OFFICE OF FAIR TRADING

Anticipated acquisition by Menzies Distribution Limited of Grays Newsagents (York) Limited

The OFT's decision on reference under section 33(1) given on 3 August 2007. Full text of decision published 10 August 2007.

Please note that square brackets indicate figures or text which have been deleted or replaced with a range by the OFT or at the request of the parties for reasons of commercial confidentiality or public interest.

PARTIES

1. **Menzies Distribution Limited** (Menzies), a wholly owned subsidiary of John Menzies plc, is a leading newspaper and magazine wholesaler in the UK.

2. **Grays Newsagents (York) Limited** (Grays) is an independent newspaper wholesaler of national and some regional newspapers mainly in the York area[1]. Grays' audited turnover was £15.266 million for the year to 30 September 2006.

TRANSACTION

3. Menzies has agreed to acquire the entire issued share capital of Grays from Perio News Limited, Grays' parent company, which is owned and controlled by Mr.Gray, Managing Director of Grays. The agreed consideration is [ ] (subject to adjustments).

4. Currently Menzies does not wholesale newspapers in the York area, only magazines, whereas Grays has only ever wholesaled newspapers in the York area. Grays' rationale for the transaction is to find a purchaser for the family owned business following Mr Gray's decision to retire and sell his business due to serious ill health. Menzies' rationale is to consolidate its

[1] Comprising postcodes YO1, YO7, YO8, YO10, YO17, YO19, YO23, YO24, YO26, YO30, YO31, YO32, YO41, YO42, YO51, YO60, YO61, YO62, YO91, HG1, HG2, HG3, HG4, HG5, LS24, YO43.

position in the York area and benefit from any efficiencies flowing from distributing newspapers and magazines together from its existing Clifton Moor depot into the York area.

5. The parties filed a Merger Notice on 11 June but later withdrew that submission; the anticipated acquisition has therefore been treated under the administrative timetable with a target date for announcing a decision of 3 August 2007.

JURISDICTION

6. The parties' wholesale newspaper distribution businesses will come under common ownership and the parties' combined share of supply of newspaper wholesaling services in the UK exceeds 25 per cent, satisfying section 23 of the Enterprise Act 2002 (the Act). The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITON

Service market

7. Depending on what market definition is adopted to assess the competitive constraints on the parties, a contemporaneous overlap is either in newspaper and magazine wholesaling together or non contemporaneous in each separately. Menzies submits that the appropriate service market is the supply of wholesaling and distribution services to publishers of national and regional newspapers as part of the wider service market for the supply of wholesaling and distribution services to publishers of national and regional newspapers and magazines.

Newspaper and magazine wholesaling

8. The OFT recently considered the mergers of **Menzies / Thos Swift - CIWN**[2] and **Menzies / Eason**[3] on the basis of newspaper and magazine wholesaling

[2] OFT decision of 27 March 2006.
[3] OFT decision of 5 April 2007. Much earlier, in 1993, the MMC considered the supply of both products 'inextricably linked'. See Report on the supply of national newspapers in England and Wales, Cm 2422, 1993.

together; considering them separately would not have altered the competitive assessment in either case. Equally, the OFT did not find it necessary in those mergers to sub-segment newspapers into newspapers types (for example, national, regional or Sunday).

9. In this investigation, some third parties informed the OFT that newspaper and magazine wholesaling should be considered together. One third party submitted that combined distribution of newspapers and magazines was more cost effective for retailers, more environmentally friendly and likely to be a more efficient service for the consumers. Another stated that in most cases a wholesaler of newspapers would have the capability to wholesale magazines and vice versa. Some third parties commented that, whilst there are some differences, newspaper and magazine distribution had mostly evolved in parallel in order to achieve scale efficiencies.

10. For the purposes of this merger, it is not necessary for the OFT to conclude on the question of whether newspaper and magazine wholesaling should be considered together or each separately as the outcome of the competition assessment is the same whichever measure is used. We have therefore assessed this merger on the basis of newspaper and magazines wholesaling together and each separately. We have also not found it necessary to sub-segment newspapers into newspapers types, as it does not affect the outcome of the competitive assessment.

