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The Battle of $9.99

How Apple, Amazon and the Big Six Publishers Changed the E-Book Business Overnight

by Andrew Richard Albanese

PW PUBLISHERS WEEKLY

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How Apple, Amazon, and the "Big Six" Publishers Changed the E-book Business Overnight

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Author's note: The following account was assembled from the documents and evidence filed by the parties in Apple's e-book price-fixing trial. We caution that some of the evidence in the case remains redacted or sealed, and as with any trial, the exact context of the statements quoted in this report may be disputed. But in synthesizing the court record into this narrative timeline, what emerges is a striking blow-by-blow account of how and why the e-book business was fundamentally changed in January 2010.

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In November 2007, David Shanks, chief executive officer of Penguin USA, the country's second-largest book publisher, was interviewed for a *Newsweek* story about the launch of the Amazon Kindle e-book reader. Among his questions, writer Steven Levy asked the CEO about Amazon's plan to charge $9.99 for e-book editions of new hardcover books.

"I hope you're kidding," Shanks recalled as his reaction.

In his article, Levy wrote that Shanks seemed "startled" when the reporter revealed that Amazon would even be charging $9.99 for the Kindle edition of former Federal Reserve Board chairman Alan Greenspan's just-published memoir, *The Age of Turbulence*, which retailed for $35 in hardcover and the rights to which Penguin reportedly secured with a hefty $8 million advance.

"I'm not going along with it," Shanks told Levy, of Amazon's $9.99 pricing.

But Amazon didn't need Shanks to go along with it. Amazon could charge whatever price it wanted for its Kindle e-books.

That's because, at the time of the Kindle launch, Penguin (and, in fact, all the major U.S. publishers) had set up their e-book businesses to work like their print book businesses. Known as a "wholesale" or "reseller" model, it has many variations, but books in the U.S. are generally sold like this: publishers set the list prices of their books (the price printed on the cover and, theoretically, the price to the consumer) and then sell copies to retailers at a discount off the list price. The standard discount is usually about 50% for most popular consumer fiction and nonfiction. Retailers then sell their copies to the consumer at whatever price they deem reasonable. And they can return any unsold stock to the publishers for credit.

For e-books, in the beginning, it worked much the same way. Except, publishers lowered their e-book prices by 20% to create a "digital list price" to reflect the costs saved by not having to manufacture, ship, and warehouse physical books. And with e-books there were no returns of unsold copies—all sales were final.

For Alan Greenspan's new book, the math for Amazon looked like this: a $35 hardcover list price meant a digital list price of $28. With the standard 50% wholesale discount applied, Amazon paid Penguin about $14 per e-book.

When Levy said Shanks seemed startled about Amazon's low price, this was why. Penguin had given Amazon no special discount on the Greenspan book. So, at its $9.99 price, Amazon was losing about $4 on every Greenspan e-book it sold.

But over the next 30 months, Amazon would build a thriving, dominant e-book business based in large part on its $9.99 bestsellers.

The publishers complained bitterly. But they had all signed the contracts that made $9.99 possible. And they cashed the checks.

Then, over a two-week period in January 2010, everything would suddenly change. Using the entrance of a major new player into the e-book business—Apple—five of the six biggest U.S. publishers devised a way take back a measure of control over the final consumer prices of e-books.

Unfortunately, the U.S Department of Justice, along with 33 state attorneys general, determined that plan was illegal.

In April 2011, five publishers—the Hachette Book Group, HarperCollins Publishers, Macmillan Publishers, Penguin Group USA, and Simon & Schuster, along with their newest partner, Apple, were charged by state and federal regulators with a sweeping conspiracy to fix the prices of e-books. Ultimately, the five publishers would settle the charges against them.

Apple, however, would fight on.

On June 3, 2013, for the first time in its corporate history, Apple stood in the dock of a federal courtroom to face off against U.S attorneys. Given the company's high public profile and its impact on so many industries—from mobile devices to music—perhaps it was inevitable that such a day would come. But few would have predicted that it would be e-books to land the company in trouble with the government.

This story, however, is not a courthouse drama. Whether Apple and five major publishers did or did not illegally collude to fix e-book prices may be the question now before Manhattan federal judge Denise Cote, but there is no question that Apple's entry was used to fundamentally change the e-book businesses for a vast portion of new-release books and most *New York Times* bestsellers. The outcome of Apple's trial will not change that.

The more interesting question is: How did it come to this?

How did the "big six" U.S. publishers find themselves locked in a bitter dispute with Amazon over its $9.99 e-book prices? Why were they powerless to change course without the help of Apple? And why were Apple and the five publishers charged with violating the Sherman Antitrust Act?

This is the story of how that die was cast, in a quickly unfolding cascade of events. Thanks to a lengthy investigation involving testimony from key executives at each of the big six publishers, Apple, and Amazon, along with thousands of pages of records and documents, we now know the story.

