



July 29, 2019

Makan Delrahim
Assistant Attorney General
Antitrust Division
Department of Justice
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Ste. 3109
Washington, D.C. 20530

Dear Assistant Attorney General Delrahim:

We write to urge the Department of Justice to block the proposed merger between Cengage and McGraw-Hill, the second and third largest publishers in the college textbook marketplace. The proposed merger would create a company worth approximately \$5 billion, dwarfing all but one competitor,¹ and likely would lessen competition in the textbook marketplace. It would harm students through higher prices, diminished choice, and reduced value. And it would harm scholars, authors, and editors by restricting the purchasing market for new educational materials.

The textbook industry, once a robust market with a multitude of competing publishers, is now dominated by a handful of giants. Starting in the mid-1970s, a push toward standardization of course materials, combined with a growing interest in more visual content in academic texts, triggered a fundamental shift in the college textbook industry.² Textbooks became more colorful, more frequently updated, and more expensive. The Bureau of Labor Statistics' Consumer Price Index shows that the price of textbooks has increased a staggering 1,041% since 1977 – annually, three times faster than inflation – due in large part to publisher efforts to eliminate the used book market.³ Our research shows that 65% of students have skipped buying a book at some point in their college career because of cost despite 94% of them knowing it would hurt their grade.⁴

Now, about 20 years into the digital age, the problems of the college textbook industry are poised to become much worse as the industry shifts toward a digital-centric model. This letter explains why the proposed merger – between two leading publishers eager to eliminate the secondary market for print textbooks and dominate the emerging digital textbook market – threatens the interest of students and academic authors and should be blocked by the Justice Department in court.

The merging parties have pledged to eliminate the secondary textbook market which students rely on for affordable materials.

¹ Cara Lombardo, *McGraw-Hill to Merge with Rival Textbook Publisher*, Wall Street Journal (May 1, 2019), <https://www.wsj.com/articles/mcgraw-hill-cengage-plan-all-stock-merger-11556683590>.

² Ernie Smith, *A Brief History of the College Textbook Pricing Racket*, Atlas Obscura (Aug. 29, 2016), <https://www.atlasobscura.com/articles/a-brief-history-of-the-college-textbook-pricing-racket>.

³ U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: Educational books and supplies [CUSR0000SEEA], retrieved from FRED, Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/CUSR0000SEEA>, July 16, 2019.

⁴ Ethan Senack, U.S. Public Interest Research Group, *Fixing the Broken Textbook Market: How Students Respond to High Textbook Costs and Demand Alternatives* (2014), <https://uspirg.org/sites/pirg/files/reports/NATIONAL%20Fixing%20Broken%20Textbooks%20Report1.pdf>.

Traditionally, Cengage and McGraw-Hill (and their peer companies) have viewed the textbook resale market as a threat to their revenues and have employed a variety of tactics to restrict it. For instance, publishers generally push textbook writers to issue new editions approximately every three years.⁵ Oftentimes, these “revised” editions could have edits as simple as swapping the order of chapters or replacing images within the text. Publishers also approach individual faculty to create “custom” editions for a class, containing similarly superficial revisions. Companies even reduce the physical shelf life of used textbooks, by releasing some titles as paperback or loose-leaf versions (which degrade more quickly than hardcover books).

While these strategies have resulted in a print textbook market characterized by unnecessary – and frequent and expensive – new editions, within the last decade publishers have turned to the digital space in hopes of eliminating the secondary market for college textbook materials. To that end, both Cengage and McGraw-Hill have pledged to transform themselves from traditional print textbook publishers to digital software and content providers, accelerating a trend currently playing out across the higher education textbook industry. Cengage CEO Michael Hansen, speaking to the strategy underlying his company’s digital-first focus, noted that his company hopes to “[recapture] students who have been using our materials but have not given us any revenue...These are students that are buying a used book from another student. No revenue for us.”⁶ Cengage isn’t the only publisher intent on eliminating the secondary market. Just last week, industry leader Pearson announced that from now on, students would only be able to rent – not own – physical textbooks.⁷

A shift to the digital medium allows Cengage and McGraw-Hill to pursue strategies to rapidly eliminate the secondary market for print textbooks.

