



Summary of Three Publications Issued by the OFT Analysing Newspaper and Magazine Distribution in the UK October 2008

- 1. Competition Law Guidance (the Opinion)**
- 2. National Newspaper Code of Practice**
- 3. Consultation on proposal not to refer to the Industry Competition Commission**

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EXECUTIVE SUMMARY

In the **Opinion**, the OFT have provided guidance to help publishers and wholesalers assess for themselves whether their newspaper and magazine distribution agreements comply with the Competition Act. These agreements provide 'absolute territorial protection' (ATP), with wholesalers granted exclusive territories. European Competition Law states that ATP is likely to be illegal except under exceptional circumstances.

The OFT believe that newspaper distribution may meet the criteria for an exemption set out in Section 9(1) of the Act, but that magazine distribution is unlikely to. One of the key differences between newspapers and magazines is that magazine sales are not subject to the same 'extreme' time sensitivity as newspapers.

The OFT highlighted two key areas where newspaper distribution benefits from ATP:

- There will be meaningful competition for the market. Competition in the market is unlikely due to the extreme time sensitivity of newspapers.
- With ATP publishers can insist that wholesalers supply hard-to-serve retailers (within reason) – those retailers that receive minimum supplies – therefore maintaining the obligation to supply which is currently guaranteed through the Newspaper Code of Practice with the Minimum Entry Level (MEL).

While recognising that there may be an element of time sensitivity with some types of magazines the OFT maintain that that sensitivity is not as extreme as it is for newspapers – for instance, 70% of newspapers are sold before 10am – which means that there may be greater scope for competition to develop in the distribution of magazines in the absence of ATP.

In the **Code Review**, the OFT has found that changes in the market since the Code was introduced, including greater commercial incentives to supply new retail outlets now exist, and as a result the OFT has advised the Secretary of State for Business Enterprise and Regulatory Reform (BERR), the ultimate decision-maker regarding the review of the Code, that wholesalers should be released from the undertakings underpinning the Code.

The commercial incentives include greater income from CSCs; wholesalers now recover three quarters of their distribution cost through CSCs; wholesalers receive a significant proportion of their revenue from CSCs (as much as 80% from outlets on MEL).

Also, as a result of the Opinion it is expected – in order to satisfy criteria for exemption – that publishers will insist, through their agreements with wholesalers (the contracts granting exclusive territories), that wholesalers supply all (within reason) retailers that want supply.

The request for a **Market Investigation Review** has been turned down by the OFT. It is the OFTs belief that although there were reasonable grounds for suspecting that certain features of the industry met the criteria for a review, the remedies outlined in the Opinion would, at the very least, create sufficient flux within the industry that the Competition Commission would be unable to evaluate the positive effects that may be delivered by the Opinion at this time.

BACKGROUND

Competition Law Guidance (the Opinion)

In June 2003 the Department of Trade and Industry (now BERR) announced that it would modernise UK competition law in order to bring it in line with that of the European Union. As a consequence of this action the vertical agreements between publishers and wholesalers that granted wholesalers exclusive sales territories for newspapers and magazines would potentially become illegal.

In May 2004 and in order not to fall foul of the law, publishers and wholesalers asked the OFT to grant them an exemption from the effects of these changes, or failing that if the OFT could issue an Opinion offering guidance to the industry instead.

A draft Opinion was issued in May 2005, this was subsequently withdrawn and the OFT published a revised draft Opinion for consultation in May 2006. The Opinion published 22nd October 2008 concludes the OFT's work on this issue.

National Newspaper Code of Practice

In August 1992 the Director General of Fair Trading (latterly the DTI and now BERR) referred the supply of national newspapers by both publishers and wholesalers to the Monopolies and Mergers Commission (MMC - now the Competition Commission) after identifying practices which it found may operate against the public interest:

- The refusal of wholesalers to supply newspapers to retailers in an area where the wholesaler thought the area was adequately served.
- Wholesalers' insistence that retailers may only sell newspapers by retail and from their own retail outlet.