Cats

On the morning of January 21, 2010, Carolyn Reidy, the CEO of Simon & Schuster, e-mailed Apple senior vice president for Internet and software services Eddy Cue, a 24-year Apple veteran who for much of his career worked closely with Apple's iconic leader, Steve Jobs. It had been just 10 days since Cue, the man who negotiated the launch of iTunes in 2003 and the App Store in 2008, had started negotiations in earnest for a potential Apple e-bookstore. In her e-mail, Reidy promised Cue a phone call and said she looked forward to hearing an update on his progress "herding us cats."

The "cats" were the six largest publishers in the United States: Random House, Penguin, HarperCollins, Simon & Schuster, Hachette Book Group, and Macmillan.

Around lunchtime, the two executives connected for a short 11-minute phone call. Later that afternoon, Cue separately e-mailed two of Reidy's fellow publishing CEOs, Macmillan's John Sargent and Penguin's David Shanks.

He delivered an almost identical message.

"We have completed our first deal," Cue proclaimed, "and are very close with two other publishers."

Phone records from that day show a flurry of more than 25 calls between various big six publisher CEOs. The "logical inference," government attorneys would later argue, was that each executive was seeking to confirm Cue's information.

The following day, January 22, Reidy called Simon & Schuster's largest e-book reseller, Amazon. In a brief call, she told Russell Grandinetti, Amazon vice president of Kindle Content, that the publisher would soon be changing its terms of sale.

Also on January 22, Macmillan CEO John Sargent called Apple's Eddy Cue. He had good news: Macmillan was ready to sign. Cue responded by telling Sargent that Macmillan was the third publisher to agree to terms. Although Cue did not say specifically who else had signed, Hachette, along with Simon & Schuster, had also struck a deal.

Still, the fate of Apple's e-bookstore remained uncertain.

When Apple executives first began planning its e-bookstore, in November 2009, maximum publisher participation was considered essential. After all, if the company couldn't offer all the titles and authors consumers had come to expect from existing retailers, the effort was doomed to fail. To that end, Apple would simultaneously open talks with each of the big six publishers—and it wanted all of the publishers onboard before it would formally agree to open its e-bookstore.

This was a strategy that had worked for Apple in the past. With iTunes, for example, Cue had successfully negotiated simultaneously with the five major music labels at the time. And when iTunes launched, it would change the music business, with over 26 billion songs sold to date.

But as the negotiations wore on with publishers, Apple executives at some point determined that signing four of the big six publishers would be an acceptable level of support to launch its store—at least to start.

They now had three. The fourth would take a little more work.

By January 22, two of the big six publishers had already told Apple they were out, including the world's largest publisher, Random House.

Like the other publishers, Random House was eager to have a major new player get into the e-book business, but Apple's business proposal was simply too extraordinary. Not only did it involve a business model foreign to publishing, it included price protections for Apple and less revenue per e-book sale for the publisher.

On January 21, Random House CEO Markus Dohle e-mailed Cue his rejection of Apple's terms. There were too many unknowns, and Cue was demanding an answer. In the end, the deal was too complex to rush, Dohle concluded.

HarperCollins, too, rejected Apple's terms—although CEO Brian Murray made at least two counterproposals, both of which were summarily rejected by Apple. In an e-mail to Steve Jobs, Cue noted how Murray's counterproposals had gotten steadily worse.

“I actually think he’s an idiot,” Cue wrote of Murray.

As the clock ticked down to Apple’s self-imposed negotiating deadline Apple assumed that HarperCollins, like Random House, was out.

It would come down to Penguin.

On January 22, Penguin CEO David Shanks e-mailed Cue. He asked if Apple had “any more of the big six confirmed yet.”

On “orders from London,” Shanks explained to Cue, referring to Penguin’s British parent company, Pearson, Penguin needed “assurances” that Apple had at least four of the big six, or the publisher would not be able to sign.

“Hopefully this is not an issue,” Cue replied to Shanks in an e-mail. “It would be a huge mistake to miss this if we have three.”

Phone records show that Shanks and Cue spoke five times over the next two days, January 24 and 25. On January 25, Shanks had a four-minute phone call with Simon & Schuster CEO Carolyn Reidy. He received the assurances he needed. Penguin was in.

On January 24, Hachette became the first to officially sign its new e-book contract with Apple. Macmillan, Penguin, and Simon & Schuster all signed the next day, January 25.

It was official: Apple was getting into the e-book business—and soon. In just two days, on January 27, Apple’s new e-bookstore would be announced at a public unveiling of the company’s much-anticipated new device—the iPad.

But there was more to come. Just 24 hours before the iPad launch, Apple would get a fifth big six publisher.

On January 25, Steve Jobs made a personal appeal to HarperCollins’s parent company, News Corp., reaching out to News Corp. deputy chief operating officer James Murdoch, son of chairman Rupert Murdoch.

