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DOJ Publishing Win May Mean More Labor, Salary Challenges

By **Alexandra Lewis, Glenna Siegel and Joel Grosberg**
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U.S District Judge Florence Pan for the District of Columbia blocked Penguin Random House LLC's planned $2.2 billion acquisition of Simon & Schuster, representing the U.S. Department of Justice Antitrust Division's first major merger win following a string of losses this fall.

Following the district court ruling, Simon & Schuster's parent company Paramount Global terminated the transaction and subsequently the possibility of appeal.

Judge Pan's decision is significant because she accepted the DOJ's theory that the merger would lead to lower compensation for best-selling authors. This decision may embolden the Department of Justice and Federal Trade Commission to challenge more transactions based on the impact on labor and salaries rather than the impact on consumer prices.

The DOJ recently lost several merger cases, for a few reasons:

- U.S. v. Booz Allen Hamilton Holding Corp, before the U.S. District Court for the District of Maryland;
- U.S. v. UnitedHealth Group Inc., before the U.S. District Court for the District of Columbia; and
- U.S. v. United States Sugar Corp, before the U.S. District Court for the District of Delaware.

These cases were based primarily on theoretical arguments and economists' theories.

In the Penguin-Simon & Schuster challenge, the DOJ was able to rely on hard evidence to support its case: specifically, bad internal documents and strong opposition from third parties.

The contrast between Penguin and the three cases above demonstrates that enforcement agencies have a greater likelihood of prevailing in court when they have actual documents

as well as customer and competitor opposition to support their complaint.

The Penguin-Simon & Schuster Decision

Penguin and Simon & Schuster are two of the so-called Big Five publishing houses, along with Hachette Livre, HarperCollins and Macmillan Publishers. In her recent decision Judge Pan agreed with the government that the transaction would harm the market for the acquisition of publishing rights to "anticipated top-selling books" — those where the author would earn an advance of $250,000 or higher.

The decision followed a three-week bench trial that featured testimony from high-profile members of the publishing industry, including corporate executives and top-selling authors.

Penguin Random House argued that the proper market was for all books, and that the industry does not distinguish publishing rights to "anticipated top-selling books" from other books with available publishing rights. The publishing giant argued that the Justice Department offered a narrower market because it realized early in its investigation that the overall market for publishing rights is not concentrated.

Judge Pan agreed with the government that the submarket for anticipated top-selling books was the relevant market, and that the $250,000 threshold was an effective proxy to show anticipated top-selling authors are a distinct seller group that buyers can target.

The following key takeaways from Judge Pan's lengthy opinion provide further insight into why this merger challenge was successful after the Justice Department's three prior, consecutive losses.[1]

Monopsony in Labor Markets

This case is distinguishable from most previous merger challenges because it focused on the transaction's increasing concentration in the purchases of goods or services rather than the sale. Here, the case focused on the market for publishing rights to anticipated top-selling books.

The Big Five publish 91% of anticipated top-sellers, and the proposed merged firm would control 49% of the market. A concentration of this magnitude is presumptively illegal under the horizontal merger guidelines and case law benchmarks.[2]

The court agreed with the government that the merger and subsequent consolidation of market power could allow Penguin to target authors of anticipated top-selling books for a decrease in advances. In this way the merger challenge focused on compensation for labor.[3]

Authors, through their agents, often shop manuscripts to publishing houses in a "round-robin" bidding process. The court found this auctioning elevates author advances and facilitates favorable contract terms. That fierce competition affects even one-on-one negotiations, as it provides agents leverage to walk away from the bargaining table

The government in recent years has increased its focus on competition in labor markets.[4] Having successfully argued compensation for labor as a metric of harm, enforcement agencies may now be emboldened to challenge transactions that affect salaries in narrow markets.

Narrow Submarkets Focused on Largest Customers or Sellers

This case continues a trend of the DOJ and FTC focusing on narrow "price discrimination" markets.[5] In such cases, the government argues that the merged firm would be able to target a specific subset of buyers or sellers with anti-competitive price changes that other buyers or sellers would not face.