The MMC reported their findings in December 1993 and as a result of these findings wholesalers signed a statutory undertaking, effective from October 1994, to comply with an industry code of practice. The Code included:

- An obligation for wholesalers to supply any retailer who agreed to a net minimum weekly charge from a wholesaler. This is known as the minimum entry level or MEL
- A provision to allow sub-retailing – allowing a retailer to sell or transfer newspapers to another retail outlet, as long as that retailer is within 500 metres in urban areas and 1000 metres in other areas, and is also within the wholesalers existing territory.
- A reinforcement of territorial exclusivity.

Because of its statutory nature (Enacted under laws applying to England and Wales only) the Code only applies in England and Wales. However, wholesalers agreed to apply the terms to Scotland and Northern Ireland on a voluntary basis.

There have been three Code Reviews carried out by the OFT, the first in 1997, the second in 2002 and the current review published for consultation 22nd October 2008.

Market Investigation Request

In December 2006 the OFT was asked to consider whether the conditions for making a market investigation reference (MIR) to the Competition Commission (CC) were met, and if so, whether undertakings in lieu of a reference may be available.

The OFT's decision was also published on 22nd October 2008.

CURRENT POSITION

On 22nd October 2008 the OFT issued three documents highlighting the various recommendations and conclusions reached as a result of a six year review of the newspaper and magazine industry. These reviews were managed by three separate review teams using distinctly differing terms of reference, although, as a result of the overlapping nature of these reviews the teams worked closely together.

The reports are:

1. Newspaper and magazine distribution in the United Kingdom: Opinion of the office of Fair Trading – guidance to facilitate self-assessment under the Competition Act 1998.
2. National newspapers: A review of the undertakings relating to the supply of national newspapers in England and Wales (the Code of Practice).
3. Newspaper and magazine distribution in the United Kingdom: Public consultation on the Office of Fair Trading's proposed decision on a request for a market investigation reference.

1. Newspaper and magazine distribution in the United Kingdom: Opinion of the office of Fair Trading – guidance to facilitate self-assessment under the Competition Act 1998

The Opinion does not give any definitive conclusions, but provides guidance in respect of the agreements between national newspaper and magazine publishers, on one hand, and wholesalers, on the other, that grant wholesalers exclusive territories. The guidance is published in the form of a framework that publishers and wholesalers are encouraged to use in order to make a self-assessment of the compatibility of their contracts with the Competition Act 1998 (CA).

The OFT suggest that there are factors, for the supply of newspapers, that may demonstrate that the agreements benefit from exemption under the CA. However, for magazines they state that it is unlikely that these factors will apply, making it less likely that the supply of magazines would benefit from exemption under the CA.

The OFT provides guidance on the factors that are likely to be relevant in assessing agreements. They are whether an agreement:

- i. Prevents, restricts or distorts competition under section 2 of the Competition Act, and
- ii. Benefits from a parallel (or Block) exemption conferred by section 2 of the Competition Act, and/or
- iii. Satisfies the exemption conditions set out in Section 9(1) of the Act.

The CA prohibits agreements which have as their object or effect an appreciable prevention or distortion of competition unless they fall within an excluded category or are exempt in accordance with the ACT.

The contracts between both magazine and newspaper publishers and wholesalers grant exclusive territories and therefore prevent competition. As a result they are caught by section 2 of the ACT and are potentially illegal unless they satisfy the criteria for exemption either through a 'parallel exception' or under section 9(1) of the ACT.

It is unlikely that the agreements (Magazine or Newspaper) will be granted a parallel exemption as they contain a black-listed, or hard core, restriction: that is, they prevent passive sales.

