse its leverage.[87] He compared Penguin Random House to U.S. Steel, and recalled that, once it got large enough, U.S. Steel "hardly worried about competition; it had little need to innovate or compete on price . . . [and then] U.S. Steel all but collapsed [in the 1980s], and a chunk of the U.S. economy went down with it."[88] Recall the *Apple* antitrust suit in which the publishers, without admitting to wrongdoing, settled suit brought by the DOJ.[89] The court found—in the trial against Apple—that the publishers had conspired to *raise e-book prices*. It's easy for this fact to get lost in the fray with all of this talk of preserving industries. There has been remarkably little discussion about the impact on *consumers*. In finding

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[85] Dennis Johnson, *The Real Story Behind the Penguin-Random House Merger*, MOBY LIVES (Feb. 15, 2013), *available at* http://www.mhpbooks.com/the-real-story-behind-the-penguin-random-house-merger/.

[86] Adam Davidson, *How Dead Is the Book Business*?, N.Y. TIMES, Nov. 13, 2012, *available at* http://www.nytimes.com/2012/11/18/magazine/penguin-random-house-merger.html?_r=0.

[87] *Id.*

[88] *Id.*

[89] *See generally supra* Part II.

Apple guilty of violating antitrust law, Judge Cote said that the agreements between the publishers, in which they colluded to raise prices,

> compelled the Publisher Defendants to move Amazon and other retailers to an agency model for the distribution of e-books, removed the ability of retailers to set the prices of their e-books and compete with each other on price . . . and allowed the Publisher Defendants to raise the prices for their e-books, which they promptly did on both New Releases and Bestsellers, as well as backlist titles.[90]

For this, along with other reasons (such as the resultant decrease in the quantity of e-book titles sold by Publisher Defendants[91]), Judge Cote found ample reason to conclude that the defendants violated applicable antitrust laws.[92] Judge Cote's conclusion is fascinating because it illustrates that what from one perspective seems to be pro-competition can, from another perspective, be anti-competitive. To wit: Publisher Defendants no doubt considered their collusion to be pro-competitive in the sense that it would give them an upper hand in dealing with Amazon; but that same action raised prices and prevented retailers from setting the prices of their goods which stifled competition among retailers, and therefore was detrimental to consumers who would have to pay higher prices for goods.

V. CONCLUSION: THE AGENCIES NEED TO PROVIDE GREATER TRANSPARENCY INTO THEIR DECISION-MAKING PROCESS TO CLEARLY EXPLAIN EXACTLY WHAT EFFECTS THEY PREDICT A MERGER WILL HAVE ON THE MARKET AND WHY

Citing *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962), Judge Cote reminded us that it is "essential to remember that the antitrust laws were enacted for the protection of competition, not competitors."[93] Conceptually, it seems difficult to disentangle competitors from competition, since in competition, one competitor often gains at the expense of another; thus what is good for competition may also be good for certain competitors and not for others.

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[90] *Apple*, 2013 U.S. Dist. LEXIS 96424, at *141–42.
[91] *Id*. at *142.
[92] *Id*.
[93] *Apple*, 2013 U.S. Dist. LEXIS 96424, at *185 (internal quotations omitted).

The publishing business is in a period of transition now which has upended the status quo; Amazon has changed the game and, from the perspective of the Big Five, is devaluing e-books, and consequently cutting into publishers' profits, possibly threatening the long-term viability of an entire industry. In *Apple*, Judge Cote chastised Apple by noting that even if Amazon had been engaging in commercially detrimental and monopolistic pricing, "Apple's combination with the Publisher Defendants to deprive a monopolist of some of its market power is [not] pro-competitive and healthy for our economy, it is wrong."[94] Judge Cote's point is poignantly summarized by the following: "Another company's alleged violation of antitrust laws is not an excuse for engaging in your own violations of law."[95]

There are many ambiguous variables in the Penguin Random House merger; as a foundational matter, it is necessary to ask—who is really going to benefit from this merger? At first blush it appears that Penguin Random House wins because it will have increased bargaining power, owing to the sheer amount of titles it publishes—Amazon will have to deal if it wants to provide these titles to its customers. Otherwise, the customers will go elsewhere for these titles and Amazon loses. This scenario seems straightforward, and likely, enough. However, owing to the Penguin settlement, which is binding on Penguin Random House, it is not clear at all that Amazon is the loser in this arrangement. After all, the agency pricing model that the Publisher Defendants so desperately sought is now an unavailable option for the next two years—time during which Amazon will be able to further accustom consumers to paying $9.99 for popular books and to integrate even more consumers into its Kindle platform (which is of course Amazon's end-game strategy—the goal is to get people entrenched in the platform so that they will *only* spend money at Amazon[96]). So from this perspective, Penguin Random House isn't even a clear winner.