Geographic market

11. In **Menzies / Thos Swif**t – **CIWN** and **Menzies / Eason,** the OFT left open the possibility of the geographic market for newspaper and magazine wholesaling being regional or national.

12. In this case, Menzies submits only a national geographic market for newspaper and magazine wholesaling is appropriate. Menzies takes this view because margins and service level standards are agreed nationally with publishers; there is no scope for a wholesaler to agree local variations. Some publishers explained that they award all territories on the same terms across the UK to wholesalers through a tender process. If Menzies tried post-merger to raise prices in the York area in the next tender round of publisher contract renewals, Menzies claims it would face the loss of other territories.

13. However, some publishers submitted that margins are set with wholesalers on a regional basis, with no national rates. One publisher submitted that the regional nature of wholesale distribution of newspapers and magazines was due to a combination of factors, including: natural geography; regional editions of newspapers and magazines; time sensitivity; the practical constraints of print and publishing centres; and the scale economies of regional wholesale operations. Another third party argued that the geographic wholesale area is historical and based on the area to be supplied being '*viable, sustainable and practical*....'.

14. Subject to a distribution contract of sufficient scale and duration, the OFT considers, on the basis of evidence before it, that Dawson News, Smiths News and Menzies (the 'multiples') are able to supply wholesaling services across the UK.

15. For the purposes of this merger, it is not necessary for the OFT to conclude on whether the market is regional or national. We have taken a cautious approach in this particular case and applied a regional geographic market for the assessment on the basis that if there are no concerns regionally for newspaper and magazine wholesaling together or each separately, there will be no concerns nationally.

HORIZONTAL ISSUES

Shares of supply

16. As Grays is not active in magazines, Menzies' share of supply of magazines will be unchanged on any geographic basis. For the wholesaling of national newspapers, Menzies' share of UK supply will increase as a consequence of the merger by 0.9 per cent to 31.4 per cent, with the multiples and independents making up the remainder. In respect of newspapers and magazines combined in the UK the post-merger share is 29.6 per cent, with an increment of 0.4 per cent.

17. At the regional level (i.e. the York area territories serviced by Grays), Grays has a market share of 54.6 per cent in magazine and newspaper wholesaling and Menzies 45.6 per cent, a contemporaneous overlap only arises if newspapers and magazine wholesaling is treated together, because Menzies currently has no distribution contract for newspapers but supplies 100 per cent of magazines; conversely, Grays has no magazines contract

but supplies 100 per cent of national newspapers in this territory. However, as competition occurs 'for the market' at each tender round for newspaper and magazine wholesaling, these share data are arguably a snapshot. The critical measure of market power and each supplier's relative competitive positions is their future ability and incentive to tender for such contracts. Past evidence of submitted tenders and successes are relevant in this regard, as are publishing customers' views on the pool of suppliers they regard as potential wholesalers for their business.

Unilateral effects

Magazines

18. The OFT does not regard Grays and Menzies as material actual or potential competitors for magazine wholesaling because Grays has only bid for two magazine contracts in the York area in the last 17 years. On losing the second bid 12 years ago Grays made a positive decision to focus on newspapers only.[4] No concerns therefore arise as regards magazines, as the merger does not make a material difference.

Newspapers

19. Any possible merger effects in newspaper wholesaling appear to be limited to the York area. Grays has been successful as a newspaper distributor in its local York area, but has never competed on a newspaper contract outside the York area. Conversely, of several York area newspaper publisher contracts tendered in 2005/6, Menzies only bid against Grays for one. Its previous (two) unsuccessful bids were in a previous tender over ten years ago, in 1994/5. In assessing the constraint imposed by Menzies on Grays absent the merger, based on its pre-merger record at least, therefore, such constraint on Grays' bidding for and performance of newspaper wholesaling in the York area would appear to be relatively limited.