The only other way for an exemption to be granted is for the agreements to satisfy the four exemption conditions in section 9(1) of the Act. These conditions are cumulative and they must all be met. The agreements must:

1. contribute to improving production or distribution, or promoting technical or economic progress, and they must;
2. allow consumers a fair share of the resulting benefit, and must not;
3. impose restrictions which are not indispensable to the attainment of the efficiencies, and that there is;
4. no possibility of eliminating competition in respect of a substantial part of the products in question.

It is also important to understand what the OFT's definition of 'consumer' is. The OFT state that:

“all direct or indirect users of the products covered by the agreement, including producers that use the products as in input, wholesalers, retailers and final consumers... In other words, consumers within the meaning of the Article are the customers of the parties to the agreement and subsequent purchasers”.

1. Contribute to improving production or distribution, or promoting technical or economic progress	
Newspapers	Magazines
The OFT suggest that there are several factors that may demonstrate that ATP in newspaper agreements satisfy condition 1. These include:	Similar arguments could apply to the supply of magazines, but the OFT does not believe that the extent to which ATP contributes to producing efficiencies is significant enough to satisfy the first condition. The agreement should be the direct cause of the potential efficiency, and in the case of magazines it is likely that:
More effective competition <u>for</u> the market, enabling publishers to achieve reduced margins and improved service quality from wholesalers and providing a stimulus for wholesalers to innovate – This is an important factor as competition <u>in</u> the market is unlikely due to time constraints and the economies of scale, scope and density in newspaper wholesaling.	A greater degree of competition <u>in</u> the market is likely to arise in the absence of ATP, therefore it cannot be said that ATP is the direct cause of efficiencies.
ATP may enable publishers to include in their contracts with wholesalers an obligation to supply all retailers (within reason) in a territory – This is particularly important as the OFT has recommended the removal of the Code which guaranteed universal supply through MEL. As newspapers have dual income, advertising and cover price, publishers are likely to ensure high availability to maintain circulation.	Magazines are less time sensitive, making an obligation to supply less important for magazines.
ATP provides cross-subsidy of the costs of delivering newspapers to small and remote retailers, thereby improving distribution.	Retailers may be better placed to drive innovation, for instance through the development of systems, than publishers, although benefits maybe mutual, retailers will have stronger incentives due to strong competition between retail outlets.
Prevents waterbed effects. Meaning that, absence ATP, some retailers would be able to negotiate lower prices and this would require wholesalers to increase prices to other retailers in order to recoup lost revenue, potentially forcing large numbers of retailers to exit the market.	Retailers' experience in other supply chains may also reveal innovation opportunities that magazine publishers would not be aware of.
	Retailers are better informed regarding local knowledge.

2. Allow consumers a fair share of the resulting benefit	
<p>Fair share is assessed on a sliding scale and the pass-on of the overall benefits must at least compensate consumers for any actual or likely negative impact caused to them by the restrictions in competition.</p> <p>Parties to the agreement will need to consider whether the benefits of the efficiencies identified in the first condition will be passed on to the consumer.</p>	
Newspapers	Magazines
<p>The OFT have stated that it would appear that for newspapers there are several factors which may demonstrate that consumers receive a fair share of the benefits outlined above. Relevant considerations would be:</p>	<p>For magazine supply it is unlikely that that the first condition will be met, as a result the second condition cannot be met. In the unlikely event that the first condition is met then some of the benefits outlined for newspapers may be applicable to magazines. However, there are a number of elements which are not likely to be met:</p>
<p>Whether publishers have incentives to pass the benefits they receive in terms of reduced costs to the consumer in the form of lower prices and/or improved product quality – competition between publishers is high and consumers benefit from product innovation as well as reductions in price, including promotions.</p> <p>- Here the OFT have argued that a fixed cover price is good for the consumer as publishers have an incentive to keep the price low in order to increase circulation and therefore increase advertising revenue. Retailer price reductions would have limited impact as in reality the ability of consumers to switch purchase locations is limited due to timing of newspaper purchases.</p>	<p>In relation to service standards it is likely that publisher and retailer interest may diverge significantly. For example, in relation to copy allocation, publishers may send retailers particular titles in order that they are displayed alongside their competitors, whereas retailers may not want to stock these titles in order to maximise the profitability of their shelf space, or some retailer may want to differentiate their outlet from competing retailers through the range they offer.</p> <p>This is less likely to apply to newspapers as a result of the limited number of titles.</p>
<p>Whether consumers benefit from the obligation to supply by having copies more readily available to them – widespread availability increases opportunity to buy for consumer.</p>	<p>As magazines are less time sensitive consumers are likely to have greater flexibility about when and where they can purchase magazines.</p>
<p>Whether retailers benefit from the obligation to supply – absence ATP smaller retailers may find it difficult to receive newspapers.</p>	<p>Also absence ATP some retailers may be able to negotiate better terms from wholesalers and these retailers may have greater incentive to reduce their retail price if they believe that consumers are likely to switch their purchases to these outlets.</p>
<p>Whether retailers benefit from the ability of publishers to exercise control over wholesaler service standards – ATP could give publishers greater ability to insist on higher standards for retailers. It is argued that retailer and publisher interest are likely to be closely aligned, for instance, getting the right number of copies delivered to the right retailers at the right time.</p>	