Jobs and James Murdoch had met for the first time just 11 days earlier, on January 14, in Apple’s Cupertino, California, offices. Cue recalled that Murdoch had reached out to Apple to set up the meeting to discuss ways the two companies could further collaborate on various enterprises, whether movies, TV, news—or, as it would happen, books.

In a frank e-mail exchange, “just between us,” Jobs pushed Murdoch on the terms Murray was reluctant to accept.

“Heck, Amazon is selling these books at $9.99, and who knows, maybe they are right,” Jobs told Murdoch. “But we’re willing to try at the prices we’ve proposed. We are not willing to try at higher prices because we are pretty sure we’ll all fail.”

As Jobs saw it, HarperCollins had three choices: The publisher could “throw in with Apple and see if we can all make a go of this to create a real mainstream e-book market at $12.99 and $14.99.”

Alternatively, the publisher could continue the status quo with Amazon and their $9.99 consumer prices.

“You will make a bit more money in the short term but in the medium term Amazon will tell you they will be paying you 70% of $9.99,” Jobs argued, referencing Amazon’s price point for Kindle e-books—a serious bone of contention among the publishers. “They have shareholders, too.”

The third scenario involved HarperCollins taking a hard line with Amazon in new contract talks and withholding its e-books. But that, Jobs said, would only serve to create frustrated consumers, who would quickly turn to digital piracy.

“I’ve seen it happen with my own eyes,” he wrote.

“If you stick with Amazon, B&N, Sony, etc., you will likely be sitting on the sidelines of a mainstream e-book revolution,” Jobs warned, vowing that Apple would sell more of its revolutionary new iPad in the first few weeks than all of the Amazon Kindles sold so far.

As for any potential concerns with “the artists” whose royalties might be affected by a potential switch in e-book terms following an Apple deal, Jobs offered this gem: “Send them all a letter telling them that you will pay them a higher percentage for e-books,” he advised. “They won’t be sad.”

The exchange proved persuasive. On January 26, HarperCollins signed with Apple at the urging of its corporate parent. Murray ultimately endorsed signing the deal. If the decision was to be made just for HarperCollins, Murray later explained, he wouldn’t have signed. But in terms of News Corp.’s overall relationship with Apple, the deal made strategic sense.

With that, Apple had pulled off a remarkable feat. Although Random House remained unsigned, Apple had successfully negotiated identical retail agreements with five of the six largest U.S. trade publishers in less than two weeks. None of the publishers had yet to even see an iPad, or an Apple e-books app. In fact, Apple developers hadn't even begun working on the Apple e-bookstore until mid-December.

The very next day, on January 27, 2010, Steve Jobs personally unveiled the iPad at a glitzy public event in San Francisco. This, however, was no mere product announcement. It was news—big news—*global* news. It would even make page one of the *New York Times.*

When Jobs began his demonstration of the iBooks app, a picture of an Amazon Kindle flashed on the screen behind him, displayed as if it were some obsolete 1980s mobile phone.

"Amazon's done a great job pioneering this functionality," Jobs said of the e-book market. "We're going to stand on their shoulders and go a bit further."

He then debuted the iBookstore by purchasing an e-book copy of the late Massachusetts senator Edward M. Kennedy's bestselling autobiography, *True Compass*, published by Twelve, an imprint of the Hachette Book Group. He paid $14.99.

Reporters were dazzled by the iPad, a sleek tablet device that would soon kick off a new revolution in personal computing. But *Wall Street Journal* columnist Walter Mossberg had a simple question about e-books: Why would customers pay $14.99 for an e-book from Apple, when they could get it from Amazon or Barnes & Noble for $9.99?

"That won't be the case," Jobs responded. "The prices will be the same."

Executives at the big six publishers must have winced. None of Apple's publisher partners had yet to negotiate a single new contract with any other e-book retailer. How could Jobs stand there in public and predict with such certainty what the future e-book prices of his competitors would be?

Elisa Rivlin, then general counsel for Simon & Schuster, would later express her disbelief. "Incredibly stupid," she wrote of Jobs's comment in an e-mail exchange with Carolyn Reidy and Adam Rothberg, Simon & Schuster's head of corporate communications.

Rothberg responded that he'd already had one "minor blog query" about Jobs's comment, to which he had not responded.

"But," he added, "I expect more."

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The Battle of $9.99: How Apple, Amazon, and the "Big Six" Publishers Changed the E-book Business Overnight publishes on June 20, 2013, and is available at all major e-book retailers.

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About the Author

Andrew Richard Albanese is senior writer and features editor at *Publishers Weekly*. As a journalist he has covered the publishing and information technology field since 1999, and has written about the industry for numerous publications in the U.S., Europe and Asia. He is also a former editor of American history at Oxford University Press.

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