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

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| THE STATE OF TEXAS,<br><br>Plaintiffs,<br><br>v.<br><br>PENGUIN GROUP (USA), INC., et al.,<br><br>Defendants. | : | 12-CV-03394 (DLC) |
| IN RE ELECTRONIC BOOKS ANTITRUST LITIGATION | : | 11-MD-02293 (DLC) |
| This Document Relates to:<br><br>ALL ACTIONS | : | |

**DEFENDANT APPLE INC.'S MEMORANDUM OF LAW IN OPPOSITION TO CLASS PLAINTIFFS' MOTION TO EXCLUDE EXPERT OPINIONS OFFERED BY DR. JOSEPH KALT**

**CONTAINS MATERIAL DESIGNATED AS HIGHLY CONFIDENTIAL PER PROTECTIVE ORDER**

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## PRELIMINARY STATEMENT

Plaintiffs' expert, Dr. Roger Noll, proffered two damages models—both of which were engineered to demonstrate common impact across e-book purchasers. Apple's expert, Dr. Joseph Kalt, explains the "fundamental methodological" errors in Dr. Noll's analysis and sets forth the uncontroverted economic data revealing that e-book prices across consumers' purchases are subject to "pervasive dispersion and 'churning' (i.e., prices moving up and down both absolutely and relatively)." Declaration of Joseph P. Kalt, Ph.D. ("Kalt Decl.") ¶ 12. Dr. Kalt's analysis finds that Dr. Noll's model is demonstratively unreliable because it was specified to find injury for virtually all putative class members on individual purchases regardless of whether such injury actually exists. Accordingly, as Dr. Kalt concludes, "Prof. Noll's analysis does not demonstrate that common proof shows that anticompetitive harm (injury) has been suffered by virtually all consumers or that damages to individual consumers can be calculated by a method that is common." *Id.* ¶ 17. Dr. Kalt further finds that "Prof. Noll's methodology and conclusions (whether related to injury or damage, individual or aggregate) are speculative, unreliable, or otherwise unreasonable as a matter of economics." *Id*.

Class Plaintiffs seek to exclude Dr. Kalt's opinion "in its entirety."[1] Memorandum of Law ISO Class Plaintiffs' Motion to Exclude Opinions Offered by Dr. Joseph Kalt ("Pls'

[1] Dr. Kalt has also offered an opinion in the State Action. *See* Declaration of Joseph P. Kalt filed in opposition to Statement of Damages. No. 12-cv-03394, Dkt. 367 ¶ 11 ("I have also been asked to assess the implications of my analyses for the fact and magnitude of claimed antitrust injury and damage in the aggregate and individually to the consumers of e-books represented in this litigation by the putative class and the litigating state jurisdictions."). State Plaintiffs have filed a response to Class Plaintiffs' motion to exclude Dr. Kalt's opinion, in which they join Class Plaintiffs' arguments to exclude Dr. Kalt's opinion. *See* Dkt. 494. Accordingly, Apple has filed this opposition brief in both the Class Plaintiffs' and State Plaintiffs' actions. The only issue before the Court is whether to certify the proposed class under Federal Rule of Civil Procedure 23, however, and thus the States' motion is premature. And to the extent that the Class Plaintiffs' motion addresses issues beyond class certification, it too is premature.

Mem.") at 3. But notably absent from their motion is any attack on Dr. Kalt's central critique of Dr. Noll's methodology—*i.e.*, that Dr. Noll assumes what needs to be proved with respect to class-wide injury. Plaintiffs have offered no reason why Dr. Kalt's opinions regarding the flaws in Dr. Noll's methodology should be excluded.

In fact, despite the sweeping scope of the relief sought (and the overblown rhetoric in Plaintiffs' motion), Plaintiffs admit that their quibbles with Dr. Kalt's report go to "subsidiary opinions." Pls' Mem. at 2. Plaintiffs' complaints are, in any event, minor and flawed. *First*, contrary to Plaintiffs' accusations, Dr. Kalt does not confuse pre-agency prices with post-agency prices. Under the agency agreements, a publisher's ability to set prices with agency retailers was limited by the pricing practices of retailers still on the wholesale model. Dr. Kalt therefore appropriately used the date that a publisher moved its *last* active retailer to agency as the dividing line between pre-agency and post-agency pricing. This was a principled and economically sound decision.

*Second*, Plaintiffs' contention that Dr. Kalt lacks "any understanding of how e-book prices are set" is false (and puzzling in view of their own damages analysis and their own expert's repeated disavowal of any understanding of how e-book prices were set in the pre- and post- agency periods). Pls' Mem. at 1. Plaintiffs, who bear the burden of proving damages and establishing that the requirements of Rule 23 have been satisfied, did not rely on the existence of a pricing structure in their motion for class certification, nor is Dr. Noll's damages analysis predicated on the existence of a pricing structure employed by retailers or publishers. Dr. Kalt examined the prices that the publishers *actually* set, which necessarily reflect the pricing practices and policies of market participants. Plaintiffs' claim that Dr. Kalt should have focused

on the publishers' internal "formulas" for setting prices rather than on actual prices is itself "obfuscation" (Pls' Mem. at 1, 9) and makes no sense as an economic matter.

*Third*, Dr. Kalt's opinion that Dr. Noll's analysis yields millions of false positives is reliable. Dr. Kalt reaches this conclusion by comparing the prices at which transactions actually occurred to the "but for" prices from Prof. Noll's own model.