3. Impose restrictions which are not indispensable to the attainment of the efficiencies	
<p>This is a two-fold test in that both the restrictive agreement and the individual restrictions of competition flowing from it, must be reasonably necessary for the attainment of the efficiencies, for instance, whether these restrictions make it possible to perform the activity in question more efficiently than would have likely been the case in the absence of the agreement or the restriction concerned. They must also be specific to the agreement in question and there must not be any other economically practicable and less restrictive means of achieving those efficiencies.</p>	
Newspapers	Magazines
<p>The OFT believe that there are several factors which may demonstrate that ATP restrictions in newspaper agreements are indispensable in order to attain the efficiencies created by these Agreements:</p>	<p>In analysing magazine distribution the same argument could be applied as was applied for newspapers. However, as identified earlier in the absence of ATP:</p>
<p>Competition <u>for</u> the market is necessary to enable the achievement of those benefits outlined in 1 above. Competition <u>in</u> the market, due to the time sensitivity of newspapers, is not a realistic or practical option. Without ATP it is unlikely that wholesalers would reduce their bids to tender for an area where competing wholesalers could respond to passive sales. On this basis, it would appear likely that the margins publishers pay to wholesalers would rise. It could therefore be argued that absence ATP efficiencies could be eliminated or significantly reduced and the benefits to consumers through reduced prices and product innovation could be at risk.</p> <p>Effective competition <u>for</u> the market is a key element in the continuing existence of ATP, it is therefore vital that newspaper publishers ensure genuine and meaningful competition to serve a particular territory. Frequency of tender is also an issue, if competition takes place too infrequently incentives to improve distribution will be weaker therefore the necessary efficiencies that will flow from ATP would be limited or less likely to arise.</p>	<p>Efficiencies in the magazine supply chain would be likely to materialise, or would not be significantly reduced.</p> <p>Without ATP, wholesalers appear likely to be more responsive to retailer requirements. It is possible that the incentives to innovate in relation to features such as SBR may be greater for retailers than publishers.</p>
<p>Without ATP it is also unlikely that publishers could insist that wholesalers supply all (within reason) retailers that want supply thereby guaranteeing the obligation to supply. The obligation to supply is also a key component in the indispensability argument it will therefore be important that publishers amend wholesalers' contracts to allow for this</p>	<p>The obligation to supply is likely to be less important for achieving wide distribution of magazines because consumers have more flexibility about where and when they purchase magazines.</p>

In light of the above it would appear unlikely that magazine agreements and the ATP restrictions are indispensable to the attainment of efficiencies.

