Newspaper and magazine distribution

Opinion of the Office of Fair Trading - guidance to facilitate self-assessment under the Competition Act 1998

October 2008
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EXECUTIVE SUMMARY

This Opinion provides guidance to facilitate self-assessment of the compatibility with the Competition Act 1998 (CA98) of the agreements between national newspaper publishers or consumer magazine publishers / distributors on the one hand, and wholesalers on the other (the Agreements) in which the former grant the latter exclusive territories for distribution of their products from which all competing wholesalers are excluded (that is, there is absolute territorial protection, ATP\(^1\)).

This Opinion does not reach any definitive conclusions on the status of any individual existing Agreement under the CA98. The parties to the Agreements are encouraged to use the framework provided in this document to make an individual self-assessment of the compatibility of their own Agreements\(^2\) with the relevant provisions of the CA98.

An Opinion cannot prejudge the assessment of the same question by the European Commission, the European Court, or the Competition Appeal Tribunal. Nor does it bind other national competition authorities or courts having the power to apply Articles 81 and 82 or the prohibitions in the CA98. An Opinion also cannot bind the subsequent assessment of the same or similar issues by the OFT, although the OFT will have regard to its Opinion when carrying out any such assessment.

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\(^1\) The exclusive territorial rights conferred by the Agreements are underpinned by contractual provisions prohibiting both active and passive sales between territories. The ban on active sales means that the wholesaler is prevented from actively marketing the newspapers or magazines to retailers outside its allocated territory. The ban on passive sales means that the wholesaler is prevented from responding to unsolicited requests to supply newspapers or magazines from retailers outside its allocated territory. The combination of the award of exclusive territories and bans on active and passive sales across distribution territories results in ATP.

\(^2\) In general most publishers are likely to have Agreements with several wholesalers, and most wholesalers are likely to have Agreements with several publishers, but it is possible that a company could be party to a single Agreement (for example, an independent wholesaler that distributes a single publisher’s titles).
The publication of this Opinion follows a request from a group of newspaper and magazine publishers and wholesalers to either recommend an industry-specific block exemption under section 6 of the CA98 to remove the Agreements from the scope of section 2 of the CA98, or issue an Opinion to provide guidance to the industry on the compatibility of the Agreements with competition law.

The OFT has published two draft Opinions for consultation (in May 2005 and May 2006) and the Opinion published here takes into account the responses to both these consultations.

In producing this guidance the OFT has also taken into account relevant matters arising from, and in the context of, its work on the review of the National Newspapers Code of Practice and its consideration of a request for a market investigation reference. These additional work-strands have enabled the OFT to take a holistic view of the supply chains for newspapers and magazines and to gain a more detailed perspective on their operation.

The OFT has engaged extensively with stakeholders at each level of the supply chain, including individual parties and trade associations. This has involved meetings with a wide range of stakeholders and the consideration of various submissions and detailed responses to OFT questionnaires. The OFT has also visited a newspaper publisher, wholesaler and retailer and a magazine distributor to further its practical understanding of how the supply chains operate. The OFT values the constructive engagement it has had in this context with very many stakeholders.

In order to inform this guidance, this Opinion includes a discussion of the factual and economic background to the Agreements. This comprises an overview of the supply chain, discussions of the current arrangements for newspaper and magazine distribution and how newspaper and magazine distribution may operate in the absence of ATP and some comments on market definition.

Unlike supply chains for many other products, which are retailer-driven, the newspaper and magazine distribution supply chains are supplier-driven. Publishers / distributors exercise a strong degree of influence over the supply chain, in particular over pricing (through the use of cover prices), the volumes of
the product received by individual retailers (copy allocation) and the nature of the service that wholesalers provide to retailers.

