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Submission of the United States Department of Justice

The Antitrust Division of the U.S. Department of Justice (the "Division") has been very active in carrying out its enforcement and advocacy missions in the last year. I am pleased to be able to share some of this with you today.[1]

Civil Enforcement

E-books

Culminating an investigation that involved close cooperation with the European Union, as well as state Attorneys General, the Division, in April, filed a lawsuit against five of the largest U.S. book publishers (Hachette Book Group (USA), HarperCollins Publishers L.L.C., Simon & Schuster Inc., Holtzbrinck Publishers LLC (which does business as Macmillan), and Penguin Group (USA)) (collectively "Publisher Defendants") and Apple Inc. for conspiring to raise the price of e-books to consumers. Four of the publishers, Hachette, HarperCollins, Simon & Schuster and Penguin have settled with the United States. A trial against Macmillan and Apple is currently scheduled to begin in June.

The civil lawsuit, filed in U.S. federal court in New York, alleges that beginning no later than the summer of 2009, executives at the highest levels of the Publisher Defendants, concerned that e-books were being sold to consumers too cheaply, agreed to work together to increase retail e-book prices.

Technological advances have enabled the production, storage, distribution and consumption of books in electronic format, lowering significantly the marginal costs to publishers of offering books for sale. E-books can be read on a variety of electronic devices, including dedicated devices ("e-readers") such as Amazon's Kindle or Barnes & Noble, Inc.'s Nook, tablet computers such as Apple's iPad, desktop or laptop computers, and smartphones. E-book sales are growing, and e-books are increasingly popular with American consumers. E-books now constitute more than ten percent of general interest fiction and non-fiction books (commonly known as "trade" books) sold in the United States and are widely predicted to reach at least 25 percent of U.S. trade books sales soon.

As explained in the complaint, until Defendants' agreement took effect, publishers sold e-books under a wholesale model that had prevailed for decades in the sale of print books. Under this wholesale model, publishers typically sold copies of each title to retailers for a discount (usually around 50%) off the price printed on the physical edition of the book (the "list price"). Retailers, as owners of the books, were free to determine the prices at which the books would be sold to consumers. Thus, while publishers might

[1] The views expressed herein are not purported to reflect those of the U.S. Department of Justice.

recommend prices, retailers could and frequently did compete for sales at prices significantly below list prices, to the benefit of consumers.

In 2007, Amazon became the first company to offer a significant selection of e-books to consumers at the same time it launched its Kindle e-reader device. From the time of its Kindle launch, Amazon offered a portion of its e-books catalogue, primarily its newly released and *New York Times*-bestselling e-books, to consumers for $9.99. To compete with Amazon, other e-book retailers often matched, or at least approached, Amazon's $9.99-or-less prices for e-book versions of many new releases and *New York Times* bestsellers.

Publisher Defendants, however, feared that the Amazon-led $9.99 price for e-books would significantly threaten their long-term profits. Publisher Defendants feared $9.99 e-book prices would lead to the erosion over time of hardcover book prices and an accompanying decline in revenue. They also worried that if $9.99 solidified as consumers' expected retail price for e-books, Amazon and other retailers would demand that publishers lower their wholesale prices, again compressing their profit margins. Publisher Defendants also feared that the $9.99 price would increase e-book popularity to such a degree that digital publishers could achieve sufficient scale to challenge the Publisher Defendants' basic business model.

Each Publisher Defendant feared that if it attempted unilaterally to impose measures that would force Amazon to raise retail e-book prices, Amazon would resist. And each Publisher Defendant recognized that, even if it succeeded in raising retail prices for its e-books, if its competitor publishers' e-books remained at the lower, competitive level, it would lose sales to other Publisher Defendants. Accordingly, Publisher Defendants agreed to act collectively to raise retail e-book prices.

To effectuate their agreement, Publisher Defendants considered a number of coordinated methods to force Amazon to raise e-book retail prices. For example, they explored creating purported joint ventures, with exclusive access to certain e-book titles. These joint ventures were intended not to compete with Amazon, but to convince it to raise its price above $9.99. Publisher Defendants intended these strategies to cause Amazon to capitulate on its $9.99 pricing practice. None of these strategies, though, ultimately proved successful in raising retail e-book prices.

Apple's entry into the e-book business, however, provided a perfect opportunity to collectively raise e-book prices. In December 2009, Apple approached each Publisher Defendant with news that it intended to sell e-books through its new iBookstore, in conjunction with its forthcoming iPad device. Publisher Defendants and Apple soon recognized that they could work together to counter the Amazon-led $9.99 price.

In its initial discussions with Publisher Defendants, Apple assumed that it would enter as an e-book retailer under the wholesale model. At the suggestion of two Publisher

Defendants, however, Apple began to consider selling e-books under the "agency model," whereby the publishers would set the prices of e-books sold and Apple would take a 30 percent commission as the selling agent. In January 2010, Apple sent to each Publisher Defendant substantively identical term sheets that would form the basis of the nearly identical agency agreements that each Publisher Defendant would sign with Apple ("Apple Agency Agreements"). Apple informed the publishers that it had devised these term sheets after "talking to all the publishers."