*Fourth*, Dr. Kalt properly based his opinions on modal pricing. Plaintiffs' argument—that modal pricing is unreliable because "outliers" skew the results—has no basis in the data; over 99% of transactions for Publisher Defendants' e-books occurred at the relevant title's daily modal price. *See* Sur-Reply Declaration of Joseph P. Kalt, Ph.D ("Kalt Sur-Reply Decl.") ¶ 76, filed concurrently herewith. Indeed, Plaintiffs' theory at trial was that the alleged conspiracy destroyed the industry-standard—*i.e., modal*—$9.99 price point.

*Fifth*, Dr. Kalt's opinions are legally relevant because they squarely address the question of whether injury and damages can be proved on a class-wide basis through common proof—the very question the Court must now decide.

*Sixth*, Dr. Kalt's opinions about offsetting benefits are admissible for the same reasons set forth in Apple's brief opposing Plaintiffs' motion to exclude Jonathan Orszag's opinions. *See* Memorandum in Opposition to Plaintiffs' Motions to Exclude Opinions of Jonathan Orszag ("Orszag Opp."), filed concurrently herewith.

Dr. Kalt's opinions are reliable and relevant. This Court should admit them.

## ARGUMENT

Under Rule 702 of the Federal Rules of Evidence and *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993), trial courts are gatekeepers responsible for "ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand." *Id.* at 597. The Court "is to make certain that an expert . . . employs in the courtroom the same level

of intellectual rigor that characterizes the practice of an expert in the relevant field." *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 152 (1999). There must be a "fit" to be admissible, meaning the expert's testimony must be "sufficiently tied to the facts of the case that it will aid the jury in resolving a factual dispute." *Daubert*, 509 U.S. at 591 (quoting *United States v. Downing*, 753 F.2d 1224, 1242 (3d Cir. 1985)).

Dr. Kalt's opinion easily satisfies Rule 702 and *Daubert*'s strict standard. His opinions are tied to the facts and law applicable to this case, and he employed the same level of intellectual rigor that characterizes the practice of an expert economist. Further, his opinion is the product of reliable economic principles and methods. Accordingly, his expert opinion should not be excluded.

## I. Dr. Kalt's Critique Of Dr. Noll's Use Of Average Pricing Is Valid And Un-Rebutted

Dr. Noll's methodology for calculating common impact is hopelessly flawed because he assumes the very thing he purports to prove—that all e-book prices within a certain category behave the same way. *See* Kalt Decl. ¶¶ 106-140. Plaintiffs do not rebut this portion of Dr. Kalt's declaration, and Dr. Noll fails to respond to Dr. Kalt's criticism.[2]

In his original declaration and during his deposition, Dr. Noll claimed to have calculated "[d]amages for each sale of each e-book title in each period" by subtracting his "predicted, but-for price" for a given title from that title's actual price during the given time period. Corrected Declaration of Roger Noll, ("Noll Decl.") at 6. That is not what he did, however, and Dr. Noll admits in his Reply Report that he is *not* calculating damages for each sale of an e-book based on

[2] Dr. Noll's methodological failures are discussed in detail in Apple's motion to exclude Dr. Noll's opinions and its reply brief in support of that motion. *See* Dkt. 445 at 16-19; Reply ISO Apple's Motion to Exclude Opinions Offered by Dr. Roger Noll ISO Class Certification at 4-8, filed concurrently herewith.

individual but-for prices at all. Rather, as he now explains, his damages model calculates "*the average percentage mark-up* for ebooks in [one of his] categories" (Reply Declaration of Roger Noll ("Noll Reply Decl.") at 5)[3] and "[t]o implement the model for each customer, the damage associated with that transaction would be the *percentage overcharge* multiplied by the actual transaction price for that customer" (*id.* at 16 (emphasis added)). But Dr. Kalt explains the fatal flaw in this approach: "[I]n computing percentage overcharges, Prof. Noll's calculation imposes the requirement that all transaction in any one of his . . . groupings had the same percentage overcharge." Kalt Decl. ¶ 111; *see also* Noll Reply Decl. at 15-16 (acknowledging that he calculates damages by applying percentage overcharges within groups). In other words, Dr. Noll assumes the very thing that he sets out to prove—common impact. *See* Kalt Decl. ¶ 111.

Dr. Kalt substantiates this critique in a comprehensive mathematical appendix detailing the fundamental problem with assuming that the same overcharge applies to all transactions within a particular genre category. *See* Kalt Decl. A-3–A-6. As evidenced by Plaintiffs' silence in response to Dr. Kalt's analysis, its reasoning is unassailable. Plaintiffs do not even make passing reference to the appendix in their motion to exclude Dr. Kalt's opinions. Nor does Dr. Noll's Reply Report attempt to address the methodological errors described therein.[4] For that

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[3] Dr. Noll states that "[t]he percentage is calculated based on the differences in prices between each defendant publisher and publishers that did not adopt the agency model when price collusion began. These calculations take into account other characteristics of the transaction (best-seller status, publisher, physical copy editions, e-retailer, release date) and other factors taking place in the market." Noll Reply Decl. at 16. In other words, Dr. Noll assumes that all fiction non-best sellers published by Penguin and distributed by Amazon, for which hard copy and paperback editions are available, and have both been released for at least a year, exhibit the same pricing dynamics. Dr. Noll makes *no effort* to demonstrate that this assumption is supported by the *facts*.