The OFT considers that the 'publisher-led' nature of the supply chains largely arises from the particular characteristics relating to the supply of national newspapers and magazines. In particular:

- **Markets for newspapers and magazines are 'two-sided', that is, the publications provide both editorial content and advertising space, and publishers receive revenue from both readers and advertisers** - publishers and retailers are therefore likely to face different incentives regarding prices and quantities. Publishers will take account of how changes in circulation figures and readership profiles will affect both their cover price revenues and advertising sales revenues, whereas retailers' incentives will relate only to how sales volumes respond to cover price changes. As a result, publishers may have stronger incentives to increase circulation than wholesalers or retailers.

- **Each issue of a newspaper or a magazine is in some respects a new product in that the content will vary from issue to issue, albeit within a consistent 'product image' that publishers will seek to maintain** - this means that demand can vary from issue to issue depending on the content and publishers may be better able to gauge these likely fluctuations in demand than retailers, particularly if there is little notice that the 'big story' or feature will be included.

- **The fixed costs involved in production and printing are substantial and the marginal costs are relatively low, and producing editorial content involves significant fixed costs and zero marginal costs** - this means that it is relatively cost effective for publishers to print more copies than they expect to sell to allow for variability in sales at individual outlets and to use availability as a form of promotion.

In relation to how the market may develop in the absence of the Agreements, the OFT considers that there is a significant difference between national newspaper distribution and magazine distribution. In relation to:
• **Newspaper distribution** - the tight timescales required mean that wholesalers are limited in the areas that it is feasible for them to serve from their depots. In addition, economies of scale, scope and density mean that it is unlikely that wholesalers would wish to establish a large number of small depots that compete to serve areas. As a result, it appears that relatively limited 'competition in the market' may emerge in relation to newspaper wholesaling in the absence of ATP. Such competition appears likely to arise where there are other wholesalers that can reach the retailer within the tight timescale required for newspaper distribution, most likely in areas around the boundaries of wholesalers' territories. It appears likely that there will be areas where retailers would have no choice of wholesaler, most likely closer to wholesalers' depots.

• **Magazine distribution** - the timescales for distribution are typically longer\(^3\) than those for newspapers, suggesting that the potential geographic reach of wholesaler depots would be considerably greater for magazines than for newspapers. In addition, the longer timescales may also make it feasible for new entrants to join the wholesaling market, or for new methods of wholesaling to develop. This means that there is more likely to be scope for 'competition in the market' to develop for magazine wholesaling in the absence of ATP.

In relation to the guidance as to whether the Agreements are likely to be caught by section 2 of the CA98, this Opinion addresses the general relevant principles of European case law regarding agreements which have the object of preventing, restricting or distorting competition, and sets out the considerations which the parties should take into account in applying these principles to their Agreements. In particular:

• agreements that grant wholesalers exclusive territories and prevent them from making passive sales to other territories would, by their very nature, prevent wholesalers from entering into arrangements to supply any retailer that they choose in those other territories, and

\(^3\) However, there are some magazines, such as classified advertising magazines, which have very compressed timescales, similar to those for newspapers.
where retailers are not able to switch between wholesalers, competition at the retail level is in turn likely to be restricted.

In relation to the guidance as to whether the Agreements are likely to benefit from exemption under the CA98, this Opinion addresses the general relevant principles and sets out the considerations which the parties should take into account in applying these principles to their Agreements.

In relation to the first exemption condition, that is that the agreement contributes to improving production or distribution, or promoting technical or economic progress, this Opinion sets out a number of factors that may demonstrate that ATP in the Agreements generates potential objective efficiency gains in relation to the newspaper supply chain. The main potential efficiency benefits discussed are that ATP:

• may make 'competition for the market' more effective, enabling publishers to achieve reduced margins and improved service quality from wholesalers and providing a stimulus to wholesalers to innovate, and

• may support the wide availability of newspapers, in particular by enabling publishers to include in their contracts with wholesalers an obligation to supply all retailers (within reason) in a territory.