Cengage and McGraw-Hill, among others, have used the digital medium to limit the secondary market in a way that would not be possible in the traditional print market. In particular, the companies have advanced the use of access codes, automatic billing, and subscription plans to almost completely eliminate the used textbook market. These practices only deepen the problems that have led to skyrocketing textbook prices over the past four decades.

An access code is a semester-long expiring login to a proprietary online platform containing supplemental materials like homework, as well as e-textbooks, study aids, and even exams. Because students are required to purchase an access code to submit homework and cannot retain and resell the code at the end of the course, they cannot recoup any of the cost of the code and may end up spending more in the long run for course materials.⁸ Fundamentally, the use of access codes – an expiring product – eliminates the used materials market, leaving the publisher as the sole provider of course content. As Cengage CEO Michael Hansen said, the used book

⁵ Kate Rube, State Public Interest Research Groups, *Ripoff 101: 2nd Ed.*, at 1 (2005), https://www.immagic.com/eLibrary/ARCHIVES/GENERAL/ST_PIRGS/C050201F.pdf.

⁶ Tony Wan, *In Move to ‘Unlimited’ Pricing Model, Cengage Hopes for a Comeback*, EdSurge (Apr. 24, 2018), <https://www.edsurge.com/news/2018-04-24-in-move-to-unlimited-pricing-model-cengage-hopes-for-a-comeback>.

⁷ *Education Publisher Pearson to Phase Out Print Textbooks*, BBC News (July 16th, 2019), <https://www.bbc.com/news/business-48998789>.

⁸ Ethan Senack et. al., U.S. Public Interest Research Group, *Access Denied: The New Face of the Textbook Monopoly* (2016), <https://uspig.org/reports/usp/access-denied-new-face-textbook-monopoly-0>.

market is “a market that should fall by the wayside if we do our job the right way.”⁹ All major publishers have adopted access codes in their offerings.

Automatic billing – also known as “inclusive access,” – merely expands the use of access codes and other expiring digital products by billing students via an opt-out fee on their tuition bill. Students often do not realize that they are subject to such arrangements. According to a recent lawsuit,¹⁰ one campus bookstore displayed certain digital materials as “free” – when in reality, participating students had, in many instances unknowingly, already paid for them via an automatic fee on their tuition.

This practice means that students cannot shop around and find the best price on course materials. Based on conversations with industry observers and participants, some contracts for automatic billing programs include an almost six percent *annual* price increase (ensuring the price of books increases much faster than inflation), and student opt-out rates for automatic billing programs are estimated at around one percent today – an abysmally low figure. Automatic billing mechanisms lock students into buying from a single approved vendor: the school itself. All three of the major publishers, including Cengage and McGraw-Hill, have established automatic billing programs.

The third strategy to limit the secondary market and students’ ability to shop for the best prices is a subscription service called “Cengage Unlimited.” It is a “Netflix-style” subscription to Cengage’s entire catalog of access codes and e-textbooks, bundled with a set of ancillary study tools. Many members of the higher-ed community have expressed serious concerns with this model. Using such “Netflix-style” platforms, publishers can replace straightforward sales of hard-copy learning materials with digital “licenses” that restrict sharing and re-sale.

In light of the unique features of the digital textbook medium, the Justice Department’s longstanding distinction between used and new materials is even more relevant to this proposed merger.