[4] Dr. Noll claims that his model is now reliable because he has now "estimated the same damages model using one-week average prices and individual transactions prices." Noll Reply Decl. at 16. Not so. Dr. Noll's "new modeling and associated method of damage calculation

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reason alone, the Court should not exclude the opinions rendered in Section V of Dr. Kalt's declaration. *See* Kalt Decl. ¶¶ 106-140. Dr. Kalt's un-rebutted criticism of Dr. Noll's methodology will greatly aid the Court in determining whether injury and damages are susceptible to common proof and therefore whether a class should be certified.

## II. Dr. Kalt's Opinions Are Based On Sufficient Facts And Data

Dr. Kalt's opinions are based on actual e-book pricing data from the pre- and post-agency periods, as well as the economics of e-book pricing during the transitional phase from wholesale to agency pricing. Plaintiffs' contention that Dr. Kalt ignored evidence of a price structure that supposedly existed before and after the move to agency is false and little more than a transparent attempt to shift the focus away from the serious flaws in their own expert's analysis. Dr. Kalt's opinion that many putative class members were not injured as a result of the alleged conspiracy is consistent with the data.

### A. Dr. Kalt Did Not Improperly Designate Post-Agency Prices As Pre-Agency Prices

In evaluating e-books pricing data, Dr. Kalt found that "the majority of Publisher Defendants' titles' prices are in the category of 'fell or did not rise' upon the advent of agency marketing (taking the onset of agency to cover the first four weeks of agency for a publisher, and measuring changes relative to prices in the week prior to the advent of agency)." Kalt Decl.

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explicitly builds into their *ex ante* mathematical structure the *assumption* that each of the typically very large numbers of transactions in a given Noll grouping of e-book titles bore the same, single overcharge percentage as the group average percentage overcharge, and did so on every day of the damage period." Kalt Sur-Reply Decl. ¶ 4; *see also id.* ¶ 9 ("Prof. Noll has revealed no effort on his part to demonstrate that the group average percentage change in prices he asserts are due to the subject conduct are 'approximately the same' for all the titles within any of his groups.").

¶ 81. Specifically, he found that "60% of units sold within the four weeks after the shift to agency did not experience pricing above pre-agency levels." *Id.* And he found that approximately 25 million transactions in the two-year post-agency period occurred at or below pre-agency prices. Kalt Decl. Figures 20A-20E.

Plaintiffs contend that Dr. Kalt erred by using the date of the "move to agency with last retailer" as the relevant date for distinguishing pre-agency pricing from post-agency pricing. Pls' Mem. at 4-5. According to Plaintiffs, "Dr. Kalt has created so-called 'pre-agency' prices that are actually prices *set by Publisher Defendants after the move to the agency model*." *Id.* at 5. Plaintiffs assert that Dr. Kalt should have used the date on which a publisher moved its *first* retailer to agency as the dividing line for pre- and post-agency prices and that his failure to do so "massively overstated" and "distort[ed] on a massive scale" the number of sales at or below pre-agency prices. *Id.* at 4-6. They further claim that Dr. Kalt's misspecification of the pre- and post- agency periods "leads to an egregious overestimate for the entire conspiracy" and that "when corrected" the number of transactions below pre-agency prices "fall[s] from approximately 25 million to approximately 7.8 million." *Id*. at 7.

Plaintiffs' hyperbolic argument is much ado about nothing, and their "corrections" are misleading sleight of hand. Dr. Kalt made appropriate adjustments to his calculations to test the effect of the two specific (and minor) issues identified by Plaintiffs and Dr. Noll. These adjustments resulted in only slight changes to Dr. Kalt's conclusions: The total number of post-agency transactions occurring at or below pre-agency prices dropped from 25 million to 23.5 million, *not to* 7.8 million as Dr. Noll claims. Kalt Sur-Reply Decl. ¶ 69, Figure 15A.

In his initial report, Dr. Kalt explained that he used April 19, 2010, as the start of agency pricing for Simon & Schuster because it did not move to agency with Sony until that date.

Plaintiffs and Dr. Noll point to evidence that Simon & Schuster withheld its titles from Sony as of April 3, 2010 (*see* Pls' Mem. at 5; Noll Reply Decl. at 30 (citing SEL-R-00014849 and SEL-R-00049758)) and posit that it was therefore error to include its sales from the two-week period between April 3, 2010, and April 18, 2010, in the "pre-agency" period. Pls' Mem. at 5-7. Plaintiffs also point to evidence indicating that Penguin withheld certain new release titles introduced after April 1, 2010, from Amazon until it signed an agency agreement with Amazon on May 27, 2010. Pls' Mem. at 5; Noll Reply Decl. at 30.