Although one could argue that the largest buyers or sellers are better positioned to defeat price changes, the courts have often ruled that a transaction harms these larger firms because of the unique needs or specialized services that larger buyers and sellers require.

Antitrust regulators have successfully challenged mergers using price discrimination theories by offering evidence that large buyers or sellers have unique needs that can only be served by a limited set of suppliers.

Here, the DOJ argued that best-selling authors are drawn to the Big Five because they can offer wide-reaching publicity, higher advances, advance copy circulation, more book tour locations and large editorial staffs out of reach from smaller firms.

As a result, Judge Pan found that the Big Five are the only options for those select best-selling authors who require a high level of support to meet the demand for their books. Given the large combined share of the merging parties, Penguin Random House would have been able to suppress the compensation for best-selling authors.

In addition, the judge rejected the defendant's concerns over whether the $250,000 threshold was a correct demarcation for best-selling books. Judge Pan said that the DOJ economic expert established similar anti-competitive effects when looking at different thresholds. She stated, "[t]he market that the government seeks to define is the one for anticipated top-selling books, and the $250,000 demarcation was adopted only as an analytical tool to help it group together the books in question."[6]

While this case proved that defining a market with a limited set of customers with unique needs can be successful, other cases show that courts are still willing to limit the narrowness of a proposed market definition. Just a few weeks prior, the DOJ defined a market too narrowly in U.S. v. Booz Allen Hamilton Inc.

There, the judge rejected the government's argument that the relevant market was a single contract for a single customer when the needs of the customer — the National Security Agency — were not so niche that no other customer could benefit from the knowledge and skills acquired in fulfillment of the contract. The Booz Allen and Penguin decisions may provide courts with guardrails in future merger challenges.

Past Collusion Makes Further Consolidation More Difficult

Judge Pan pointed to prior allegations of collusive behavior against Big Five publishing houses as evidence that the merger would likely result in harm to authors.

The court also found that present market conditions show that the Big Five engage in "tacit collusion," or parallel actions that benefit all of the firms without explicit exchange of information or agreements. Judge Pan cited standardized contract terms and payment schedules as present examples of how an already consolidated industry harms authors by minimizing competition. She concluded that the merger would only amplify the industry's existing vulnerability to collusion.

The Importance of Credible Executive Testimony

Judge Pan placed significant weight on executive testimony and carefully scrutinized expert testimony at trial. Judge Pan found that the defendants' executives were not credible while the DOJ's competitor and author witness testimony was more accurate and supported by facts.

Judge Pan dismissed testimony from agents and executives speaking for the defendants, who said that bidding wars over publishing rights are about more than just the advance that authors receive. Instead, Judge Pan found the testimony from DOJ witnesses, such as Stephen King, that the advance is critical to be much more believable.

Importance of Conducting an Independent Efficiencies Analysis

Penguin Random House sought to introduce evidence of predicted cost-savings from the merger, calculated by a Penguin executive, which it argued would be passed on to authors through higher advances. The court granted the Justice Department's motion to exclude the evidence because the cost-savings analysis was not verified by an independent party. If merging parties hope to use efficiencies as a defense, this decision demonstrates that merging parties should retain a third-party accounting or consulting firm to conduct such an analysis.

Rejecting the Behavioral Remedy

In the Penguin challenge, Judge Pan rejected the defendants' behavioral remedy offered by the defendants. Penguin offered a letter from Penguin's CEO to agents that promised Simon & Schuster would bid independently against Penguin after the merger. Judge Pan offered three reasons for rejecting Penguin's behavioral remedy argument.

First, she gave "no weight" to an "unenforceable" promise she felt was "made just to get the deal done."[7] She said it was unclear how such a policy would financially benefit the company and pointed to a lack of economic incentive for the parties to maintain the policy.

Second, Judge Pan pointed out that the promise could be broken at any time by Penguin's current or future leadership. Penguin argued that changing such a policy would result in backlash from agents, but Judge Pan pointed to evidence that agents do not have enough economic power over Big Five publishers to harm the post-merger firm if it did rescind the policy.

