**UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

UNITED STATES OF AMERICA, Plaintiff, v. APPLE, INC., et al., Defendants.	Civil Action No. 12-cv-2826 (DLC)
THE STATE OF TEXAS; THE STATE OF CONNECTICUT; et al., Plaintiffs, v. PENGUIN GROUP (USA) INC. et al., Defendants.	Civil Action No. 12-cv-03394 (DLC)

DIRECT TESTIMONY OF RUSSELL C. GRANDINETTI (AMAZON.COM)

1. My name is Russell C. Grandinetti. I am employed by Amazon.com ("Amazon"); my current position is Vice President – Kindle.

2. After earning a Bachelor of Science in engineering from Princeton University, I worked in London at a children's psychiatric clinic. When I returned to New York, I worked at Anderson Consulting for two years writing software and building systems, and then I spent almost two years at Morgan Stanley in equity research following technology companies, which is how I was introduced to Amazon.

My Duties and Responsibilities at Amazon

3. I have worked for Amazon for the last 15 years. Immediately prior to joining the Kindle team, I was Vice President in charge of Amazon's book business (now known as the print books business) in North America. In that role I reported to Jeff Wilke, who reported to Jeff Bezos, CEO of the company.

4. I joined the Kindle team in October 2009 and reported to Steve Kessel, who reported to Mr. Bezos. Mr. Kessel went on sabbatical in late fall 2011; since that time I have reported directly to Mr. Bezos. In my role as VP-Kindle, I have overall responsibility for Kindle content worldwide.

The Launch of Kindle and the Early Years

5. After more than three years of work on the project, the Kindle store opened in November 2007, with most of the books then on the *New York Times* bestseller list and 90,000 others available to customers. Prior to that time, digital books and digital book readers had been sold by other companies, such as Sony and RocketBook, but electronic reading hadn't yet really caught on with consumers.

6. Although I was the head of Amazon's print books business when Kindle launched, I was involved in and familiar with the company's goals and the principles that drove the Kindle business. Amazon's mission is to be earth's most customer-centric company and to help people find and discover anything they want to buy online. Especially in the early years when we were creating the Kindle store, the print books team and the Kindle team had to work

together to build a great website experience where a customer could easily find a book, see what our pricing and delivery options looked like, and then choose between the Kindle format or the print format. In addition, the work we did to negotiate with publishers to make books available for Kindle in advance of the launch went hand-in-hand with some of the work we were doing in the print book part of the business, so I was also involved in that aspect of the Kindle launch.

7. [redacted]

8. [redacted]

9. [redacted]

[redacted]

10. [redacted]

11. In our effort to reinvent reading, we also included from the beginning things like an in-line dictionary, highlighting and note-taking capability, and the ability to change font size. We also had to figure out how to create the ability to sync between devices, so customers could read on a variety of devices without losing their place in the book or their highlights and notes.

12. Of course we also had to do a lot of work to ensure that the content customers wanted would be available to them in the Kindle store. We worked very hard with publishers to get their new releases and backlist titles digitized and to negotiate new contracts that would allow us to sell digital editions. We also invested quite a bit ourselves in digitizing books so that

when we launched Kindle, a large percentage of the bestselling books was available. This required a huge investment of time and money before the Kindle store even opened, and we continued to invest in the store after launch to add new titles and improve the customer experience.

13. We were surprised by the early success of the Kindle. In fact, the first Kindle sold out within a few hours and remained out of stock for months. We were encouraged by the response, so we redoubled our efforts to get more titles into the Kindle store. One thing we did early on to help the publishers prioritize the process of digitizing their catalogs was to create a widget that allowed customers to tell them what they wanted to read. A customer who found a listing for a print book on our site that wasn't available yet in digital form could click to tell the publisher that they wanted to read the book on their Kindle. We would send publishers reports that showed the ranked order of the most requests for one of their books so they could see where latent demand existed that they could capture if they digitized the book.