Dr. Kalt adjusted the start of agency pricing for Simon & Schuster from April 19, 2010, to April 3, 2010. *See* Kalt Sur-Reply Decl. ¶ 68, Figure 13. He also adjusted the beginning of agency pricing for certain Penguin new release titles that were not sold by Amazon to April 3, but he properly held the agency onset date for all other Penguin titles at May 28. *Id.* Taking the date the last active retailer adopted agency marketing for each Publisher Defendant, including the noted changes for Simon & Schuster and Penguin, and excluding e-books that experienced the introduction of a paperback, Dr. Kalt again found that "the 'fell or did not rise' category applies in the first four weeks of agency marketing to over 60% of transactions, amounting to over 1.5 million transactions." Kalt Sur-Reply Decl. ¶ 71, Figure 13. And, as noted, he found that 23.5 million transactions over the two-year post-agency period occurred at or below pre-agency prices. *Id.* ¶ 69, Figure 15A. Thus, any error in Dr. Kalt's initial declaration is *de minimus* and does not detract from the validity of his overall opinion that Dr. Noll's methodology is unreliable.[5]

[5] Plaintiffs also argue that Dr. Gilbert's testimony that "more than 80% of agency sales were of titles for which the price increased after agency" is irreconcilable with Dr. Kalt's conclusions. Pls' Mem. at 4. The key differences between Dr. Kalt's calculations and Dr. Gilbert's calculations "lie in the treatment of the following issues: (1) the time periods examined and

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In any event, Plaintiffs' critique betrays a misapprehension of critical market dynamics. Their argument that "even for those backlist titles that Amazon was able to carry and price, it placed limited downward pressure on its agency competitors" is misplaced. Pls' Mem. at 6. The fact that Dr. Ashenfelter found that Penguin titles were on average more expensive at Apple and Barnes & Noble than at Amazon does not speak to what prices *would have been* at Apple and Barnes & Noble in Amazon's absence. *See* Pls' Mem. at 6. Dr. Ashenfelter admitted at trial that he did not attempt to calculate but-for prices (No. 12-cv-02826, Dkt. 312 at 1490:5-22), and thus his calculations do not measure the degree of downward price pressure Amazon placed on its rivals operating under agency agreements.

This market reality is most relevant with respect to Penguin's pricing. Although the iBooks Store launched on April 3, 2010, Penguin remained on a wholesale model with Amazon until May 28, 2010. *See United States v. Apple Inc.*, 2013 WL 3454986, at *34 (S.D.N.Y. July 10, 2013). Between April 3 and May 28, [redacted] Penguin titles were available on Amazon.com. Amazon—not Penguin—set the price of these titles. Kalt Sur-Reply Decl. ¶ 69. And, because of the retail price MFN, Penguin was obligated to match any lower Amazon prices for certain titles on the iBooks Store. It makes little sense to describe Penguin's prices during that period as "agency prices," particularly given that *Amazon set the price of* [redacted] *of Penguin's e-books sold* [redacted] while Penguin operated on a hybrid model. *Id.* ¶ 69. As both Dr. Gilbert, upon whose analysis Plaintiffs rely, and Dr. Kalt recognize, Penguin could not

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measurement of e-book prices; and (2) e-books that transacted at a price of zero." Kalt Sur-Reply Decl. ¶ 64. As Dr. Kalt explains, his calculations more accurately capture the dynamics of e-book pricing during this time period. *See id* ¶¶ 65-66.

engage in true "agency pricing" until it moved Amazon from wholesale to agency.[6] In the face of these economic realities, Dr. Kalt's analysis appropriately treats the date on which retail prices reflected Penguin's control (i.e., "agency prices") as the date the last retailer in the marketplace (Amazon) signed an agency agreement with Penguin.

Plaintiffs purport to have calculated the "actual number" of Penguin titles whose prices stayed the same or fell following the onset of agency as 1.8 million titles, using "genuinely pre-agency prices." Pls' Mem. at 6 (citing Noll Reply Decl. at 33). These calculations are, to use Plaintiffs' phrase, "distorted on a massive scale" (*id.*) because "they treat *all* Penguin e-books as having been withheld from Amazon from April 1, 2010, through May 27, 2010, instead of only the universe of titles he asserts were withheld, i.e., Penguin e-books released [between April 1 and May 28, 2010]" (Kalt Sur-Reply Decl. ¶ 69). This confusion produces significant calculation errors.

First, it fails to consider that [redacted] Penguin titles remained under Amazon's pricing control until late May 2010. Kalt Sur-Reply Decl. ¶ 69. Ignoring this inconvenient fact, Dr. Noll uses March 25-31, 2010, as the pre-agency period for *all* Penguin e-books, (Noll Reply Decl. at 32-33), even though Amazon sold [redacted] on the wholesale model between April 1 and May 28, 2010 (Kalt Sur-Reply Decl. ¶ 69). This error severely distorts Dr. Noll's results because he compares post-agency transactions for these titles to irrelevant pre-agency prices.

[6] *See* Richman Decl., Ex I, Direct Testimony of Richard L. Gilbert, Ph.D. ¶ 147 ("Figure 4 shows that Penguin's weighted average e-book price increased significantly around May 28, 2010, corresponding to its transition to agency at Amazon"); *id.* ¶ 154, n.108 ("For Penguin I picked the pre-switch week to be the week ending May 15, 2010, and the post-switch week to be the week ending June 12, 2010.").

Second, Amazon's transaction data indicate that Penguin *did not* withhold from Amazon approximately [redacted] titles that it newly released between April 1 and May 28, 2010. Kalt Sur-Reply Decl. ¶ 68 n.95. Amazon sold these [redacted] up through May 28, 2010. Amazon's prices for these titles are indisputably *pre-agency* prices. Yet Dr. Noll's model erroneously assumes that *no* pre-agency price exists for these titles, and he therefore excludes all post-agency transactions for these titles from his dataset. This error reveals a notable disregard of the available data.