Third, the court found that the promise would not address internal bid coordination among agents in the post-merger firm. The firm could still consolidate divisions within the company or direct its agents to focus on noncompeting genres, thereby preventing pursuit of the same books.

Government witness Stephen King testified at trial that removing bidders would harm him and other authors: "You might as well say you're going to have a husband and wife bidding against each other for the same house." Here, the court held that a unilateral promise by the merging parties not to use their post-merger market power is not enough to rebut the government's case.

By contrast, behavioral remedies were sufficient for defendants to survive merger challenges in recent cases. In U.S. v. UnitedHealth, for example, U.S. District Judge Carl Nichols accepted the defendants' evidence of competitive incentives to protect consumer data and found proposed divestures adequately

remedied potential harms.

Behavioral remedies like those in UnitedHealth are distinguishable from Penguin as they involved signed contracts or amendments that contractually bound the merging parties. The courts viewed these as more enforceable and binding.

Implications for Other Industries

The Penguin decision will likely provide support for the DOJ and FTC to challenge transactions in the health care industry, particularly related to the compensation or reimbursement rates for doctors and other health care workers. For local health care transactions, merging parties will need to evaluate not only the impact on prices for payors and patients, but also analyze whether enforcement agencies could allege a significant impact on the wages and reimbursement rates for health care workers.

Agriculture is another industry where the DOJ and FTC could potentially utilize this decision to support a challenge to the wages or prices that manufacturers pay farmers. Similar to health care, many agricultural markets are local in nature, and a transaction in a local area could potentially provide the merging parties market power to suppress the prices paid to farmers for a particular crop, poultry or meat product.

Outside of the health care and agriculture industries, merging parties should be prepared for questions from the DOJ and FTC about the impact on salaries or compensation of employees. Transactions in other industries are unlikely to raise significant monopsony issues unless the merging parties have a large share in a particular local geographic area and require some highly specialized type of service or worker.

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[1] Compare Memorandum Opinion, U.S. v. Bertelsmann SE & Co. KGaA et al., No. 1:21-02886-FYP, Dkt. 194 (Nov. 7, 2022) with Memorandum Opinion, U.S. v. Booz Allen Hamilton, Inc., No. 1:22-cv-01603, Dkt. 227 (Oct. 17, 2022) (finding DOJ failed to show direct evidence of harm, was inconsistent in their argument, and that their market calculations were analytically incomplete), and Memorandum Opinion, U.S. v. UnitedHealth Group Inc., No. 1:22-cv-0481, Dkt. 138 (Sept. 21, 2022) (finding UnitedHealth's remedies for DOJ's vertical and horizontal consolidation concerned sufficient to prevent harm), and Memorandum Opinion, U.S. v. U.S. Sugar Corporation, No. 1:21-cv-01644, Dkt. 242 (Sept. 23, 2022) (finding DOJ failed to properly define the relevant market).

[2] Memorandum Opinion, United States v. Penguin Random House et al., No. 21-2886-FYP, Dkt. 194 (Nov. 7, 2022) at 45–46.

[3] Id. at 25.

[4] See Executive Order on Promoting Competition in the American Economy, July 9, 2021, https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy/; Acting Assistant Attorney General Richard A. Powers, Remarks at Fordham's 48th Annual Conf. on International Antitrust Law and Policy, Oct. 1, 2021, https://www.justice.gov/opa/speech/acting-assistant-attorney-general-richard-powers-antitrust-division-delivers-remarks; see also Making Competition Work: Promoting Competition in Labor Markets, FTC and DOJ Joint Public Workshop, held Dec. 6-7, 2021.

[5] See e.g., FTC v. Wilh. Wllhelmsen Holding ASA, 1:18-cv-00414-TSC (D.C. Cir. May 4, 2018); FTC et al. v. Staples, Inc. et al., 1:15-cv-02115 (D.C. Cir. Dec. 9, 2015); FTC et al. v. Sysco Corporation et al., 1:15-cv-00256 (D.C. Cir. Feb. 20, 2015).

[6] Memorandum Opinion, United States v. Penguin Random House et al., Dkt. 194 at 29.

[7] Id. at 68.