20. In any event, the OFT considers the weight of third party evidence in this case to indicate that, going forward, publishers have the ability and incentive to replicate the competitive constraint posed by Menzies as an

[4] Some magazine publishers/distributors have also recently publicly stated that they do not wish to contract with independents.

alternative bidder on newspaper contracts historically won by Grays post-merger. This is reflected in the fact that all large publishers either actively support, or are materially unconcerned, about the merger, indicating in the OFT's view that they do not perceive that they will be subject to adverse merger effects flowing from it, such as higher distribution costs or lower performance standards. The evidence on the strength of their countervailing ability to protect themselves from adverse merger effects in this particular case may be summarised as follows.

- **Sponsored entry.** Publishers can sponsor the entry of, for example, another multiple (Dawson, Smiths) including by means of reconfiguring distribution territories if necessary. Some publishers commented that if they needed to encourage more bids at the next tender round, they have the power to reorganise territories to make them more financially attractive to wholesalers. Another publisher also stated that in a previous tender they contacted logistics companies that they believed would be interested in wholesale distribution.

- **Self-supply.** News International already engages in self-supply via its NSRL business. Past evidence aside, one publisher explained to the OFT that they would consider pursuing self-supply if prices increased post merger in the next tender round.

- **Other evidence of countervailing publisher power.** Various submissions by Menzies on the leverage wielded by publishers has not been contradicted by, and is otherwise broadly consistent with, evidence from other sources. For example, Menzies submits that the publishers' ability to specify high service standards in contracts is also indicative of buyer power. According to Menzies however, the ultimate manifestation of publisher power lies in the ability to terminate agreements under a 'change of control' clause, giving 90 days notice. Menzies considers this right as significant in enabling the extraction of significant commercial benefits as a condition of not terminating agreements in the event of a merger and even to defeat any suspected unilateral effects of a merger, such as this one. Menzies confirmed that publishers have used these rights in the past to prevent transactions or require modifications/capital payments.

21. Menzies also argues that there is potential for new entry in the York area, submitting that the capital expenditure required to set up a modern depot

from scratch capable of handling all publishers' titles in a territory is estimated to be approximately £1m to £1.5m. Menzies listed examples of another multiple establishing new depots in the Chester and Preston area following newspaper contract wins and another upon commencing a national distribution service for magazine publishers. While the majority of third parties (including Menzies) submitted that the critical pre-condition to entry is obtaining a distribution contract from a publisher of sufficient scale and duration, most also explained that a new entrant could put the necessary practical arrangements in place in a timely manner as wholesaling is considered essentially a logistics business.

22. Other multiples aside, evidence before the OFT confirms however that, historically, entry by non-traditional wholesalers has not in fact taken place in the York area or indeed nationally. Third parties allege this is due to a number of reasons including:- the determination of publishers to deal with existing multiples rather than independents (which many publishers believe facilitates transactional efficiencies, harmonised service levels and greater wholesaler incentives to invest); decreasing newspaper volumes and wholesaler margins; more stringent publisher service standards. These factors would not change as a result of the merger.

23. Overall, therefore, the above evidence leads the OFT to conclude that merger does not present a realistic prospect of a substantial lessening of competition with respect to large publishers post-merger relative to reasonable definition of the counterfactual, that is the competitive outcome absent the merger. These large publishers account for around 90 per cent of newspaper and magazine distribution turnover in the York area.[5]

24. With respect to the residual approximate 10 per cent of combined newspaper/magazine turnover and approximate 25 per cent of newspaper-only turnover accounted for by small/medium-sized publishers, often of regional publications, the competition between the parties for these customers is on the evidence available, in the OFT's view, limited in the sense that the configuration and operational performance of their delivery networks are principally driven by agreeing the terms of the publishers which account for 90 per cent of business, including non-price terms such as key performance indicators on timely delivery and so forth; these