Dr. Kalt has recalculated the number of post-agency Penguin sales occurring at or below their pre-agency price using May 28, 2010 as the onset of agency marketing for all Penguin e-books except the approximately [redacted] withheld from Amazon after April 1, 2010. Kalt Sur-Reply Decl. ¶ 69. He now calculates that "approximately 17.3 million Penguin transactions were priced at or below their pre-agency price." *Id.* ¶ 69, Figure 15E. Given that Dr. Kalt initially calculated that number at 17.4 million, Plaintiffs' accusation that Dr. Kalt overestimated the number of Penguin sales at or below their pre-agency price "***by an order of magnitude***" (Pls' Mem. at 6) (emphasis in original), is completely unfounded. To the contrary, it is Dr. Noll's fundamental methodological errors that render his calculations unreliable for the purpose of critiquing Dr. Kalt's opinion.

### B. There Is No Evidence Of A "Pricing Structure" For e-Books

Plaintiffs claim that Dr. Kalt's opinions should be excluded because he ignored evidence demonstrating the fact that e-books were "subject to a price structure both before and after the inception of conspiracy," and that "prices during the conspiracy exhibited an elevated pricing structure across the board." Pls' Mem. at 8. Using characteristic rhetoric, they claim Dr. Kalt has a "complete lack of understanding of even the most basic facts about how e-book prices were

actually set" and note Dr. Kalt's purported "complete disinterest in the Publisher Defendants' pricing formulae." *Id.* at 11. Even if these allegations were true (and they are not), they would be more appropriately leveled against Plaintiffs, *who bear the burden of proffering a common methodology for determining individual damages*, and their expert, who betrayed complete ignorance of basic record facts on pricing—admitting, for example, that he had no idea how Amazon priced e-books on the wholesale model. *See* Richman Decl., Ex. A, Deposition of Professor Roger Noll ("Noll Dep.") 60:12-13 ("I have not seen the actual [Amazon] algorithms, no.").[7] In fact, Dr. Noll admitted that his model "wouldn't be Amazon's pricing Algorithm" (*id.* at 59:20-21), and was "not intended to be anybody's pricing algorithm" (*id.* at 59:22-23).

If Plaintiffs wish to rely on the existence of a pricing structure to support their class-certification arguments—that the issues of injury and damages are "common to the class" and "predominate" over individual issues—they have the burden of proving that such a price structure exists. *See Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2548 (2011) (party seeking certification has burden of demonstrating compliance with Rule 23's requirements). But Plaintiffs did not carry this burden in their initial filings, as Dr. Kalt's opinion reliably demonstrates. And the "documentary and statistical evidence" that Plaintiffs now point to does not indicate the presence of a pricing structure either before or after the allegedly unlawful conduct. Plaintiffs and their expert have not reliably established any pre-agency pricing

[7] And Plaintiffs resisted additional discovery of Amazon, including documents related to its pricing algorithm. *See* Dkt. 392 (Class Plaintiffs' letter to the Court); No. 12-cv-03394, Dkt. 283 (Plaintiff States' letter to Court).

structure, and their criticism of Dr. Kalt's ignorance of Amazon's pricing algorithm is therefore meritless.[8]

According to Plaintiffs, the alleged pricing structure "after" the conspiracy consists of the various "pricing grids" established by the individual publishers.[9] *See* Pls' Mem. at 9-10. Plaintiffs also purport to discern a pricing structure from the fact that the Publisher Defendants priced new release and NYT Bestseller titles sold through Apple and Amazon within 1% of the price caps in their agency agreements. Pls' Mem. at 8-9. But Dr. Noll does not rely on any such pricing grids or rules in his opening report in his effort to establish any overcharge. He uses his regression, rather than any structural formula, to explain pricing in the post-agency period. Noll Decl. at 23-27. The same is true for his reply report. *See* Noll Reply Decl. at 15-22. Neither do Plaintiffs point to any evidence of a pricing structure in their motion for class certification as a basis for establishing common impact. The fact that some titles were, for some period of time, priced within 1% of their price caps does not prove the existence of a "price structure." When titles' prices move in opposite directions—for example, with some titles' prices decreasing and

[8] Plaintiffs also mischaracterize Dr. Kalt's testimony regarding the "indispensab[ility]" of knowledge about Amazon's pricing practices. Pls' Mem. at 11. A proper reading of Dr. Kalt's testimony makes clear that he is describing the infirmities of the approach employed by Dr. Noll—i.e., the inability of a model employing generalized supply and demand factors to reliably estimate individualized marketplace outcomes.

[9] The Publisher Defendants' supposed pricing formulae are not formulae at all—they are ad hoc responses by some publishers to the new agency model that are not comprehensive for the full period or binding in all cases. The very sources cited by Plaintiffs confirm this point. *See, e.g.*, Pls' Mem. 9 n.40; Declaration of Steve W. Berman, Ex. 34 [redacted] *id.* Ex. 35 [redacted] *id.* Ex. 38 [redacted] As these sources make clear, the pricing grids referred to by Plaintiffs relate only to the immediate period following the switch to agency—they do not cover the full two years of the class period and therefore provide no evidence of a pricing structure applicable to Plaintiffs' damages analysis.

others increasing to within 1% of the price caps—no price structure can be shown to exist without first explaining these differential price movements. Dr. Kalt's analysis demonstrates that such differential price movements occur within Dr. Noll's categories, each of which purportedly controls for *all* the relevant factors determining the price of a given title in that category.[10] *See* Kalt Sur-Reply Decl. ¶¶ 39-45, Figures 8A, 8B, 9, 10.