14. We also reached out directly to authors to introduce them to the Kindle and encourage them to work with their publishers and agents to make their books available digitally. We literally had folks just go visit authors and have them look at a Kindle and flip through some pages to take some of the uncertainty out of what this thing was. Our experience was that as soon as someone actually sat and used the device they realized it wasn't as much of a departure from what they knew reading to be as they might have conceived, and it took a lot of the anxiety about the change out of the way.

15. We knew that now that we had established a successful and growing ebooks business, more competition would be coming, and quickly. We didn't know from where, but when something gets that kind of customer excitement and enthusiastic adoption, competitors are sure to follow, so we felt a lot of pressure to continue to digitize more books, introduce ourselves to customers, improve the device, and expand beyond the U.S.

16. We also started to add reading apps so people could read Kindle books without a Kindle device and also could sync between reading options. People read a variety of different

kinds of books and like to read in different contexts, so reading a book on a computer screen, or on an e-ink reader, or on a phone or some other device may all be useful, even to the same customer. What we wanted to do was recapture as many minutes of the day as possible for a customer to read. So, if you kept your e-ink device by your bedside and you read in the morning and at night, and then you read on your phone when you had 20 minutes in a doctor's waiting office, we saw that as 20 minutes where you got through more of a book and you made reading more a habit. That was just great for readers – they would email us over and over again (we would literally get hundreds or thousands of feedback emails each week, and many of us read them regularly) about how digital books had either renewed or improved their time spent reading.

17. Our first Kindle app, which was for the iPhone, came out in early 2009. Others quickly followed and as of today, free Kindle apps are available for a lot of different devices, including iOS, Android, Windows tablets and smartphones, Blackberry, and Mac and Windows computers. The Kindle Cloud Reader allows for reading in a browser.

18. We don't see it as inconsistent to work on trying to build the best reading device in the world, and also to recognize that people are going to want to read on different devices at different times, and to support that. [redacted] We have a healthy business selling Kindle books to people who don't own a hardware device that we built, and we like that.

19. As noted above, there had been other companies offering digital reading options when we launched Kindle, but as consumer interest in ebooks grew, more competitors began offering ebooks options, including Barnes & Noble, Google, Kobo, and Apple. Barnes & Noble released their first Nook ereader in 2009. We took all this competitive entry seriously. Barnes & Noble is a large, successful bookseller with a lot of stores, and a lot of traffic in those stores; they

have a great ability to introduce people to their own products. We're a customer-focused company, not necessarily competitor-focused. But if you're a customer-focused company, it's important to see what other choices customers have and evaluate what you're doing in that context. So of course we paid attention to the other ereaders and digital bookstores and tried to see what else we could do to make the Kindle and Kindle content as attractive as possible to customers in terms of pricing and features. (AMZN-TXCID-0009533 – 35; AMZN-TXCID-0009536)

20. [redacted]

Amazon's Pricing for Kindle Ebooks

21. From the beginning of Kindle, we took an approach to pricing ebooks very similar to what we had done successfully in pricing print books, by which I mean both that the pricing was attractive to customers and we knew we had a [redacted] sustainable business. We started with those two important points, and developed our ebook pricing the same way.

22. Until agency, ebooks were sold on the wholesale model, just as print books had been sold for many years. In a wholesale model, the publisher sets a list price and then sells books to Amazon at a discount off of list; Amazon then decides how to price the book to the consumer. When we launched Kindle, many publishers were setting digital list prices about 20% lower than the equivalent print list price.

23. We have always thought that ebooks should generally be priced lower than physical books. This makes logical sense, because the costs of manufacturing, freight, warehousing, delivery to consumers and returns are taken out of the process of delivering a digital book. And so we looked at our discounts and we looked at our customer pricing and we looked at what we thought the mix would be between bestsellers and backlist books as more

books were digitized, and we arrived at a pricing approach that in many ways mirrored the success that we had in print books.

