

State of Connecticut

RICHARD BLUMENTHAL
ATTORNEY GENERAL



Hartford

July 29, 2010

Bruce Sewell
General Counsel
Apple, Inc.
1 Infinite Loop
Cupertino, CA 95014

Dear Mr. Sewell:

In March, I read with great interest an article in the *New York Times* entitled "*A Rift at Amazon on E-Book Prices.*" I have continued to follow some of the issues raised by that article since that time. The article described the dispute between Apple, Inc.'s ("Apple") planned adoption of the "agency model" pricing strategy for e-books and that of Amazon.Com, Inc.'s ("Amazon") competing e-book pricing strategy, referred to as the "wholesale pricing model". My understanding is that Amazon, which currently holds a commanding share of the e-book market, has now shifted its pricing strategy to incorporate the agency model advocated by the five largest book publishers in the United States.

Of even greater concern, is the potential broader anticompetitive impact of Apple's "requirement," as noted in the article, that in exchange for Apple agreeing to the agency pricing model, the largest e-book publishers must agree not to permit Apple's competitors to sell any e-books for less than what price is listed in Apple's iBookstore. Such price guarantees are often referred to as "most favored nation" ("MFN") clauses. Essentially, in this context, an MFN is a promise by a supplier (i.e., the publisher) to treat a buyer (i.e., Apple) as well as it treats its best, "most favored" customer. In other words, if the publisher lowers its price for e-books to Amazon, the publisher must offer that price to Apple as well. The article further stated that Amazon has demanded an MFN as well.

I fully understand that MFNs are not *per se* illegal under our antitrust laws. Yet, as I am sure you are aware, MFNs are not *per se* legal either. MFN clauses - - especially when they are offered to two of the largest e-book retail competitors in the United States - - have the potential to impair horizontal competition by encouraging coordinated pricing and discouraging discounting. The net effect is fairly obvious, in that MFNs will reduce the publisher's incentive to offer a discount to Apple if it would have to offer the same discount to Amazon, leading to the establishment of a price floor for e-books offered by the publisher. Of course, the concerns are compounded, and hence potentially more troublesome, since this arrangement appears to be something that will be agreed to by the largest e-book publishers in the United States and two

competitors who combined will likely command the greatest retail e-book market share. Indeed, by all press accounts, and if recent history is a predictor of future results, I fully expect that Apple's iPad tablet will soon attract (if it has not already) an important share of the e-reading device market.

These concerns appear to have already manifested themselves in the e-book market. My office recently conducted an informal survey of e-book prices offered by Apple, Amazon, Borders and Barnes & Noble for a number of the books in the New York Times Bestseller list, both fiction and non-fiction. Almost uniformly, the prices were identical among all four sellers.

Firms that demand and get MFN treatment from important suppliers are assured that new entrants (i.e., Apple) and existing competitors will not be able to offer consumers lower costs by getting better e-book pricing from publishers. I am concerned that Apple and Amazon's decision to use the agency pricing model, coupled with the MFN, has already resulted in achieving or maintaining uniform prices for e-books, to the ultimate detriment of the consumer.

Given my very real concerns over the possible anticompetitive consequences these pricing policies may have on such a dynamic, burgeoning and exciting market, I would request that your company's counsel arrange to meet with me to discuss the issues I have raised in greater detail. My goal is that through such a discussion, Apple can allay my concerns. You can contact Assistant Attorney General Michael Cole, Chief of the Antitrust Department, at 860-808-5171 to schedule the meeting.

I look forward to your response and anticipated cooperation in this inquiry.

Very truly yours,



RICHARD BLUMENTHAL

RB/pas