Recognizing the tactics employed by textbook publishers to marginalize the secondary market, the Justice Department has consistently held the view that used textbooks are not a reasonable alternative to new textbooks. First, in *United States v. Pearson P.L.C.*, 55 F. Supp. 2d 43 (D.D.C. 1999), the Justice Department remedied Pearson’s acquisition of Viacom’s education, professional, and reference publishing business. In its complaint, the Department noted that “[t]extbooks are generally revised every three to four years, and professors usually require use of the newest edition. This limits the ability of used textbooks to compete with new texts. Supply of used textbooks is also limited by the number of students that sell their textbooks back to college bookstores. Used textbooks cannot defeat an increase in the price of new textbooks or a decrease in the supply of the ancillary materials included or sold with them.”¹¹

A few years later, in *United States v. Thomson Corp.*, 2001 U.S. Dist. LEXIS 27383 (D.D.C. 2001), the government remedied Thomson’s acquisition of the college textbook publishing and computer-based testing businesses of Harcourt General from Reed Elsevier Inc. The government

⁹ Carl Straumsheim, *Cengage Surfaces*, Inside Higher Ed (Apr. 2, 2014),

<https://www.insidehighered.com/news/2014/04/02/cengage-learning-emerges-bankruptcy-focus-digital-growth>.

¹⁰ Paul Bowers, *Textbook ‘Scam’ Alleged in Federal Lawsuit Against SC’s Biggest Technical College*, The Post and Courier (Feb. 1, 2019), https://www.postandcourier.com/news/textbook-scam-alleged-in-federal-lawsuit-against-sc-s-biggest/article_d266c94a-262e-11e9-a6dd-ab6ac37fa3d1.html.

¹¹ Complaint at 9, *United States v. Pearson P.L.C.*, 55 F. Supp. 2d 43 (D.D.C. 1999).

took the same position as it had in *Pearson* on the lack of substitutability between used and new textbooks.¹² And most recently, in *United States v. Cengage Learning Holdings I, L.P.*, 2008 U.S. Dist. LEXIS 106356 (D.D.C. 2008), the Justice Department obtained divestitures in Cengage’s acquisition of Houghton-Mifflin College Division, making the same argument as it had in *Pearson* and *Thompson*, and noting in particular that “revised textbooks often differ substantially from their prior edition.”¹³

As publishers shift from hardcopy to digital materials, the Justice Department’s traditional distinction between new and used materials is further accentuated. Features like automatic billing and inclusive access, as discussed previously, mean that the difference between digital textbook products and traditional hardcopy materials is far greater than that between successive editions of a print textbook. Digital “textbooks” are not just textbooks; they are also assessment, analytics, and adaptive learning platforms that could not exist outside the digital medium. These features render them qualitatively different from traditional print textbooks and compel a market definition that excludes secondhand materials.

Within the market for new materials, Cengage and McGraw-Hill are two of the leading companies in an already extremely concentrated space.

Only five companies currently control 80 percent of the U.S. college textbook market:¹⁴ Pearson, Cengage, McGraw-Hill, Macmillan, and Wiley. The remaining 20 percent of the market is divided among smaller independent and university presses that produce lower-run volumes for more specialized classes.

The proposed merger is unlawful under long-standing antitrust law. Section 7 of the Clayton Antitrust Act forbids any merger or acquisition “where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”¹⁵ Supreme Court and lower court precedents have made clear that the government has to show only a reasonable probability, not certainty, that competitive harm will result from a combination.¹⁶ The Department of Justice and Federal Trade Commission’s joint 2010 Horizontal Merger Guidelines state, “The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market.”¹⁷

The evidence clearly shows that the merged entity’s market share in the relevant market – new higher education textbooks and digital learning products – should be presumed to produce competitive harm and is accordingly illegal. Cengage CEO Hansen has stated that his company’s US higher education market share, reported in 2018 as \$790 million, is “slightly north of 20 percent.”¹⁸ McGraw-Hill’s self-reported market share for the fiscal year ending in 2018 is 21

¹² Complaint, *United States v. Thomson Corp.*, 2001 U.S. Dist. LEXIS 27383 (D.D.C. 2001).