24. As a company, even beyond books, our goal is always to pass on as much of the efficiency and innovation that we can deliver to customers by lowering prices, because by lowering prices over time we think that we can attract customers and also have a great business. We are always seeking a really good balance between great customer value and a healthy long-term business [redacted]

25. I participated in the decision to establish Amazon's price for the Kindle version of most current *New York Times* best sellers and some other new releases at $9.99. In many cases early on, $9.99 was a breakeven price. For example, on a hard cover new release with a list price of $25, the digital list price was 20% less, or $20. Trade terms are usually in the range of a 50% purchase discount, which meant the cost to us was $10. This is what I mean when I say that selling at $9.99 was often a roughly breakeven price. In any event, having some titles as loss leaders is quite common in both book-selling and retailing generally. [redacted] And of course prices on many ebooks that we sold varied widely. [redacted]

26. We also have never used sales of ebooks directly to subsidize the Kindle device. We don't think of it simplistically as one part of the business subsidizing another part of the business. Rather, our goal has been to have both parts of the business sustainable in their own right. But we're also not blind to the fact that they're related businesses and so there have been various times where we looked at the business holistically as the sum of what the device business and the content business provide together. We have thought about some trade-offs with that

concept, but never solely in that context and never absent that context. And it's important to keep in mind that there may be people who buy our Kindle Fire device who don't really read much, so the ebook business may not apply to those customers at all. Conversely, there are many people who don't own any Kindle hardware but who buy Kindle books from us. And both of those cases are big business opportunities so we can't just look at it as one subsidizing the other.

Complaints About Kindle Ebook Prices

27. From the beginning, publishers complained about our pricing. They repeatedly complained about our $9.99 pricing for *New York Times* bestsellers and other new releases, and at any number of turns, encouraged us to raise our prices. These complaints came from many publishers, including Hachette, HarperCollins, Penguin, Macmillan, and Simon & Schuster. We refused to raise prices in response to these complaints; we always set our prices unilaterally until the agency model was introduced.

28. We did this even when many of the large publishers raised their digital list prices significantly, in an apparent attempt to force us to raise our consumer prices. In some cases, certain publishers even set them higher than the corresponding physical list prices. [redacted] Also, building and maintaining customer trust is critical to Amazon's long term success, and we had made a commitment to customers from the earliest days of the Kindle that most bestsellers would be priced at $9.99.

29. Some of the publishers argued with us that our pricing for ebooks wasn't sustainable, or that we must have a plan to gain control of the market and then raise prices. None of these claims were true, and we told them that repeatedly. There never has been any plan or assumption that at some point in the future consumer prices could or should be higher. We were completely convinced based upon our experience in print books and what we knew about our terms in digital that our pricing approach to Kindle books allowed us to run a very successful business without raising our prices.

30. While we didn't need to get lower list prices from publishers to sustain our pricing approach, we did suspect that list prices for digital would have some rational relationship with the print list prices over time; this is just logical. Some publishers had digital list prices the same as print and there were any number of publishers that had digital list prices that were a bit lower than print, which felt like the more logical place to us and if we had to bet, I think we would have bet that that's where things would go over time. Of course, we asked for better terms every year, as I suspect customers of suppliers always do. It's good for our business to negotiate better terms, and like any other bookseller we worked hard to achieve them. [redacted] Our pricing model did not require any kind of reduction in list prices from where they were when we started the Kindle business in order to succeed.

Windowing Ebooks

31. We have always strongly believed that offering ebooks for sale at the same time that the print book was published was the best approach, not just for consumers, but for publishers and authors, too. In the early days after the launch of the Kindle, publication of some ebooks was delayed because there was no digital version. In those early days, it took quite a bit of time and effort to digitize all the print books in the catalogue and many new books were being released before they were available in digital form. As systems were put in place to manage the digitization process, however, and as the ebook business grew it became the norm for publishers to release ebooks at the same time as the print version.

