

jcannonbooks

Because everybody  
needs an editor . . .

and a newsletter



## Glad I read that

**Louise Penny, *Kingdom of the Blind*:**

He saw the dealers and addicts and prostitutes going about their business in broad daylight. Knowing no cop would stop them.

This part of Rue Ste.-Catherine wasn't so much an artery as an intestine.

\*

**Tom Cekay, *Rage Against the Dying Light: Fishermen's Stories of Life, Death and Struggle on the Lower Columbia*:**

The son could loosen his grip on gentleness; the father held tight. The son grew comfortable in the present; the father never forgot the past. The younger man gained weight as he aged; the older man remained painfully thin. One could listen; the other only lectured. But together, father and son—one the backbone, the other the heart—carved out a legacy on the island as constant as the river itself: a family.

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## Antitrust, but verify



*John Lopatka delivers the faculty lecture to Penn State's first-year law students at orientation in 2018. Penn State Law photo.*

Writers have dreams.

They imagine the manuscript they have honed for years has the strong voice, innovative plot, unforgettable characters, and authentic setting that will cause the Big Five publishers to slobber on themselves as they contemplate bringing it to the masses. A bidding war. A book tour. Trading bon mots with Stephen Colbert.

That dream, as understandable as it is fanciful, might be headed toward absurd. Or maybe not.

Two huge book publishers, Penguin Random House and Simon & Schuster, want to merge. News stories and opinion pieces have explored whether consolidation will mean predictable, safe books will dominate even more of the market, thus muffling the voices of new writers. And would authors get paid less? Would advances get smaller? Worries have abounded; teeth have been

gnashed. Of course, I could hold forth on what this proposed merger could mean to authors and readers, just as I could tell you everything I know about high-energy physics. Upon reflection, it seems wise to ask an expert.

We need John Lopatka.

He is the A. Robert Noll Distinguished Professor of Law at Penn State University and specializes in antitrust matters. Professor Lopatka, or John as I call him, earned a master of laws degree from Columbia University after receiving his J.D. from the University of Chicago and his B.A. from Loyola University of Chicago. This man entrusted his education to the nation's finest schools. Penn State Law, as it calls itself, describes him as one of the nation's leading antitrust scholars. He has written articles and books, helped guide the Federal Trade Commission's Bureau of Competition (which enforces antitrust laws), and worked at private law firms in Chicago and New York.

He has agreed to this email interview to help us understand what is at stake. Yes, we could have done a phone interview, but John is a talented writer, which makes this Q&A method way more fun.

Before we start the Very Important Stuff, I want to pay John for his graciousness. Not with money, of course, because he wouldn't accept it and jannonbooks.com doesn't have it. I mean with apologies. I'm sure I failed to express gratitude for kindnesses he showed me when I was young and foolish. Now that I am old and foolish, I hope public groveling will cover some of my debt. For example, when he was editor-in-chief of our college newspaper, he convinced the university administration that certain jobs I performed as a *Phoenix* staff member were worthy of work-study recompense. Sure, he would say, it was nothing, what are friends for. But think of all the Italian beef sandwiches I bought with that money. And I'm sure I failed to thank him properly a few years later for straightening out a landlord who refused to return my security deposit. John insisted that the landlord do so, a demand outlined on the letterhead of the storied Chicago law firm where John worked at the time, Isham, Lincoln & Beale. The landlord was properly chastened, and the deposit equal to one month's rent (\$175) soon made its way to me. It helped me pay the monthly levy at my next residence, a bigger but no less shabby apartment. Did I thank him? Not enough.

**Q:** Let's get to it. I want to ask you, John, about the potential effects of the federal government suing to halt the proposed merger of two giant publishers. But first, can you tell readers of this blog and newsletter how you came to focus on antitrust law in your career? You teach it at the Penn State University law school. You have written articles and books about antitrust matters, and the

record shows that you take pity on stray journalists who find their way to you in search of expert enlightenment as they prepare articles about antitrust issues.