¹³ Complaint at 5, *United States v. Cengage Learning Holdings I, L.P.*, 2008 U.S. Dist. LEXIS 106356.

¹⁴ Senack, U.S. Public Interest Research Group, *Fixing the Broken Textbook Market*.

¹⁵ Clayton Antitrust Act of 1914 § 7, 15 U.S.C. § 18 (1914).

¹⁶ *Brown Shoe Co. v. United States*, 370 U.S. 294, 317 (1962); *United States v. Penn-Olin Chemical. Co.*, 378 U.S. 158, 171 (1964); *United States v. Von’s Grocery Co.*, 384 U.S. 270, 285 (1966); *United States v. Dairy Farmers of America, Inc.*, 426 F.3d 850, 858 (6th Cir. 2005); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Circ. 2011).

¹⁷ U.S. Department of Justice, *Horizontal Merger Guidelines*, 30 n.14 (Aug. 19, 2010).

¹⁸ Wan, *In Move to ‘Unlimited’ Pricing Model, Cengage Hopes for a Comeback*, EdSurge.

percent.¹⁹ In *United States. v. Philadelphia National Bank*, 374 U.S. 321 (1963), the Supreme Court ruled that a merger which results in an entity controlling at least 30 percent of a defined market is presumed to be violative of the Clayton Act.²⁰ The combined entity would control at least 40 percent of the U.S. higher education textbook market and exceeds that threshold.

The Herfindahl-Hirschman Index (HHI), a commonly used measure of market concentration and a key analytical tool in the Horizontal Merger Guidelines,²¹ points to the same conclusion. An estimate of the HHI for this market – under assumptions *most favorable* to Cengage and McGraw-Hill – makes clear that the proposed merger demands closer scrutiny, if not outright prohibition. We take as inputs the following conservative market share figures for the three leading competitors in the higher education textbook industry:

Pearson:	41% ²²
Cengage:	20%
McGraw-Hill:	21%

Based on these figures and ignoring other competitors in the industry (Macmillan Inc. and smaller specialty publishers), the lowest possible pre-merger HHI is approximately 2520. The 2010 Horizontal Merger Guidelines state explicitly that an industry with an HHI above 2500 is “highly concentrated.”²³ Note that this HHI does not include the market shares of Wiley, MacMillan, or any other publisher accounting for the rest of the roughly 20 percent of the market. The HHI for the textbook publishing market is almost certainly higher than 2520.

The post-merger HHI would be significantly higher and trigger the presumption of illegality established in the Horizontal Merger Guidelines. The combined Cengage-McGraw entity would control 41 percent of the market. With all other assumptions unchanged, the lowest possible post-merger HHI would be approximately 3360—840 points higher than before the merger. The Horizontal Merger Guidelines state that “[mergers] resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be *presumed* to be likely to enhance market power. The presumption may be rebutted by *persuasive evidence* showing that the merger is unlikely to enhance market power.”²³ (Emphasis added).

Even with the most favorable assumptions, the evidence clearly shows that this industry is highly concentrated, and the proposed merger threatens to increase that concentration significantly. By the government’s own guidelines, the burden shifts to Cengage and McGraw-Hill to furnish “persuasive evidence” that their merger is unlikely to enhance market power.

¹⁹ McGraw-Hill Educ., Inc., *Annual Report* (2018), https://s22.q4cdn.com/942918855/files/doc_financials/annual/2018/MHE-2018.12.31-Annual-Report_FINAL.pdf.

²⁰ See also: *Polypore Int’l Inc. v. FTC*, 686 F.3d 1208 (11th Cir. 2012), which shows that enforcers and courts continue to recognize the *Philadelphia National Bank* structural presumption for horizontal mergers; Peter C. Carstensen, *The Philadelphia National Bank Presumption: Merger Analysis in an Unpredictable World*, 80 *Antitrust L.J.* 80, 251 (2015).