32. During the summer and fall of 2009, certain publishers began to experiment with "windowing," a practice in which the release of the digital version of a new book is delayed for some time after the print book is published. This happened with a few high profile bestsellers, such as Stephen King's *Under the Dome*, published by Simon & Schuster. We told the publishers that this was a very bad idea for them and their authors. Based on my years in the book business, I felt the publishers' decision made no economic sense, would alienate customers and result in lost sales. At the time, the publishers involved told us that their decision to window

was done on a book-by-book basis and that there was no plan for widespread windowing of ebooks.

33. In early December 2009, however, several publishers raised the prospect of delaying ebooks across-the-board. Hachette was the first to announce their plans; this happened immediately following an in-person breakfast meeting between Hachette CEO Arnaud Nourry and my colleague, David Naggar, [redacted]

34. The next day, December 4, I reviewed an email that Nourry sent to Jeff Bezos, telling him that the Hachette board had met and that his team would be in touch with the Amazon Kindle team about the decisions that had been made; he invited Jeff to contact him if he thought it would be helpful. Jeff responded that weekend that he would be interested in getting together to discuss matters "before any decisions are finalized or positions become hardened." Nourry responded that it made no sense to meet in person because he had the feeling that "Amazon's decision to price best sellers at 9$99 (*sic*) is a hard point for you." (AMZN-TXCID-0018798) I understood Nourry to mean that unless we were willing to raise prices, Hachette's decision to withhold digital versions of their new titles from us would stand.

35. The following week, Simon & Schuster announced it would delay release of the ebook versions of new hardcovers beginning in January 2010; a few days later, HarperCollins told the *Wall Street Journal* that it would be delaying five to ten new hardcover releases every month. Less than a week later, Macmillan announced that it also would delay digital versions of new releases for several months after the print release, unless the digital version had enhanced content (and would, presumably, sell for a higher price). Amazon told these publishers that delaying the release of ebooks was bad for consumers, authors and for them. Amazon was also opposed to raising its consumer prices to avoid windowing.

Five Large Publishers Simultaneously Demanded the Agency Model

36. In mid-January 2010, we learned that the big publishers were planning to move away from the traditional reseller model for ebooks and that Apple was apparently involved in

this move. This was a huge change in the way books in all formats had always been sold, and we saw nothing about the digital nature of ebooks that made the agency model more appropriate for them than the traditional wholesale model.

37. On January 18, my colleague Laura Porco reported that Madeline Macintosh, from Random House, told her that the other largest publishers were going to enter into deals with Apple that would allow the publishers to control prices, and that they would delay titles for any retailer that didn't go along with the new model. Madeline expressed concern that Random House would be the only one of the Big Six publishers not included in the Apple store. (AMZN-MDL-0160969 – 971)

38. That same evening, David Naggar forwarded an email from Michael Cader, of the trade publication *Publishers Lunch*, asking if we'd heard about a new "Apple and beyond" model for selling ebooks. (AMZN-MDL-0077424) The following day, *Publishers Lunch* ran a long and detailed article reporting that the six largest publishers all were negotiating terms with Apple, and that this gave publishers an opportunity to impose agency on the entire industry and raise prices.

39. We were very concerned about this news because it would mean higher prices for our customers, or, if we refused to go along with agency terms, ebooks from our major publishers wouldn't be available in the Kindle store. Either option would be a bad customer experience and could hurt the attractiveness of Kindle.

40. A few days later, David Naggar and I were in New York to meet with publishers. We met with Brian Murray at HarperCollins on January 20. During the meeting, Brian again expressed concern over our pricing practices, and raised the concept of agency. We made it very clear that we did not want to move to agency and strongly preferred to continue to do business on the wholesale model, and I recall that the meeting was somewhat contentious. I also met with John Sargent of Macmillan on January 20. John told me he was working on an agency model, but planned to offer both an agency and reseller model. [redacted]

[redacted]

41. The next day, January 21, I got a call on my cell phone from John Sargent while I was on Eighth Avenue in New York with David Naggar. John told me that he wasn't sure he'd be able to keep us on reseller terms after all, because he was about to sign a contract that required him to offer only the agency model. Based on everything we had heard and read in the last week, it was clear to me that he was talking about Apple.

