Insight

DOJ Employs a Novel Approach in Antitrust Lawsuit

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Executive Summary

- The U.S. Department of Justice (DOJ) sued to stop Penguin Random House – the world's largest book publisher – from acquiring its rival Simon & Schuster, the fourth-largest U.S. book publisher.
- Rather than measuring the downstream effects of increased market power, the lawsuit adopts a novel approach contending that the merger will result in monopsony power – where there is only one buyer – and negatively impact payments to authors.
- This case could have broad implications for future antitrust litigation, including how labor and wage effects will be considered and if the relevant section of the *Horizontal Merger Guidelines*, jointly published by the U.S. Department of Justice and the Federal Trade Commission, will be expanded upon in the forthcoming rewrite.

Introduction

In November 2021, the Department of Justice (DOJ) sued to block the merger between Penguin Random House, the world's largest book publisher, and rival Simon & Schuster, the fourth-largest U.S. book publisher. If allowed to proceed, the merger would create a publishing behemoth with revenue twice that of its next closest competitor, according to the DOJ's complaint.

The trial that began on August 1, 2022, has already featured testimony from bestselling author and government witness Stephen King, and like any King novel, this lawsuit promises to have an extensive cast of characters, plot twists, and an unpredictable ending.

In a typical horizontal merger challenge, the federal government is primarily focused on the downstream effects.

Rather than measuring monopoly power and the effects on the end consumer, this case focuses on monopsony power – a market situation in which there is only one buyer. The DOJ asserts that a merger between the two publishers will create a company with "outsized influence over who and what is published and how much authors are paid for their work." The DOJ states that reduced competition will "enabl[e] the merged firm to pay less and extract more from authors…."

Although monopsony cases are uncommon, President Biden's *Executive Order on Promoting Competition in the American Economy* may have been the catalyst behind this novel DOJ approach. The directive tasks antitrust enforcement agencies to consider a worker's ability to bargain for higher wages and better working conditions when seeking to block a merger. The worker in this case is an author trying to sell their manuscript to the highest bidder.

The DOJ's Penguin Random House and Simon & Schuster lawsuit could have broad implications for how the

Biden Administration approaches antitrust cases. If its lawsuit is successful, the DOJ could leverage the monopsony argument to broaden the number of potential targets subject to antitrust litigation. Additionally, the forthcoming rewrite of the *Horizontal Merger Guidelines* (HMG), jointly published by the DOJ and Federal Trade Commission (FTC), could include a more concrete framework for analyzing and measuring labor and wage effects in cases involving a merger of competing buyers.

Background and a Brief Overview of the Complaint

Currently, Penguin Random House and Simon & Schuster are two of what are known as the "Big Five" U.S. publishers. The others include HarperCollins, Hachette Book Group, and Macmillan Publishing Group. The lawsuit claims that if Penguin Random House's acquisition of Simon & Schuster is "consummated…Penguin Random House's next largest competitor would be less than half its size."

These publishing companies compete intensely to acquire publishing rights from authors and provide them with various publishing services. This competition, as explained in the lawsuit filing, "resulted in authors earning more for their publishing rights in the form of advances (i.e., upfront payments made to authors for the rights to publish their works)…. In 2020, publishers paid over $1 billion in advances and authors rely on these advances to fund their writing and pay their bills."

The DOJ claims that the merger "would eliminate this head-to-head competition, enabling the merged firm to pay less and extract more from authors."

Relevant Market

A typical starting point for merger analysis, and often the subject of fierce debate among the parties, is defining the relevant market (additional information on relevant markets can be found here). As is commonplace, the government will attempt to establish a narrowly defined relevant market while the merging parties will argue that such a limited scope does not accurately reflect the industry structure. A narrow definition leads to a higher perceived level of market concentration, while a broader definition makes the merging companies appear to have less market power.

In a pre-trial briefing, the DOJ stated that "the proposed merger is likely to lessen competition substantially in at least one relevant product market: the market for the acquisition of publishing rights to anticipated top-selling books." An advanced payment of at least $250,000 is used to "identify anticipated top-selling books."

The defense countered this definition of the relevant market in its pre-trial briefing. It argued that the government has too narrowly limited the market to a "set of about 1,200 books acquired annually for advances of at least $250,000, or about 2% of all books published by commercial publishers." The brief alleged that the government model "applies only to a specific kind of transaction – one very uncommon in the publishing industry. Based on the best available data, the type of transaction modeled by the government accounts for approximately 85 books acquired annually, out of more than 55,000 total books published annually, and out of approximately 1,200 books acquired annually for advances of $250,0000 or more."

To demonstrate a robust level of competition within the industry, the defense also pointed out that Penguin Random House and Simon & Schuster were the top two bidders involving advances of $250,000 or more in just 7 percent of such acquisitions.

HGM Section 12

The defense brief notes that the "government found no evidence that combining [Penguin Random House] and [Simon & Schuster] would diminish competition in any consumer market." In a typical merger case, this claim would be key to the defense strategy.

Section 12 of the *HGM* notes, however, that the DOJ and FTC (together the "Agencies") need to present no such evidence. The *HGM* reads, "The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell." The *HGM* provides an example of such an analysis:

Example 24: Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.

Applying this example to the case, firms A and B are Penguin Random House and Simon & Schuster, the agricultural product is the publishing rights to a book, and the farmers are the authors. The DOJ alleges that a merger would cause a transfer of wealth from the authors to the publishers because fewer firms will be competing for publishing rights, resulting in a lower value of advances paid to authors.

Section 12 also tasks the Agencies to explore "alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist" as part of their relevant market analysis. The DOJ addressed this requirement in its complaint.

The DOJ asserts that both self-publishing and "work-for-hire" arrangements are not viable substitutes to authors receiving advances from publishers. The agency argues that "[b]y definition, self-publishing does not pay authors advances, which authors often use to fund their writing. Self-publishing also does not include the breadth of editorial, distribution, and marketing services that are important factors in whether a book will become commercially successful." It adds that in a work-for-hire arrangement, "[t]he publisher, and not the author, owns the publishing rights…. Moreover, such authors generally are compensated differently than authors who sell the rights to publish their books in exchange for an advance…." In both instances, the DOJ concludes that authors would not substitute to self-publishing or work-for-hire arrangements "in sufficient numbers to deter a hypothetical monopsonist from imposing a small, but significant, and non-transitory decrease in advances."

Plot Twist

Part of the defense's strategy was to explain how post-merger operations would not hinder or eliminate competition and negatively impact advances paid to authors.

To that end Penguin Random House CEO Markus Dohle testified that "we want to keep [Simon & Schuster] as external and independent as possible," according to The Associated Press. They reported that Dohle "assured agents that he would permit competitive bidding between Simon & Schuster and Penguin Random House imprints even if no other publisher was in contention, an expansion upon the current [Penguin Random House]

policy of allowing bidding between imprints as long as outside competitors were still in the running."

Dohle admitted that his promise was not legally binding and, should he leave the parent company of Penguin Random House, the practice could stop.

This idea that the combined firms would continue competing for the same publishing rights was met with skepticism by author Stephen King, who testified, "[y]ou might as well say you're going to have a husband and wife bidding against each other for the same house."

Conclusion

Suing to stop a merger of competing buyers is not a typical horizontal merger antitrust case. The strategy adopted by the DOJ could serve as a prelude to how it and the FTC intend to implement the directives from the president's executive order in their rewrite of the *HMG*. The result could be an expanded Section 12 of the *HMG* with a more concrete analytical framework.

A successful block of the merger could also open the floodgates to future antitrust cases relying on the monopsony framework.