**A:** Stray journalists are a pathetic lot, like shivering puppies. They deserve everyone's pity. When I graduated from law school and started practicing at a firm then considered large, I had visions of becoming a Renaissance lawyer, practicing in all fields, and doing so well. I soon realized this was a romantic notion far removed from the actual practice of law. I needed to specialize. I thought about what intrigued me in law school, and antitrust stood out, partly because of several excellent teachers. I also had been fortuitously assigned to an antitrust case at the firm. I concluded that antitrust was to me exciting and infinitely challenging. I could spend a career doing antitrust law and never feel bored. Off I went—and I've never looked back.

**Q:** If Penguin Random House is allowed to purchase Simon & Schuster (who makes that decision anyway?) for a mere \$2 billion and the publishing Big Five becomes the Big Four, many suspect that aspiring authors will have an even harder time attracting the attention of a major house. The Grishams and Pattersons will be fine, if you like that sort of thing, but new, worthy voices could have a more difficult time breaking through, this reasoning goes. Do you think that will happen? Why?

**A:** Firms decide to merge. The government or even private parties can sue to block the merger, and if they do, a court will decide whether the merger can proceed. In the publishers' merger, the United States, acting through the Department of Justice, has sued to block the deal. That case is now before a federal district court. The decision of the district court is subject to appeal by the losing party to the relevant circuit court of appeals, here the District of Columbia Circuit Court of Appeals. That appellate court decision would theoretically be subject to review by the U.S. Supreme Court, though it's highly unlikely that the Supreme Court would accept the case. Of course, the merging parties, if they lose at trial, could call it quits and walk away from the deal without an appeal.

You raise an interesting point that antitrust lawyers and economists would characterize as an issue of market definition. In most horizontal mergers, or mergers of competitors, the issue is whether purchasers of their products will be harmed. The focus is on the output of the firms. That is not the focus in this merger. The focus is on authors, who are in economic terms input suppliers. The concern, as you point out, is that elimination of competition between the two big publishers will reduce the amount paid to authors. Now, to talk about "competitors" is to imply that the firms compete in a market. What is the market here? The government alleges two markets: the acquisition of U.S. publishing rights to books from all authors; and the acquisition of those rights to

“anticipated top-selling books.” In other words, the government claims that all authors would suffer anticompetitive harm, and it also claims that a subgroup of authors would be harmed. The focus of the case, however, has been on authors of anticipated bestsellers. These are the authors who, according to the government, will be primarily injured. The reason the market definition is important here is that the publishing options that less-known authors have are different from those bestselling authors have. You suggest that the merger of two of the Big Five publishers would not have a serious impact on prominent authors, but it would have on new voices. But new voices can be published by smaller houses. For them, the smaller houses are good alternatives. Even self-publishing might be a reasonable option. As the market expands, a merger of any two publishers is of less competitive concern. The government’s theory, however, is that prominent authors cannot obtain the services they need from small publishers. They need promotion and distribution that small publishers do not offer. And only big publishing houses have the wherewithal to pay these authors what they demand, because the scale of their operations makes their investment in a book reasonable. A large advance paid by a small publisher to a prominent offer would represent an intolerable risk.

I tend to think that unknown authors won’t be appreciably worse off. They’re likely to publish with smaller houses anyway, until they become prominent. For prominent authors, the situation is different. Will they be injured? That’s harder to predict. This is a complicated market. In some markets, buyers set a price for a fungible input—\$100 for a barrel of crude oil—and suppliers either sell to them at that price or don’t sell at all. But books are what economists call differentiated inputs. One book is not a perfect substitute for another. And the “price” paid for a book is the subject of negotiation, after a kind of auction. In this kind of market, the elimination of one bidder because of a merger with another bidder might or might not affect the price ultimately paid. Penguin Random House and Simon & Schuster argue that the firms rarely bid against each other for books; the government maintains that they often do. The government’s expert economist testified that the two firms finish first and second in auctions around 12 percent of the time. If these publishers are routinely competing against each other, their combination would likely lower the amount paid to authors. But maybe the price paid authors, or the “advance,” isn’t that important to top-selling authors. One author testified that the advance is not terribly important because he earned out the advance anyway, and the bulk of his compensation came from royalties. The court was skeptical, pointing to evidence that 85 percent of books never earn out their advances. Another possibility is that authors choose publishers because of editors rather than the size of the advances. Some agents and authors indeed testified that they cared more about editors than about advances. But there is evidence that all the big publishers have good editors and that advances are important after all.