42. On January 22, Brian Murray sent an email outlining HarperCollins' proposed agency terms. (AMZN-MDL-035986 – 987) That same day, I got a call from Carolyn Reidy of Simon & Schuster, who told me that they were planning to move their entire business to agency terms. Again, I was clear in telling her that we did not want to move to agency terms.

43. The next Wednesday, January 27, Apple held an event to announce the iPad. During that event, Steve Jobs revealed that five of the largest publishers would all be in the iBookstore. Immediately afterwards, Jobs told an interviewer that ebook prices would be the same for all retailers, and that the publishers were withholding books from Amazon because they didn't like our pricing. (AMZN-MDL-0142728) Immediately following the Apple announcement, John Makinson of Penguin called to tell me that they had moved to agency with their first customer (from the timing, that was clearly Apple), and that he wanted to discuss agency with us when they visited in mid-February. I told John I did not understand why they were working so hard to have us send them less money on each sale while at the same time, reducing total sales and frustrating us. That same day, Brian Murray of HarperCollins wrote to tell me that they had decided to move their new releases to an agency model, and that they had reached an agreement with Apple the night before. (AMZN-MDL-0035988)

44. My team started preparing a document that summarized Amazon's communications with publishers to date on or about January 27, 2010. (AMZN-MDL-0161084 – 087) I reviewed and edited that draft the following day, prior to our meeting with Macmillan (described below). (AMZN-MDL-0161098 – 103) My edits were intended to focus the

publisher update section on the current status of discussions; I did not believe the information in the earlier version was inaccurate.

45. On January 28, John Sargent and Brian Napack of Macmillan came to Seattle to meet with us and John delivered an ultimatum: we would either move to agency terms with them, or they would withhold Kindle versions of all new releases for seven months. We clearly expressed our view that this was a terrible move for them, for customers, and for authors; it made no sense for them economically. John was not open to discussing the option of staying on reseller terms with us, so the meeting was cut short. Later that night, we decided to stop selling Macmillan titles – both print and Kindle – in an attempt to convince them to reconsider their position.

46. By that time it had been made clear to us by Simon and Harper and Macmillan and Hachette and Penguin that they were all going to require us to move to agency. And because we faced having to make that change with all of them simultaneously, we tried with Macmillan, who was the first to give us a hard ultimatum, to see if we could get them to relent. But that weekend, as we looked over all of the communications from publishers and assessed the situation, it became obvious that the odds of that strategy working were very, very low, and it was highly likely that we would lose ebooks from those publishers unless we moved to agency with all of them. If it had been only Macmillan demanding agency, we would not have negotiated an agency contract with them. But having heard the same demand for agency terms coming from all the publishers in such close proximity, Amazon was concerned that the publishers were acting illegally. In response, Amazon's lawyers drafted a letter to the FTC describing the situation, a letter I contributed to and reviewed. [redacted]

Agency Negotiations

47. Much as we disagreed with the publishers' decision to move to agency and wanted to forestall it, we could not have new titles from five of our biggest publishers unavailable to our customers, so we really had no choice but to negotiate the best agency contracts we could with these five publishers.

48. It was already clear from our conversations with publishers and their public statements that the publishers were going to raise prices. And, given the apparent coordination among the publishers and our sense that we were the target of their efforts, we were concerned about retaliation that would make things even worse for Kindle customers. Several of the publishers were quite public in expressing their displeasure with the success of Kindle and their desire to slow down both the transition to digital and the success of Kindle. Several of them said as much openly in the press. So we were worried that if this move to agency didn't give them the results they were seeking, we could reasonably expect additional changes that would have been much more directly discriminatory against us relative to other agents. We didn't want to be in a position where publishers could threaten to withhold selection, charge higher prices for items sold on the Amazon platform, or offer reseller terms to another retailer without offering reseller terms to Amazon, which would have resulted in Kindle customers having a worse experience than other ebook buyers.