The applicability of these factors to the Agreements between magazine publishers / distributors and wholesalers is also discussed. It would appear likely that, in relation to the first exemption condition, the potential objective efficiency gains regarding ATP in Agreements relating to magazine distribution are not as significant as for newspaper distribution as there is greater scope for 'competition in the market' to emerge in the absence of ATP. In addition, there is less likely to be a need for an obligation to supply since consumers are likely to be able to purchase from a range of retail outlets. Consequently, it may be difficult to demonstrate that magazine Agreements satisfy the first exemption condition.
In relation to the second exemption condition, that is that consumers are allowed a fair share of the benefits resulting from the agreement, this Opinion sets out two key considerations in relation to the Agreements between newspaper publishers and wholesalers regarding pass on to final consumers, namely:

- **whether publishers have incentives to pass the benefits they receive in terms of reduced costs to consumers in the form of lower prices and/or improved product quality** - this will depend on the intensity of competition between publishers. In addition, publisher incentives to pass on benefits in the form of lower prices may be stronger than the incentives for retailers because of the two-sided nature of the markets (which gives publishers an incentive to hold down prices because of the impact this has on circulation volumes which in turn affects advertising revenues) and the limited ability of newspaper purchasers to switch between retail outlets (which gives retailers limited incentives to cut prices in order to induce purchasers to switch to their outlet), and

- **whether consumers benefit from the obligation to supply in publisher-wholesaler contracts** - this is likely to be of direct benefit to consumers since it will reduce the 'costs' they incur in purchasing their newspapers. If wider availability increases circulation and reduces the costs of producing the title, it may also enable publishers to reduce cover prices. Wider availability leading to higher circulation may increase advertising demand, which may also enable publishers to reduce cover prices.

In relation to the Agreements between magazine publishers / distributors and wholesalers and pass on to final consumers, it would appear that magazine publishers are likely to have incentives to pass on any benefits they receive in terms of reduced costs to consumers in the form of lower prices and/or increased quality, for similar reasons to those set out above in relation to newspapers. However, these considerations should be assessed by reference to the fact that there is greater potential for 'competition in the market', which is restricted by ATP, in relation to magazines than there is for newspapers.
It is also relevant to note that there are two differences between newspapers and magazines in terms of publisher versus retailer incentives to pass on benefits:

- **advertising typically accounts for a lower share of revenue for magazines than it does for newspapers** - this may mean that the two-sided nature of the markets provides less incentive for magazine publishers to pass on cost reductions than for newspapers, and

- **customers are likely to have greater flexibility about when and where they purchase magazines because magazines are not as extremely perishable as newspapers** - this would create greater incentives for retailers to pass on any cost reductions in relation to magazines than would appear to be the case for newspapers.

The extent to which retailers are likely to benefit from the Agreements will vary between retailers. Those retailers that would be able to switch wholesaler in the absence of ATP are likely to receive little or no benefits from the Agreements if, by switching, they would be able to, for example, discipline wholesaler service quality. However, for those retailers that are likely to have little scope to switch between wholesalers in the absence of ATP, there may be benefits from the Agreements if publishers / distributors are able to ensure high quality of service provision to retailers by wholesalers, provided publishers / distributors and retailers have common interests in the nature of wholesaler service provision. Where the Agreements contain an obligation to supply, this will also be of benefit to retailers that would otherwise not be supplied.

Overall therefore, it would appear that for newspapers there are several factors that may demonstrate that consumers receive a fair share of the benefits which, in the event that the first exemption condition is satisfied, result from the newspaper Agreements. Since the second condition incorporates a 'sliding scale', the parties will need to take into account the extent of the restriction of competition in relation to their newspaper Agreements and assess whether the consumer pass-on of any efficiencies generated by their newspaper Agreements is sufficient to at least compensate consumers and retailers for any actual or likely negative impact caused to them by the restriction of competition, such
that the net effect of the newspaper Agreements is at least neutral from the perspective of those consumers and retailers directly or likely affected by the newspaper Agreement.