The Apple Agency Agreements contained two primary features that assured Publisher Defendants of their ability to wrest pricing control from retailers and raise e-book retail prices above $9.99. First, Apple insisted on including a Most Favored Nation clause ("MFN" or "Price MFN") that required each publisher to guarantee that no other retailer could set prices lower than what the Publisher Defendant set for Apple, even if the Publisher Defendant did not control that other retailer's ultimate consumer price. The effect of this MFN was twofold: it not only protected Apple from having to compete on retail price, but also dictated that to protect themselves from the MFN's provision, Publisher Defendants needed to remove from all other e-book retailers the ability to control retail price, including the ability to fund discounts or promotions out of the retailer's own margins. Thus, the agreement eliminated retail price competition across all retailers selling Publisher Defendants' e-books.

Second, the Apple Agency Agreements contained pricing tiers (ostensibly setting maximum prices) for e-books – virtually identical across the Publisher Defendants' agreements – based on the list price of each e-book's hardcover edition. Defendants understood that by using the price tiers, they were actually fixing the de facto prices for e-books. In fact, once the Apple Agency Agreements took effect, Publisher Defendants almost uniformly set e-book prices to maximum price levels allowed by each tier.

Starting the day after the iPad launch, Publisher Defendants, beginning with Macmillan, quickly acted to impose agency agreements on all of their other retailers. Initially, Amazon attempted to resist, but quickly came to realize that all Publisher Defendants had committed themselves to take away any e-book retailer's ability to compete on price. Amazon then capitulated and publicly announced that it had no choice but to adopt the agency model.

After Amazon acquiesced, all of Publisher Defendants' major retailers quickly transitioned to the agency model for e-book sales. Retail price competition on e-books had been eliminated and the retail price of e-books had increased.

As a result of this agreement, consumers paid higher prices for e-books than they would have in a collusion-free market. For example, the average price of Publisher Defendants' e-books increased by over ten percent between the summer of 2009 and the summer of 2010. Defendants' agreement, in addition, prevented e-book retailers

from experimenting with innovative pricing strategies that could efficiently respond to consumer demand.

Under the settlement agreement with Hachette, HarperCollins, and Simon & Schuster, and the proposed settlement with Penguin, the settling publishers agreed, among other things, to terminate their agreements with Apple and other e-books retailers, and agreed to a two years prohibition on entering into new agreements that constrain retailers' ability to offer discounts or other promotions to consumers. The settlement agreement also prohibits Hachette, HarperCollins, Simon & Schuster and Penguin for five years from again conspiring with or sharing competitively sensitive information with their competitors, and requires the initiation of a strong antitrust compliance program. As mentioned above, a trial against Macmillan and Apple is scheduled for June.

Criminal Enforcement

The Division has also been active over the last year with regard to its criminal enforcement mission. Two of our larger investigations have involved automobile parts and contracts for the investment of public funds – usually the proceeds of municipal bonds.

Auto Parts

The Auto Parts investigation is the largest criminal investigation the Antitrust Division has ever pursued, both in terms of its scope and the potential volume of commerce affected by the alleged illegal conduct. To date, in this investigation of price fixing and bid rigging among manufacturers of parts for installation in automobiles, the Division has filed cases against 9 corporations and 12 individuals, yielding fines thus far totaling almost $900,000,000. The individuals have been sentenced to more than 185 total months of incarceration, including sentences of two years for two foreign nationals.

In general, when purchasing parts, automobile manufacturers issue Requests for Quotation ("RFQs") to automotive parts suppliers on a model-by-model basis for model specific parts. Automotive parts suppliers submit quotations, or bids, to the automobile manufacturers in response to RFQs, and the automobile manufacturers award the business to the selected automotive parts supplier for the lifespan of the model – which is usually four to six years. Typically, the bidding process for a particular model begins approximately three years prior to the start of production.

As ascertained in the Division's investigation, for a number of years – the time frame varies depending on the auto part supplier, and the type of part, but in some cases beginning as early as 2000 and continuing until 2011 -- the manufacturers of a number of different specific automotive parts would communicate -- in person and through various other means -- to discuss the bids and price quotations to be submitted to specific U.S. and non-U.S. automobile manufacturers. Pursuant to these

communications, the manufacturers agreed, among other things, on the bids and price quotes to be submitted, on the allocation of the supply of specific products to specific manufacturers, and also agreed to coordinate any price adjustments requested by the automobile manufacturer. The bids submitted were in accordance with the terms of these agreements. As a result, automobile manufacturers, in the United States and elsewhere, paid collusive and artificially inflated prices for many of the automotive parts they bought for installation in the vehicles they produced.

This investigation is continuing.