4. No possibility of eliminating competition in respect of a substantial part of the products in question.	
In undertaking this test publishers and wholesalers will have to look at the impact of a restrictive agreement on competition relative to the degree of competition existing prior to the agreement. This requires an assessment of competition prevailing under the status quo against the competition prevailing in the counterfactual at the different levels of the supply chain.	
Newspapers	Magazines
One of main effects of ATP is that it prevents retailers from switching between wholesalers. This is likely to restrict intra-brand competition between retailers and in any other supply chain this would be regarded as very significant and as a result it would be very unlikely that this condition would be met. The OFT state that the parties need to take into account the various specific features of the newspaper supply chain in determining whether a newspaper agreement affords the possibility of eliminating competition.	The analysis for magazine distribution is likely to be the same in material respect as the newspaper supply chain. Adopting the same argument for magazines could, potentially, lead to the same conclusion, for instance, that ATP may not eliminate competition in the market. But, as ATP for magazine distribution is likely to fail the indispensability test this may not be relevant.
At the wholesale level meaningful competition for the market becomes a major issue.	

So on balance the OFT believe that newspaper agreements may be eligible for an exemption under section 9(1) of the Competition Act but magazines are unlikely to be eligible for such an exemption.

2. National newspapers: A review of the undertakings relating to the supply of national newspapers in England and Wales (the Code of Practice)

The OFT have a statutory obligation to periodically review the newspaper Code as outlined in the Fair Trading Act 1973. The Act provides limited reference for the review: The OFT should “consider whether, by reason of any change of circumstances, an undertaking is no longer appropriate and either the relevant parties can be released from the undertakings or the undertakings needs to be varied, or superseded by a new undertaking” – new undertakings could only be enacted in so far as they address the specific problem outlined by the MMC in 1993 (Outlined in the Background section above).

The OFT has concluded that there has been numerous changes of circumstance, relating to the publishing, wholesaling and retailing of newspapers, which means that the Code is no longer appropriate to remedy or prevent the specified adverse effects. The OFT have highlighted three changes in particular:

1. Changes in the level of CSCs
2. Changes in the role of publishers in the newspaper supply chain, and
3. Changes in the composition and relative prominence of different types of retail outlet.

1. Changes in the level of CSCs

The OFT find that wholesalers CSC income has risen significantly since 1993 to such an extent that wholesalers recover three quarters (74%) of their total distribution costs. CSCs are now therefore a significant source of revenue for the wholesalers.

The OFT have identified three specific ways in which these changes have provided wholesalers with greater commercial incentives to supply new retail outlets. These are:

- A significant growth in the minimum CSC levels provides wholesalers with a significantly increased minimum amount of revenue from supplying new outlets regardless of whether there are increased overall newspaper sales arising from that supply.
- CSCs now account for a significant proportion of the revenue gained by wholesalers from supplying retailers (as much as 80% on retail outlets at lower MEL levels).
- CSCs now result in the recovery of a significantly greater proportion of wholesaler distribution costs.

The OFT concludes that the significantly increased revenue from CSCs makes it unlikely that wholesalers will refuse to supply new retail outlets in the future.

2. Changes in the role of publishers in the newspaper supply chain

The OFT have highlighted a number of ways in which the role of publishers influences the distribution of newspapers:

- The imposition and monitoring of requirements upon wholesalers in relation to service – Obligations upon wholesalers in the relation to the provision of service to retailers has increased significantly. Publishers are imposing a wider range of KPIs on wholesalers and their performance is being closely monitored.
- Publisher incentives to encourage availability – Due to the two-sided nature of the newspaper publishing market (publishers receiving income from both advertising and the cover price) publishers have strong incentives to increase availability of their titles in order to increase circulation and maximise profit. Publishers therefore have incentives to use their ability to impose contractual obligations on their wholesalers to ensure wide availability of their titles and prevent the re-emergence of refusal to supply.
- Increased role of publishers in facilitating supply to retailers directly – publishers have instructed wholesalers to supply new outlets such as coffee shops and department stores.