**Q:** Your answer adds depth and nuance to my understanding of this case and antitrust matters in general, which until now had been based only on the offerings of stray journalists. And I'm elated to see your examination of the idea that editors might have something to do with how well a book turns out. Are all law professors this thorough?

**A:** All law professors can bloviate. We are tested on that before we're hired. If I had a good editor, my answer would have been 30 percent shorter.

**Q:** John, you point out that authors are the focus of this case, a handy bit of expert advice for all of us. But even if it is not explicitly addressed in this lawsuit, what might be the effect on We the Readers? For example, if one company instead of two can acquire publication rights to the 12 percent of potential bestsellers that the government economist says are in play, would bestseller lists become more homogenized? Could you imagine a world in which library patrons stand before the New Books shelf at the library, see even more stuff that follows a familiar formula, and leave in frustration to watch Netflix? Are we doomed?

**A:** Let me start by saying the 12 percent figure was provided by the government's expert economist, who used a model of a particular kind of auction. The publishers' economist countered that the model is inapt and does not correspond to the way rights are obtained and sold in the book world. (A great deal of antitrust law is based on economic models, and a great source of dispute in antitrust litigation has to do with identifying the model that best captures reality.) He testified that book rights are negotiated, not auctioned, and that agents select publishers for reasons other than the offered advance. But he also argued that even if the government's flawed model was used, it only shows competitive bidding in 12 percent of book deals, meaning that the merger would have no competitive impact 88 percent of the time. In short, the government's own showing is that the merger will not substantially lessen competition.

Now to your latest question. In a case like this, it's worth distinguishing between direct and derivative harm. If the government claimed that the merger would allow the merged publishing house unilaterally or in coordination with the remaining houses to raise the price of books, We the Readers would suffer direct harm. We would pay more for books, and some readers might not buy a book at all because the price would become more than they would be willing to pay. This is direct injury. We the Readers would also suffer direct injury if publishers after the merger charged the same prices but reduced the quality of the product, for instance, by publishing books on newsprint. Your question alludes to something else, and in fact the government refers to it as well. If the

merger injures authors, authors will write fewer books, and We the Readers will have fewer books to read. Given that books are differentiated, fewer books implies less variety, and less variety means library patrons will stand before the New Books shelf mouths agape at the smaller array of offerings. We can think of this as derivative harm: Injure authors, and those who benefit from what authors do will also be harmed. There's nothing wrong with the idea of derivative harm. The economy is a web of interaction, and an injury anywhere will cause harm elsewhere. I don't think demonstrating harm to readers is legally significant here. Antitrust scholars for some time have debated whether a violation requires an adverse impact on consumers, which in this case would be readers, as opposed to input suppliers. In my view, the merger can be condemned or allowed based on its effect on authors without considering derivative effects. Still, recognizing derivative effects gives context to the primary effect, and that can be useful.

You specifically suggest that, after the merger, more books will follow a familiar formula. Maybe, but that's difficult to say. If the merger has an anticompetitive impact, and if that impact is primarily on bestselling authors, we might end up with fewer books by these authors. But don't these books follow familiar formulae? There were thirty-three publishers that acquired books for advances of \$250,000 or more last year. One could argue that the non-formulaic authors, the ones writing the most creative stuff, will still be published, but by small houses, as they are now. Books published by these houses are not likely to make bestseller lists, though, so the effect of the merger on library patrons may depend on what titles the staff places on their New Books shelf.

Having said all this, yes, we are doomed.

**Q:** This is the point where careless people who have never read my harangues about overworked phrases would be tempted to use the cliché “the elephant in the room.” You and I find such usages abhorrent, so I propose that we talk about the hippopotamus in the room, Amazon. My research indicates Amazon sells a book or two, and it does not seem to matter whether the publisher is big or small. It's also a favorite platform for authors who wish to self-publish. Could this merger affect Amazon?