Dr. Kalt, conducted a granular analysis of *actual* e-book pricing, and found that "e-book transaction prices have been widely dispersed both before and after agency." Kalt Decl. ¶ 59(b). In fact, "dispersion of prices … is a defining characteristic of e-book pricing." *Id.* And dispersion "arises even within a given title." *Id.* ¶ 59(c). Dr. Kalt also observes that "e-book pricing is not only characterized by ubiquitous price dispersion; it is also subject to substantial churning." *Id.* ¶ 60. "That is, e-book prices are commonly subject to more or less continuous and tumultuous changes in prices relative to one another."[11] *Id.* Because the e-book market is characterized by dispersion and churning both before and after the onset of agency, "there are many possible prices that each consumer could have paid absent the conspiracy."[12] *Id.* ¶ 107(a).

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[10] Plaintiffs criticize Dr. Kalt for failing to analyze the "correspondence of actual prices to the stated price caps." Pls' Mem. at 12. But if this were a valid methodology for establishing a price structure, then Dr. Noll would have *used* it. He did not. For his part, Dr. Kalt explained that he analyzed the issue and "could not find a systematic way to calculate that across the entire database." Richman Decl., Ex. B, Deposition of Joseph P. Kalt, Ph.D ("Kalt Dep.") at 54:9-13. The "largest and most comprehensive database of transactional eBook sales ever compiled," referred to by Plaintiffs (Pls' Mem. at 12), did not include comprehensive *print book* data necessary to calculate adherence to the price caps. *See* Kalt Dep. at 262:3-9.

[11] This means that "title A's price [is] going up at one moment while title B's price is going down, both then rising relative to some other title C's price, then the price of C and B rising as A's price is declining, and so on. This churning occurs both within and across individual retailers' pricing." Kalt Decl. ¶ 60.

[12] "'The problem is that there are very few constraints on how to assign a price from the range of prices absent the conspiracy to a given consumer. Therefore, it is quite plausible that some consumers could have paid a lower price relative to the price each would have paid absent the conspiracy. Without additional analysis to reasonably rule out that possibility, it is inappropriate

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Plaintiffs simply ignore the evidence of dispersion and churn identified by Dr. Kalt when asserting the existence of a pricing structure.

### C. Dr. Kalt Did Not Ignore Or Edit His Sources

The focus of Dr. Kalt's analysis was an examination of the prices that the publishers *actually* set post-agency. This analysis necessarily reflected the pricing practices and policies of market participants. Thus, Plaintiffs' accusation that Dr. Kalt's opinions should be excluded because they ignore "how publishers and retailers *actually* set e-book prices" is more than curious. Pls' Mem. at 13. For example, Dr. Kalt's analysis of price churning and dispersion across e-book titles is based on pricing data from the marketplace. *See* Kalt Decl. ¶ 59; *see also id.* Ex. 1, Figs 10A-10F, 11A-11C.[13] It is not clear how his analysis could have been improved by knowledge of the hypothetical pricing "formulas" posited by Plaintiffs, which were not employed by Dr. Noll in his analysis either. *See* Pls' Mem. at 9 n. 40. There is no justification for Plaintiffs' contention that Dr. Kalt should have paid more attention to *how* the various publishers established post-agency prices than to the prices *they actually set* post-agency.

Likewise, Plaintiffs' criticism of Dr. Kalt for excluding certain e-book titles from his correlation analysis (*see* Pls' Mem. at 18) betrays a misunderstanding of that analysis. As Dr.

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to assume that all consumers would have been injured by the alleged conspiracy.'" Kalt Decl. ¶ 107(b) (quoting Lemon, Andrew Y. and Steven R. Peterson, "Using Economics to Identify Common Impact in Antitrust Class Certification," Economics Committee Newsletter, ABA Section of Antitrust Law, Vol. 11(1)).

[13] Dr. Kalt found that the dispersion across e-book titles arises even within a given title. For example, "*Atlas Shrugged* … shows dispersion of prices even for a given retailer and an extremely wide dispersion of prices across retailers—with ranges of $10 and more between the upper and lower levels of pricing." Kalt. Decl. ¶ 59(c); *see also id.* Ex. 1, Fig. 11A. Similarly, "*A Thousand Splendid Suns*, exhibits sustained dispersion of $3-$4 on a title tending to sell in the $9-$14 range." Kalt Decl. ¶ 59(c); *see also id.* Ex. 1, Fig. 11B.

Kalt explains, the purpose of the correlation analysis is to test whether e-book prices move in common over time, and it is *mathematically impossible* to calculate correlations among title-pairs whose prices do not change. Kalt Sur-Reply Decl. ¶ 48. Where the lack of price movements are such that a correlation coefficient cannot be calculated, such lack of movement cannot be taken to imply "price stability." *Id.* Moreover, the criticism has no material effect on Dr. Kalt's conclusions. Even when Dr. Kalt adopts Plaintiffs' false assumption that title-pairs that lack price movement have perfect correlation, the results still demonstrate pervasive churning. *Id.* ¶ 47.

Finally, Plaintiffs accuse Dr. Kalt of erroneously concluding that many class members purchased only a small number of e-books. They speculate that consumers who purchase only "one or two" e-books on the iBooks Store are actually purchasing many e-books from other sources such as Amazon or Barnes & Noble. Pls' Mem. at 14-15. Plaintiffs, however, do not present any *evidence* that this is so. Moreover, Dr. Kalt raised the possibility that some members of the class could have purchased a small number of e-books, including e-books that did not rise in price, as something that should be considered in determining whether an individual purchaser suffered harm. Kalt Decl. ¶ 91. As Plaintiffs are aware, the data available do not allow one to track a consumer's purchases across different retailers, and Dr. Kalt's testimony recognizes, not ignores, the limitations of the data.