The OFT concludes that there are significant reasons for publishers to ensure wide availability of their titles making it further unlikely that wholesalers will refuse to supply new retail outlets in the future.

3. Changes in the composition and relative prominence of different types of retail outlet

The MMC identified that the primary concern regarding refusal to supply related to supply of non-traditional retailers. Multiple retailers now account for over 40% of newspaper sales.

The OFT considers that the increased prominence of multiple retailers in newspaper retailing and their increased ability to engage with other newspaper supply chain participants, means that they are unlikely to be refused supply of newspapers by wholesalers.

These changes taken together represent a change of circumstance such that the OFT believes that the Code is no longer appropriate to remedy or prevent the adverse affects of refusal to supply specified in the MMC report.

The second concern expressed by the MMC in 1993 was the refusal to allow retailers to sell-on or to sub-retail.

The OFT states that the MMC's concerns regarding restrictions on sub-wholesaling were primarily linked to the specified wholesaler practice of refusal to supply, for instance, their belief that the area was adequately served. The OFT considers that due to the changes in circumstances, outlined above, the refusal to supply of the type specified by the MMC is unlikely to re-emerge in the future in the absence of the Code.

Retailers who may have needed to engage in sub-retailing are now more likely to be able to obtain supplies from a wholesaler, either directly from the wholesaler or through a publisher-facilitated supply arrangement.

As a result of the foregoing analysis the OFT has recommended to the Secretary of State for Business, Enterprise and Regulatory Reform that wholesalers should be released from the undertakings that they gave 1994 when they signed the Newspaper Code of Practice. The Secretary of State has asked interested parties to comment on this decision.

3. Newspaper and magazine distribution in the United Kingdom: Public consultation on the Office of Fair Trading's proposed decision on a request for a market investigation reference

In order to make a Market Investigation Reference to the Competition Commission the OFT must have reasonable grounds for suspecting that a feature or features of a market restricts or distorts competition. The OFT decided that there were reasonable grounds for suspecting that four features did meet these criteria:

1. ATP in relation to newspapers and magazines
2. Copy allocation for magazines
3. Cover prices on newspaper and magazines
4. The degree of publisher control (publisher-led distribution) over the magazine supply chain in general.

1. ATP - Following guidance given in the OFT's Opinion it is expected that publishers will self-assess their Agreements with wholesalers, to address the negative or anti-competitive affects of ATP, as outlined above.
2. Copy allocation for magazines – The remedies taken in view of the Opinion on ATP could potentially impact on retailers' ability to achieve greater control of copy delivered to their store.
3. Cover price – The OFT believes that there are strong offsetting customer benefits, outlined above, that exceed the likely detriment from any adverse affect on competition.
4. Publisher control of magazine supply – The OFT believes that it is at least possible that a period of flux will result from the necessary self assessments that publishers will need to carry out as a result of the Opinion. This uncertainty coupled with likely change will make it difficult for the CC to gather sufficient evidence at this point in time to enable it to properly assess the state of the market.

As a result of their analysis – which is greatly influenced by the Opinion – and although conditions for a reference have been met, the OFT is minded to decide not to make a reference to the Competition Commission, at this time. And as a result of this decision the OFT no longer has the power to accept undertakings in lieu of a reference.

The OFT has asked interested parties for views on this decision.

NEXT STEPS

The Opinion is now 'live' and it is expected that the publishers and wholesalers commence a review of their existing contracts to ensure their compliance with the 1998 Competition Act. There is no review period for the Opinion – other than on any factual inaccuracies in the report.

The Secretary of State has called for consultation on the Code decision and interested parties have 12 weeks to present their views (Closing date Wednesday 14 January 2009).

The deadline for comments on the MIR request is set for 28 days after the Secretary of State's decision on the Code Review and is likely to be April 2009 with, hopefully, the OFT's final decision announced in the summer.