**A:** Another excellent question. Have you ever thought about going into journalism? As it applies to this merger, the theory you raise has to do with countervailing economic power. Technically, the economic model is that of bilateral monopoly. Suppose a buyer with market power purchases from competing sellers. The quantity purchased will be less and the price paid will be less than if the buyer faced competition. If the sellers can merge or organize such that the buyer with monopsony power confronts a seller with monopoly

power, the quantity purchased and the price paid may increase, resulting in an outcome closer to the social optimum. Think workers organizing to bargain collectively with the employer in a company town. Hospitals competing to be included in the network of a dominant insurance company might offer this justification for a merger. In the publishers' case, the idea would be that Amazon has monopoly power in the retail distribution of books and monopsony power in the acquisition of books for retail sale. The publishers, then, might merge to acquire monopoly power in their dealings with Amazon, and the result would be socially beneficial.

The government anticipated that the publishers would assert this defense at trial, noting that Penguin Random House had claimed publicly the merger would provide a counterweight to Amazon's buying power. The government disputed the claim factually, pointing to internal documents suggesting that PRH executives anticipated embracing Amazon even more fully after the merger and that the CEO never bought into the argument. But at trial, the publishers did not assert the defense. Some antitrust scholars believe that merger law does not recognize the justification, and that would be a reason the publishers did not raise it. In my view, the defense is theoretically valid, but it can be exceptionally difficult to establish and to my knowledge has never been successfully asserted. In this case, the publishers would have to prove that acquiring countervailing economic power in transactions with Amazon would result in higher advances paid to authors. As I said earlier, this is a complicated market, and a simple model of bilateral monopoly does not apply. Authors are input suppliers to book producers, who sell to retail distributors, who sell to readers. What if a merger creates monopoly power in publishers as a counterweight to a retailer's monopsony power, which might increase the price paid to publishers and authors, but simultaneously creates monopsony power, which reduces the amount paid to authors? Are authors better or worse off? Not only is the economics complicated, but litigation would become vastly more difficult. The court would have to grapple with the state of the book retailing market. Does Amazon have market power in any economically relevant book retailing market? The answer to that could not be assumed. It would have to be litigated. In the end, the publishers may have decided not to pursue this defense both because it's legally questionable and because it might conflict with the facts and would at least be costly to establish.

But apart from the relevance of Amazon to the specific countervailing power defense, your question speaks to the general significance of Amazon in the marketplace. It seems to belie a favorable attitude toward Amazon, which is refreshing because Amazon is commonly perceived by publishers and authors as the Great Satan. As a footnote, some of the Big Five publishers, not including Random House, and Apple were held liable in 2015 for fixing retail



prices of e-books. The genesis of that case was the publishers' belief that Amazon's unduly low prices for e-books were forcing down the price of printed books. In other words, their complaint was that Amazon was charging too little for books, and the publishers wanted higher prices. Now, I do have immense sympathy for authors. I want them to flourish. But I also live in State College, PA. The Strand is not down the block. The ability to find a book on Amazon at a low price and have it arrive immediately, if on Kindle, or in two days, if in another format, is a godsend. Amazon provides immense value. As your question points out, Amazon is not only a retailer of published books but also a platform for self-published books, and it is in fact a publisher itself. One might be concerned if the merger would harm Amazon. But I don't think the merger would have much effect on Amazon, and that's true even if one had a jaundiced view of Amazon. As it stands, there are too many players in the market for a merger of two publishing houses, even two of the Big Five, to make much difference to Amazon. Whatever power it has it would continue to have, and it would take the merger in stride.

By the way, I think you can buy a hippopotamus on Amazon.

**Thank you, John**, not just for your cogent and patient explanations but for allowing me to encounter the word monopsony for the first time in my sheltered life. I'm in even deeper debt to you, but it was worth it.

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**Kind regards,  
jcannonbooks**

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