

To Macmillan Trade Authors, Illustrators, and Agents,

Last weekend I wrote you a letter which I planned to send today. Last night, Penguin settled their lawsuit with the DOJ, and Random House agreed to be governed by its terms. After some long thought, I'm sending you the letter I wrote unchanged. That is because our position has not changed. So please read on.

Holiday greetings! In the tradition of a year-end letter, I thought I would send you an update about Macmillan and a few words on publishing in general. Fear not, no family photos; instead some thoughts on flightless birds and consolidation, on the Department of Justice, on the digital transformation and on the future of our great enterprise.

Many of you have asked what the Penguin/Random merger means for us, and what the chances are of a Harper/Simon merger. I think the Random/Penguin merger is based on financial engineering, and as such is good for the financial statements of the two companies. I think others have the same sort of opportunity, but I have no idea if they are talking.

I do know that we are not in discussions, with anyone. This will leave us where we have always been, the smallest of the big publishers. It has never hurt us in the past, and I expect it will not hurt us in the future. Publishing trade books is, in the end, a human endeavor. The relationship between editor and author does not scale. Nor do the relationships between sales rep and bookseller or between publicist and producer. Certainly there are some advantages to being big, but the essence of the business is not a function of size. You need a certain level of capital and infrastructure, but that does not require being a behemoth. We will be more than fine in the land of the giants. I expect we will continue to grow and prosper.

And now for the DOJ. As part of the court-ordered mediation, I wrote a letter to the DOJ explaining why we were not going to settle our lawsuit. It occurred to me then that I had not been in contact with you since the lawsuit was filed, and that as our partners in publishing you should know what we are doing and why.

There are two reasons we decided not to settle. First, it is hard to settle when you have done nothing wrong. Much as the lawyers explain to me that settling is completely standard business procedure, it still seems fundamentally flawed to me somehow. Call me old-fashioned. The second reason is the more important one. Since the very beginning, the government's demands have never wavered in all our discussions. They still insist on the two year discounting regime that forms the heart of the agreement signed by the three settling publishers. It was our belief that Amazon would use that entire discount for the two years. That would mean that retailers who felt they needed to match prices with Amazon would have no revenue from e-books from five of the big publishers (and possibly the sixth) for two years. Not no profit, no revenue. For two years. We felt that few retailers could survive this or would choose to survive this. Simultaneous discounting across the major publishers (you could think of it as government-mandated collusive pricing) would lead to an unhealthy marketplace. As we heard of each successive publisher settling, the need to support retailers, both digital and bricks and mortar, became more important.

So what has happened since? The motions and the judge's responses are public record. We have completed the court-ordered mediation process with the DOJ without any progress toward settlement. The trial date remains June 2013. Discovery and depositions continue. The legal bills look like the unit sales numbers for 50 Shades of Grey.

We decided shortly after the suit was filed that we would cancel all our retailer e-book contracts and negotiate new ones. We did this with all our customers except one whose term was not up yet. All the new contracts are

compliant with the government's requests in their complaint. They contain no most-favored nations clauses and no price limits. They also allow 10 percent discounting on individual books priced at \$13.99 and above. In short, we complied with the demands of the complaint the DOJ filed. Needless to say, we continue to see the lawsuit as pointless and destructive. Meanwhile, the settling publishers have apparently reached terms with retailers. There is some discounting, but because it is not across the board the impact appears to be limited.

We have also been pursued by 33 states, by a large combined class, by the EU, and now even our friends in Canada are taking a look. We are proceeding in the discovery process with the states and the class. We settled with the EU because of many differences in their system and because the discounting change will not materially affect the market there for us.

Which leaves me with the final and more jolly topic of this missive-matters digital now and in the future. At this writing 26% of our total sales this year have been digital. It is good to remember that means 74% of Macmillan's total sales are ink on paper books. Just as in 2011, the percentage of e-book sales has remained consistent week by week through the year for the most part (the big uplift in the last two years has occurred the week after Christmas). Our e-book business has been softer of late, particularly for the last few weeks, even as the number of reading devices continues to grow. Interesting.

We continue to invest heavily in the digital side of the business, from anti-piracy efforts to social marketing tools. We are not managing our business with an expectation of a final e-book percentage. We are focusing instead on the rate of change. Consumers will decide in the end how they want to read books, and we will deliver your books in all the formats they desire. Our job is to get to this final state with an even playing field for retailers, a healthy marketplace, and the maximum possible distribution of your work in all formats.

And we will keep experimenting to determine the best way forward. This year we went DRM-free at TOR. It is still too early to tell the outcome, but initial results suggest there was no increase in piracy. In early 2013 we will launch library lending of e-books. As you probably know, we have not sold e-books to libraries to date, though we have been working for three years to find a model that works for the libraries, but that didn't undermine our retail partners and didn't jeopardize our fundamental business model. We have found a model we believe works for a limited part of our list, so we will now move forward.

The best news as we enter this holiday season is that independent booksellers have had a good year, booksellers in general have had the time to adjust their product mix and store counts, and consumers continue to value and buy real books. Piracy continues to be an issue, but it has not exploded. More people are reading more books. The playing field in e-book retailing, while not even, has not yet tilted too far. There is a bright future out there.

Let me end by saying there are plenty of bumps left in the long road ahead, but it is a good journey well worth taking. Thanks for riding with us here at Macmillan. We are looking forward to the years ahead!

Happy holidays to you and yours.

All best, John