²¹ The HHI ranges from 0 in markets with no concentration to 10,000 in markets with pure monopoly.

²² Pearson 2018 Preliminary Results p., Pearson P.L.C. (Feb. 22, 2019), <https://www.pearson.com/content/dam/one-dot-com/one-dot-com/global/Files/news/news-announcements/2019/2018-Prelim-Results-Press-Release-financials-20190222.pdf>.

²³ U.S. Department of Justice, *Horizontal Merger Guidelines*, at 19 (Aug. 19, 2010).

This proposed merger would harm more than just colleges and universities.

While the proposed merger would expand the catalog of titles covered under Cengage’s Unlimited model by including all of McGraw-Hill’s content, it would also harm the academics and researchers who write textbooks and the editorial professionals who support them. A combined Cengage and McGraw-Hill would deprive the market of one major publisher of textbooks and purchaser of authors’ and editors’ services.

The merged company would likely exert greater downward pressure on the number of new titles published each year, accelerating what is already a serious problem in the industry. This is in large part because industry observers note that Cengage management, as part of its shift to digital, is “more selective now than in the past” about signing new textbook authors.²⁴ And at McGraw-Hill, there has been a “general decline” in the number of new products, compared to ten years ago.²⁴ At the same time, academics who author educational materials are now asked to take on additional roles such as developing supplemental graphics and assessing peers’ content.²⁴ Authors now have fewer opportunities to publish new titles, and when they are able to sign a contract to write and publish a new textbook, they have to do significantly more than just provide the text itself. The bargaining power of a combined Cengage-McGraw-Hill would likely make these problems even worse.

This merger would also exacerbate the risk of theft or abuse of student data.

Publishers like Cengage and McGraw-Hill argue that their digital learning products (also known as “courseware”) will allow universities to better serve student needs by aggregating student data on performance. This ultimately means that students are inadvertently paying for course materials with their personal performance data.²⁵ Because students may have no choice but to purchase the digital subscription, they are functionally coerced into accepting the publishers’ data usage policies. Even if publishers claim to employ restrictive data usage policies that ensure student privacy, it is relatively common in digital product contracts for terms of use to change retroactively without the informed consent of customers. As publishers seek to increase revenues, they will be tempted to monetize the vast amount of student data they collect. Additionally, this collection of sensitive data on individual students may be highly vulnerable to breach or cyber-attack. To the extent publishers are permitted to collect student data, the data should not be concentrated in just a few publishers’ hands.

The Department of Justice should block this merger.

The proposed merger between Cengage and McGraw-Hill would combine the second and third-largest competitors in the higher education textbook market into a single entity. This company would control approximately 40 percent of the market – large enough to trigger a presumption of illegality under Section 7 of the Clayton Act. Moreover, the merger threatens to exacerbate the problem of runaway textbook prices by (a) eliminating the used book market and (b) making it more difficult for educational institutions to compare, select, and change materials as they see fit. Students, many of whom lack financial means and are effectively captive customers, would

²⁴ Lindsay McKenzie, *Shifting Focus of Publishers Signals Tough Times for Textbook Authors*, Inside Higher Ed (Dec. 12, 2018), <https://www.insidehighered.com/news/2018/12/12/switch-digital-first-products-publishers-are-signing-fewer-textbook-authors>.

²⁵ Landscape Analysis, Scholarly Publishing and Academic Research Coalition (Mar. 28, 2019), <https://sparcopen.org/our-work/landscape-analysis/>.



inevitably suffer – both from the increased cost of course materials and from the coerced extraction of personal data. We strongly urge the Department of Justice to block this merger.

Sincerely,

Open Markets Institute
U.S. Public Interest Research Group Education Fund
Economic Policy Institute
Institute for Local Self-Reliance
Open MIC (Open Media and Information Companies Initiative)
Public Citizen
Public Knowledge
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