49. To avoid these problems, we negotiated to include certain parity provisions in the agency contracts. There were price parity provisions to protect us against publishers giving higher prices to us than to other agents, and business model parity so that if a publisher offered a reseller relationship with another retailer, they would have to go back to reseller with us. We also insisted on selection parity, so that publishers couldn't withhold titles from Amazon and our customers would be able to find all the books they wanted in the Kindle store. This was especially important in light of the fact that across-the-board windowing of new titles was the leverage some of the publishers had tried to use to influence us in the past.

50. After we negotiated agency contracts with Macmillan, HarperCollins, Hachette and Simon & Schuster, we worked to reach an agreement with Penguin, even though their contract with us could not be terminated for another few months. Penguin had been as clear as the others that our only option for a new agreement with them would be one on agency terms. They stopped adding new books to the Kindle store starting April 1, 2010, so every new Penguin release was in other ebook stores but was not available for Kindle customers. It was clear that

delaying negotiations with Penguin would gain us nothing, and cause a great deal of pain in the meantime in the form of lost sales and unhappy customers. We had no choice but to negotiate early with Penguin.

Effects on Consumers

51. After agency, consumers saw an immediate double-digit percentage price increase on ebooks pretty much across the board. The higher prices appeared not only on best-selling ebooks, but even on backlist titles. [redacted] And I think one of the effects was that when you looked at the bestseller list, it started to tilt toward lower priced ebooks after agency, which is what you'd expect the market to do in the face of significant price increases on some meaningful segment of the catalog. So, it's very deceiving to look just at best-selling books during some period after agency, because consumer choices were being made in the context of what they were presented with. But if you actually look at best-selling books from *these publishers* and the prices before and after on Amazon, that will tell you a very clear story about what happened.

52. We put a statement on our website page for each agency title that said, "This price was set by the publisher." We did this for two reasons. First, we thought consumers had a right to understand, particularly in those cases where you'd see illogical things like a digital book having a higher price than a print book, what was going on. We wanted to make it clear that this wasn't our choice (though, unfortunately, many customers still blamed us for the higher prices). Second, the publisher was now the seller of record (which has specific tax and other implications), and we wanted to make that clear.

53. [redacted]

[redacted]

54. The prices under agency were not only higher than they had been under the traditional wholesale model; they often were downright nonsensical. In many cases, the agency price set by the publisher for a digital book was several dollars more than for the print book. This included current bestsellers (AMZN-MDL-0142151) but older books were also affected. For example I recall that Penguin raised the digital price of *Atlas Shrugged* by Ayn Rand to something like $19 or $20 – the paperback sold for under $10.

55. Prices also rarely changed after agency. Amazon, by contrast, has invested significantly in developing thoughtful and sophisticated algorithms about how to price and when to move prices up or down, which we do dynamically all the time on the site, not just for books. It was clear that the publishers had done nothing to develop systems for setting prices. I was surprised and disappointed by the lack of sophistication that they brought to the pricing question.

56. Agency also limited innovation and promotional options – we were unable to attempt even standard retail approaches like points systems or "buy one get one" offers – [redacted]. One particular example is the Kindle Owners' Lending Library. We did eventually launch that program, which allows Amazon Prime members to borrow up to one book a month free of charge. But there weren't any agency titles in the program, despite having made significant financial offers to the publishers to include their books, and, after launch, we showed them data about the benefits to them and their authors of participation, but they refused.

I declare under penalty of perjury that the foregoing is true and correct.

EXECUTED on April 24, 2013.

Russell C. Grandinetti