[5] The top four large newspaper publishers account for nearly 75 per cent in terms of Grays turnover in the York area.

parameters are unlikely to be driven by negotiations by such a small proportion of business with small/medium publishers. This tends to limit the parameters of competition between the parties for this 10 per cent of business, and therefore the parameters and scale of any possible merger effect in respect of these customers. Moreover, for some such customers with daily delivery needs, Grays as the newspaper wholesaler was in all probability the only realistic supplier, which would leave them unaffected by the merger. Nevertheless, in contrast to the large publishers, not all small/medium publishers were positive or materially unconcerned toward the possible impact of the merger; some commented that if there was only one wholesaler in the York area they may not have sufficient buyer power to protect themselves from unjustified wholesaler margin increases post merger. An issue is therefore whether such customers would in fact have selected from two newspaper distributors in York absent the merger.

25. While the best guide to conditions absent the merger is usually pre-merger competitive conditions, the OFT is satisfied that there is sufficient compelling evidence that this selection will not occur in this case. Unusually, the OFT has suitable evidence from Grays and from customers, respectively, that (i) Mr Grays is in serious ill health and will retire rather than continue with the business and invest capital in new equipment for the business as some large publishers recently requested; Grays stated that they will 'let publishers decide who takes over' (ii) customer evidence supports the proposition that their goodwill associated with the Grays business resides with the current management team led by Mr Gray himself and is instrumental to the credibility of the business from the perspective of publishers.

26. The OFT is also satisfied that other potential buyers of the residual Grays business, or the liquidation of the Grays business, are not realistic scenarios. Transfer of the territory to another buyer requires consent via the change of control clauses in publisher contracts, and the large publishers have in fact refused consent in prior cases in respect of the other multiples. Unlike Menzies, the other multiples are not present in and around the York and contiguous areas, nor have they historically bid for contracts in the York area. Accordingly, the OFT believes it inappropriate in this case to adopt a counterfactual is one in which the Grays business would pass to a supplier other than Menzies. With that being the case, any reduction in choice for small/medium publishers should not be attributed to the merger as such: the existence of such choice is governed by the

relationship between large publishers and wholesalers. For the York area going forward -- with the departure of Grays led by Mr Grays himself -- this relationship means that realistic alternative scenarios lead to the same competitive outcome: Menzies will inherit the relevant contracts and thus supply both newspapers and magazines in the York area. It will of course do so, as discussed above, subject to the countervailing ability of the large publishers to protect themselves from adverse merger effects.

27. Although the parties' primary customers are publishers who pay for their services via an agreed wholesaler margin, secondary customers are the retailers. Retailers have no choice of wholesaler because there is only one wholesaler appointed by each newspaper and magazine publisher in the territory. Retailers pay wholesalers for deliveries of newspapers and magazines by virtue of a carriage service charge (CSC). The OFT has no evidence before it which demonstrates that competition between wholesalers for a large publisher's contract affects the CSC charged by the wholesaler. However, Menzies has submitted that retailers which are currently customers of both Menzies and Grays in the York area will benefit from a reduction in CSCs by £144,830 per annum by savings in avoiding the payment of charges to two wholesalers to deliver newspapers and magazines, respectively. Menzies claims there would be administrative savings from dealing with one wholesaler in addition to a CSC reduction, although retailers have not confirmed the former.

Coordinated effects

28. The OFT considers the possibility of creating or strengthening coordinated effects does not arise in this merger. Collusion as a theory between two or more suppliers would only be viable as a theory of harm post-merger on a geographic basis wider than the York area. On a wider regional or national basis, there is no evidence available in this case to suggest that the addition of the Grays newspapers contracts to Menzies makes any conceivable coordination between the multiples materially more likely, durable or extensive at the wholesaler level nationally, or that it would facilitate upstream coordination by large publishers.

Barriers to entry and expansion

29. Barriers to entry and expansion are discussed above. The OFT considers, and third parties confirmed, that the critical pre-condition to market entry is

winning a distribution contract of sufficient scale and duration, which requires the relevant publisher to consent to the award of its business to that supplier.