Municipal bonds

Numerous criminal cases were filed and jury verdicts rendered against defendants in another of the Division's large and long-running investigations. For the last several years, the Division, with the assistance of the Federal Bureau of Investigation, and the Internal Revenue Service and in coordination with the Securities and Exchange Commission, the Office of the Comptroller of the Currency and the Federal Reserve Bank of New York, has been investigating fraud in the awarding of contracts to state and local governments and agencies throughout the United States for the investment of public funds – including the proceeds of municipal bonds.

Municipal bonds are issued by government entities, such as states, counties, and cities, or quasi-governmental entities, such as public authorities and school, utility or water districts (hereinafter "municipalities"), to raise money for operating funds or for specific projects, such as the construction of public facilities, and to refinance outstanding municipal debt. In some instances, the municipality issuing the bonds turns the money over to a not-for-profit entity, such as a school or hospital, or an entity that will spend the money for a specific public purpose, such as the construction of low-cost housing or waste treatment facilities.

The money a municipality raises from a municipal bond offering is typically spent over a period of time, rather than immediately in one lump sum. The municipality frequently invests some or all of bond proceeds in an investment product (sometimes referred to as an "investment agreement"), which is designed for its specific needs. Investment agreements vary in size from a few hundred thousand to several hundred million dollars and in duration from as short as one month to as long as forty years.

In addition to investment agreements, municipalities frequently enter into other municipal finance contracts such as interest rate swaps or other interest rate derivatives, which are contracts between a municipality and a financial institution that are designed to manage or transfer some or all of the interest rate risk associated with a municipal bond issue. Municipalities usually select financial institutions to provide these investment agreements and other municipal finance contracts through competitive bidding procedures designed to comply with relevant federal laws.

Municipalities often hire third party brokers to act as their agents in conducting the competitive bidding process and to ensure compliance with relevant federal regulations. The broker's fee for conducting such a competitive bidding process is generally paid by the winning bidder, which takes account of the cost of the broker's fee when calculating its bid and generally discloses the fee to the municipal issuer.

Brokers typically offer a variety of services, including suggestions about the availability and suitability of investment products, drafting bid specifications, and identifying the most competitive, qualified institutional bidders to be solicited. In some cases, the broker decides which financial institutions will be solicited to bid without consulting with the relevant municipality or any of its other professional advisers.

Brokers are also usually responsible for distributing the bid packages (specifications and bid forms) to bidders selected to receive them, keeping in touch with the potential bidders to answer questions about the bid specifications, and conducting the bidding process. After reviewing the bids to ensure conformity with the specifications, brokers then inform the municipality of the outcome of the bid, including the identity of the winning, qualified bidder and, if appropriate, any conditions that deviate from the specifications.

The Division's investigation, carried out with the help of the other named agencies, uncovered wide-spread fraud, including bid-rigging and other types of abuses, in the process for awarding these investment agreements and other municipal finance contracts.

While this portion of the finance industry is complex, many of the illegal schemes followed familiar bid rigging patterns. For example, the investigation uncovered instances in which brokers colluded with bidders, offering non-public information about the price levels of bids submitted by other bidding institutions and allowing the favored bidder to submit his bid last. In some instances, brokers received payments from winning bidders in return for these accommodations. In other instances, bidders would agree to submit intentionally losing bids for some investment agreements in return for future considerations. As a result, the effected contracts were less profitable for the relevant municipalities than they would have been if a competitive bidding process had occurred, depriving municipalities of millions of dollars in revenue.

To date, a total of 20 individuals have been charged as a result of this investigation; 19 have been convicted or pleaded guilty and one awaits trial. One company has also pleaded guilty. The investigation has also produced resolutions with large financial institutions implicated in the conspiracies which have agreed to pay nearly $745 million in restitution, penalties and disgorgement to federal and state agencies.

The investigation is continuing.

Advocacy

Finally, during the past year, the Division and the Federal Trade Commission ("FTC") have continued their advocacy and outreach work by, among other things, sponsoring two workshops on cutting edge issues.

The Department and the FTC co-sponsored a public workshop in early December to explore the impact of patent assertion entity (PAE) activities on innovation and competition, and the implications of such activities for antitrust enforcement and policy. Panelists at the day-long workshop included industry participants, academics, economists, lawyers and other interested parties.

In September, the Department and the FTC held a joint public workshop on most-favored-nation (MFN) clauses, to explore the use of MFN clauses and the implications for antitrust enforcement and policy. The most commonly used MFN provisions guarantee a customer that it will receive prices that are at least as favorable as those provided to other buyers of the same seller, for the same products or services. The workshop offered an opportunity for businesses, academics, economists, lawyers and other interested parties to consider the use of MFNs and the legal and economic analyses of these provisions.

Additional information about the PAE workshop, including a webcast as well as written submissions from interested parties – which will be accepted until March 10th – are available at: http://www.justice.gov/atr/public/workshops/pae/index.html . Additional information about the MFN workshop can be found at http://www.justice.gov/atr/public/workshops/mfn/index.html .