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[94] *Id*. at *183.
[95] *Id*. at *183–84.
[96] Jeff Bezos has been quoted as saying,

> We sell the [Kindle] hardware at our cost, so it is break-even on the hardware. We want to make money when people use our devices, not when people buy our devices. . . . What we find is that when people buy a Kindle they read four times as much as they did before they bought the Kindle. But

Moreover, as the *Apple* case has shown, publishers are interested not necessarily in innovating in order to compete with Amazon, but rather in increasing (or at least maintaining) their bottom line; they turned to each other and to Apple out of fear and powerlessness. Rather than innovate in order to incentivize consumers to shop at places other than Amazon and/or to pay more than Amazon's price for the e-books, the publishing companies sought refuge in the less creative alternative: conspire together to withhold e-books from Amazon unless Amazon agreed to allow the companies to switch to a new model in order to jack up the prices. There seems to be no reason to think that Penguin Random House is going to do anything other than force Amazon to agree to an agency pricing model; and though this may increase the publishers' revenue, it is not clear that consumers will benefit in any way, but instead will suffer by being required to pay higher prices for e-books—as the publishers have wanted all along.

The twofold layer of ambiguity here—between (1) whether Amazon or Penguin Random House will benefit from the merger; and (2) whether giving the publishers the ability to increase their bargaining power with Amazon through sheer increased market share, rather than through other clearly beneficial and competitive means, e.g. innovation, is going to benefit consumers (or merely just competition)—suggests that the DOJ erred in not publicizing its competitive assessment. How can we be sure that the DOJ, in anticipating the increased bargaining power Penguin Random House will have with Amazon, missed the forest for the trees by neglecting to consider the short-term benefit to Amazon (which may

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> they don't stop buying paper books. Kindle owners read four times as much, but they continue to buy both types of books.

Kelly Clay, *Amazon Confirms It Makes No Profit on Kindles*, FORBES (Oct. 12, 2012), *available at* http://www.forbes.com/sites/kellyclay/2012/10/12/amazon-confirms-it-makes-no-profit-on-kindles/; Tony Smith, *Amazon's Bezos Confirms Content Pays for Kindle*, REGISTER (Oct. 12, 2012), *available at* http://www.theregister.co.uk/2012/10/12/amazon_ceo_bezos_confirms_content_pays_for_kindle/. Mr. Smith notes that Kindle uses a proprietary format such that it does not work with e-books from other suppliers. (However, open-source software such as Calibre, available at http://calibre-ebook.com/, gives consumers the ability to convert between formats. This may be too advanced for the average e-book consumer.) The chain of inferences here is: 1. Amazon prices its hardware low to attract buyers; 2. Kindle owners are more likely to purchase content; 3. Kindle owners cannot easily purchase Kindle-compatible electronic media from anyone other than Amazon. Because Amazon's goal is to entice customers into its ecosystem (1); and Amazon discourages compatibility with media provided by other companies (3), we may infer that Amazon wants its customers, once integrated into its platform, to spend money at Amazon, not *any* other supplier.

translate to a long-term benefit for Amazon)? Or, if the conventional wisdom is correct, and Penguin Random House will be better poised to grapple with Amazon—is this necessarily to consumers' benefit? Has the DOJ mistakenly believed that benefitting a certain competitor is the same as benefitting competition?

As these questions illustrate, the DOJ's quiet approval of mergers leaves too much to the imagination; greater transparency in the DOJ's decision-making process would reveal the impacts the DOJ expects mergers to have on the relevant markets—as well as whether these expectations are grounded in the realities of the market. In three years, we may know the answer to these questions: either Amazon will have a more unshakeable hold over the e-book market (which, it is not at all clear is harmful to consumers); or Penguin Random House will exert its muscle against Amazon in order to raise prices (which will likely be detrimental to consumers). It's even possible—albeit somewhat improbable if the prior actions of the publishing industry are any indication—that Penguin Random House will actually use its greater resources to spur innovation to compete honestly with Amazon. Time will tell. However, had the DOJ provided more information to the public concerning their rationale for approving this merger, we would have a lot less uncertainty in, at the very least, what the *expected* pro-competitive benefits of the merger are.

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