Buyer power

30. Buyer power has been discussed above.

THIRD PARTY VIEWS

31. Third party views are expressed above. In general, the majority of publishers were in favour or neutral regarding the merger. Opinion among small/medium publishers was divided. A significant number of retailers expressed non merger specific concerns about Menzies but equally some retailers acknowledged the transactional benefits of dealing with one wholesaler for newspapers and magazines in the York area and of any CSC reduction.

ASSESSMENT

32. Any possible merger effects of this transaction are in the OFT's view limited to wholesaling in the York area, as Grays has never bid outside York. Grays has only bid for two magazine contracts in the York area in the last 17 years and has been focussed on newspapers only for nearly 12 years; the OFT therefore considers that no concerns arise as regards magazines. Based on Menzies pre-merger record of 3 bids for newspaper contracts in 12 years, the constraint imposed by Menzies on Grays newspaper wholesaling absent the merger would appear to be relatively limited. Whilst Menzies may be considered to constrain Grays newspaper wholesaling in the York area to some extent, Grays does not appear to constrain Menzies.

33. In view of the possible loss of such constraint however, third parties have submitted that large publishers do have the ability and incentive to replicate the competitive constraint posed by Menzies as an alternative bidder, which is confirmed by the lack of material concerns from large publishers. Such constraint may take the form of sponsored entry from other multiples (including reconfiguring distribution territories if necessary to encourage bids); self-supply, one large publisher explained to the OFT that they would consider pursuing self-supply if prices increased post merger in the next

tender; and publisher 'change of control' clauses, used to defeat any suspected unilateral effects of a merger or to require modifications/capital payments.

34. A wholesaling contract of sufficient scale and duration is also in the large publishers gift, to facilitate new entry. In the OFT's view, this is the critical pre-condition to entry and not the entry costs themselves, which are also largely recoverable on exit. Whilst there is a range of factors historical to wholesaling why there has been no new entry in recent years (from non multiples), these factors are unchanged as a result of the merger.

35. Wholesaler competition for many small/medium publishers appears in the OFT's view to be driven by the formers' agreements with large publishers. However, some small/medium publishers were not positive or materially unconcerned toward the merger, stating that they may not have sufficient buyer power to protect themselves post merger. The OFT therefore considered whether small/medium publishers would in fact have chosen from two newspaper distributors in York absent the merger. While the status quo is ordinarily the best guide to competitive conditions absent the merger, the OFT is satisfied that there is sufficient compelling evidence that this choice will not occur in this case because Mr Gray is in serious ill health and will retire rather than continue the business and invest capital in new equipment, and evidence shows that goodwill associated with Grays resides with the current management team led by Mr Gray himself as being instrumental to the credibility of the business from the perspective of large publishers. Due to any contract transfer requiring the consent under the change of control provision (which the large publishers have exercised unfavourably previously in respect of the other multiples but which have already exercised in favour in Menzies) and the fact that the other multiples have never bid in the York area, the OFT is satisfied that other potential buyers of the residual Grays business, or the liquidation of the Grays business, are not realistic scenarios against which the effects of the merger should be judged. Accordingly, the OFT believes it inappropriate in this case to adopt a counterfactual under which the Grays business would pass to a supplier other than Menzies.

36. Retailers have no choice of wholesaler pre-merger and this will not be altered by the merger, so the OFT considers their position as unaffected for the purposes of this merger assessment. Whilst retailers acknowledged some benefits of the merger, they also raised a large number of non merger

specific existing disputes with Menzies' service level, which the OFT does not consider relevant to its merger assessment. Menzies has submitted that retailers which are currently customers of both Menzies and Grays in the York area will benefit from a reduction in CSCs by £144,830 per annum by avoiding the payment of CSCs to two wholesalers.

37. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

38. This merger will therefore not be referred the Competition Commission under section 33(1) of the Act.