## III. Plaintiffs' Response To Kalt's Criticism That Noll's Model Produces False Positives Is Unavailing

Plaintiffs argue that Dr. Kalt's analysis of actual prices that were lower than Dr. Noll's "but for" prices—i.e., his calculation of false positives—is "irrelevant" because "the 'but-for price' is a meaningless number of Dr. Kalt's creation." Pls' Mem. at 22. But this characterization is misleading because Dr. Kalt simply compares the prices at which transactions

actually occurred to the "but for" prices Prof. Noll's model yields. Dr. Noll testified repeatedly that damages suffered by any individual consumer represents the difference between the price actually paid and his "but for" (average) price. *See* Noll Decl. at 6, 23-27; Noll Dep. at 156:8-12, 191:10-17, 199:2-14, 239:20-25. Accordingly, Dr. Kalt adopts this methodology and demonstrates that Dr. Noll's model is plagued with millions of false positives, where it reports transactions as having borne a positive percentage overcharge when, in fact, there is no reliable basis in his modeling for doing so. Kalt Decl. ¶¶ 114, 139(b). In addition, Plaintiffs' assertion that Prof. Kalt's analysis simply proves that uninjured class members can be isolated is false. Plaintiffs ignore the false positives in Prof. Noll's model and the model's inability to identify individual impact. Accordingly, Dr. Kalt's opinion regarding false positives is unquestionably relevant and demonstrates the lack of reliability in Dr. Noll's model.

## IV. Dr. Kalt's Opinions Based On Modal Pricing Are Reliable

Plaintiffs criticize Dr. Kalt's use of modal prices, claiming that the mode is "almost never used in statistical analysis because it is a poor indicator of price trends." Pls' Mem. at 16 (quoting Noll Reply Decl. at 28). This is an odd position for Plaintiffs to take since the entire theory of their case is that Apple colluded with the publishers to eliminate Amazon's "industry standard $9.99 price point," (Dkt. 47 ¶ 13, Pls' Consolidated Am. Class Action Compl.), which was a modal price, not a mean or average price. Given the Plaintiffs' focus on modal pricing, it was entirely appropriate for Dr. Kalt to focus on modes as well.

Moreover, because the class certification question is about common impact, it is appropriate to look at the price at which most transactions took place. *See* Kalt Sur-Reply Decl. ¶ 73 ("[I]t is appropriate to examine a title's modal price because it is the price that proposed class members *most frequently paid*, and is, thereby, a better representation of the distribution of

prices actually paid by proposed class members."). The very textbook cited by Dr. Noll in his Reply supports this position. *See* Bernard Ostle, *Statistics in Research* (2nd), Iowa State University Press, 1963, p. 60 ("Since the mode is, by definition, the most typical value, it is often considered the most descriptive of the representative values discussed so far. However, its importance diminishes as the number of observations becomes limited."). The concern about limited observations does not apply here since "over 99% of e-book transactions for Publisher Defendants occurred at the relevant title's daily modal price." Kalt Sur-Reply Decl. ¶ 76. This fact puts to rest Plaintiffs allegation that Dr. Kalt's method "virtually guarantees that outliers will skew his results."[14] Pls' Mem. at 17.

By contrast, "the data show that only approximately 90% of transactions for Publisher Defendants' e-books occurred at titles' daily average prices." Kalt Sur-Reply Decl. ¶ 76. "Thus, titles' daily average transaction prices are *less representative* than modal prices of the prices that the overwhelming number of proposed class members actually paid." *Id.* In short, it is Dr. Noll's *non*-modal methodology that fails to calculate damages accurately for the vast majority of purchases.

[14] As Dr. Kalt explains, the claim that use of daily modal prices "virtually guarantees that outliers will skew" his results is a "logical impossibility. Kalt Sur-Reply Decl. ¶ 74. "[T]he daily modal price does not change if there are other transactions that occur at outlying prices because the daily modal price is by definition the price that the proposed class members *most frequently paid* on a given day which is invariant to other transactions at outlying prices." *Id.* Contrary to Plaintiffs' assertion, "it is the mean price repeatedly used by Prof. Noll that is most easily 'skewed' by outliers. The statistics textbook which Prof. Noll cites explains exactly this problem with the mean: 'The one major disadvantage of the arithmetic mean [i.e., weighted average] is that it is *unduly affected by extreme values* and may therefore be far from representative of the sample.'" *Id.* (quoting Ostle, *Statistics in Research*, at 53 (emphasis added)).

## V. Dr. Kalt's Opinion Is Legally Relevant

Plaintiffs assert that Dr. Kalt's opinion is irrelevant to the issue of impact and damages. Pls' Mem. at 19. This is because, according to Plaintiffs, Dr. Kalt's "reasoning and calculations say nothing about whether Dr. Noll's estimate roughly reflects the aggregate amount owed to class members; they speak only to the reliability of *individual* calculations." *Id.* (citation and internal quotes omitted). But Plaintiffs cannot satisfy Rule 23(a)'s commonality requirement or Rule 23(b)'s predominance requirement by simply proving aggregate damages to the entire class, regardless of differences between class members. In *Dukes*, the Court unanimously "disapprove[d]" the type of "Trial by Formula" that Plaintiffs seek here. 131 S. Ct. at 2561. Similar to this case, the plaintiffs in *Dukes* proposed to generate a "percentage of claims determined to be valid" and to apply that percentage to the "entire remaining class." *Id.* "[T]he number of (presumptively) valid claims thus derived would be multiplied by the average backpay award in the sample set to arrive at the entire class recovery—without further individualized proceedings." *Id.* The Court rejected this proposal because it would deprive the defendant of its right to "litigate its statutory defenses to individual claims." *Id.* Likewise, Plaintiffs cannot satisfy Rule 23(a)'s commonality requirement by whitewashing over the myriad differences between class members and proving "average" class-wide damages that have no basis in reality.

Furthermore, Plaintiffs' theory for calculating damages does not fit with their theory of the conspiracy. As noted, Plaintiffs' theory at trial was that Apple conspired with the Publisher Defendants to eliminate Amazon's $9.99 pricing. But Dr. Noll admitted that he does not know how many predicted but-for prices in his model are $9.99 (Noll Dep. at 183:6-11), and does not "care to know the percentage of them that are predicted to be $9.99" (Noll Dep. at 185:19-23).

Plaintiffs therefore fail to present a theory of damages that fits their theory of liability and consequently run afoul of *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013), which held that "a plaintiff's damages case must be consistent with its liability case, particularly with respect to the alleged anticompetitive effect of the violation." *Id.* at 1433 (quoting ABA Section of Antitrust Law, Proving Antitrust Damages: Legal and Economic Issues 57, 62 (2d ed. 2010)). Plaintiffs rely on the same logic rejected in *Comcast*: that "at the class-certification stage *any* method of measurement is acceptable so long as it can be applied class-wide, no matter how arbitrary the measurements may be." *Id.* That is not the law.

And the Plaintiffs' claim that *Dr. Kalt* does not calculate aggregate damages is of no moment. Dr. Kalt's opinions are relevant to the only question currently before the court—whether class certification is proper. The Court may therefore "examine[] the reliability of [Dr. Kalt's] expert opinions in light of the available evidence and the purpose for which they [are] offered." *In re Zurn Pex Plumbing Products Liability Litig.*, 644 F.3d 604, 612 (8th Cir. 2011). The Court's job here is to "conduct[] a focused *Daubert* analysis which scrutinize[s] the reliability of the expert testimony in light of the criteria for class certification and the current state of the evidence." *Id.* at 614. The key question for the Court at this juncture is whether Dr. Kalt's opinion is reliable as to the issue of class certification—and it clearly is. Dr. Kalt's opinions are also relevant to the issue of damages, but the admissibility of his opinions for that purpose (if challenged) will be litigated through motions *in limine* according to the schedule established by the Court.

## VI. Dr. Kalt's Offset Opinions Are Admissible For The Same Reasons That Mr. Orszag's Opinions Are Admissible.

Plaintiffs argue that Dr. Kalt's opinions regarding offsetting benefits should be excluded on the ground that this court found that Apple engaged in a horizontal price-fixing conspiracy.

Pls' Mem. at 23. As Apple explains in its concurrently filed response to Plaintiffs' motions to exclude Mr. Orszag's expert opinions, offsetting benefits are regularly considered in antitrust cases, and courts have not carved out an exception exclusively for price-fixing cases. *See* Apple Inc.'s Memorandum of law in Opposition to Class Plaintiffs' and Plaintiff States' Motions to Exclude Expert Opinions Offered by Jonathan Orszag ("Orszag Opp. Mem.") at 3-12.

Further, plaintiffs contend that Dr. Kalt's testimony should be excluded because he cannot "offer a reliable estimate of whether 1 percent or 99 percent of the class, or any amount in between, was benefited by the alleged reduction in e-reader prices." Pls' Mem. at 23. But Apple does not have the burden of proving the precise amount of damages; Plaintiffs do. *See J. Truett Payne Co. v. Chrysler Motors Corp.,* 451 U.S. 557, 568 (1981). Dr. Kalt's assignment was primarily to evaluate Dr. Noll's damages analysis. If Dr. Noll's damages opinion is admitted (which it should not be), then Dr. Kalt's criticism of that opinion should also be admitted.

Plaintiffs also recycle their misleading argument that Amazon's fundamental change in the royalty structure for self-publishers was *not* a response to Apple's anticipated agency contracts. Pls' Mem. at 24-25. But as Apple explains in its opposition to Plaintiffs' motion to exclude Mr. Orszag's opinion, the record belies Plaintiffs' argument. *See* Orszag Opp. Mem. at 15-19. Amazon increased the self-publisher royalty only *after* it became aware that Apple would likely enter the e-retailing business on the same 70-30 terms it employed in its iTunes and Apps Stores. *Id.*

Finally, Plaintiffs accuse Dr. Kalt of failing to calculate how many iPad owners would have downloaded the Kindle app had the iBooks Store not been launched. Pls' Mem. at 25. Again, Apple does not have the burden of proving the precise amount of the benefit to consumers resulting from the alleged conspiracy (*see J. Truett Payne*, 451 U.S. at 568), and Dr.

Kalt's opinion is admissible for the purpose of demonstrating that Dr. Noll overlooked this key variable in his damages' calculation.

## CONCLUSION

For all of these reasons, this Court should deny the motion to exclude expert opinions offered by Dr. Joseph Kalt.

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By: /s/ Theodore J. Boutrous, Jr.

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