In relation to magazine Agreements, however, it would appear that there are likely to be fewer objective efficiency gains regarding ATP for magazines than for newspapers, and that the incentives for publishers to pass a fair share of any such benefits on to consumers may be weaker. Applying the 'sliding scale' test, these considerations should also be assessed by reference to the fact that there is greater potential for 'competition in the market' in the absence of ATP, and thus a greater restriction of competition under section 2, in relation to magazine Agreements than there is for newspaper Agreements. As such, it may be difficult to demonstrate that magazine Agreements satisfy the second exemption condition.

In relation to the third exemption condition, that is that the agreement does not impose restrictions which are not indispensable to the attainment of the efficiencies created by an agreement, this Opinion sets out the following guidance. In relation to:

- **Newspapers** - where there are limits to the scope for competition 'in the market', the third exemption condition is likely to be satisfied provided that efficiency of distribution is increased by exclusive territories, and ATP makes competition for these territories more effective. In addition, this condition is likely to be met if, in the absence of ATP, it would be impossible, or significantly less likely to be possible, to include an obligation to supply.

- **Magazines** - since the scope for competition in the market is likely to be more significant, it may be difficult to demonstrate that this condition is satisfied, since efficiencies in distribution may be achieved through competition in the market.

In relation to the fourth exemption condition, that is that the agreement does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question, this Opinion provides
guidance that there are factors that may demonstrate that this condition is met in relation to both newspaper and magazine Agreements, notwithstanding the impact of ATP on the ability of retailers to switch between wholesalers, and given the particular characteristics of these supply chains. These factors include the extent to which competition would remain at each level of the supply chain, with ATP. In this regard parties will need to consider:

- in relation to wholesaling, the effectiveness of competition for the market and the ability of publishers to discipline the quality of wholesaler service provision during the life of a contract,

- in relation to retailing, the extent to which publishers work with retailers to facilitate competition, for example through retailer specific promotions, and retailers compete on the level of service they provide, and

- in relation to publishing, the effectiveness of inter-brand competition.

As a whole, therefore, for the supply of newspapers, there are factors that may demonstrate that the Agreements benefit from exemption under the CA98. For the supply of magazines, however, these factors appear less likely to apply such that it may be difficult to demonstrate that magazine Agreements benefit from exemption under the CA98. The parties will need to consider whether the arguments discussed in this Opinion apply in relation to their Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Alongside this document, the OFT has also published a paper setting out an introductory overview of the newspaper and magazine supply chains. This paper is supplementary to, and does not form any part of, the Opinion but may be of assistance to those less familiar with the industry. The OFT’s Code Review and proposed decision on an MIR, which are published alongside this Opinion, may also provide useful further background.
1 INTRODUCTION

Purpose of this document

1.1 This Opinion provides the OFT’s guidance in respect of the agreements between national newspaper publishers or consumer magazine publishers/distributors on the one hand, and wholesalers on the other, (the Agreements) in which the former grant the latter exclusive territories for distribution of their products from which all other competing wholesalers are excluded.

1.2 The exclusive territorial rights conferred by the Agreements are underpinned by contractual provisions prohibiting both active and passive sales between territories. The ban on active sales means that a wholesaler is prevented from actively marketing the newspapers or magazines to retailers outside its allocated territory. The ban on passive sales means that the wholesaler is prevented from responding to unsolicited requests to supply newspapers or magazines from retailers outside its allocated territory. The combination of the award of

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4 Consumer magazines are magazines that are typically aimed at consumers’ leisure interests and generally made available through retail channels, although they may also be sold via subscription, as distinct from business magazines or other periodicals which are typically focused on an industry or profession and are generally distributed via subscription and not available in retail outlets.

5 In the case of magazines, there are distributors who aggregate a number of magazine titles prior to their distribution by a wholesaler. It should be noted that not all magazines are distributed in this way. Some titles are delivered directly to the wholesaler by the magazine publisher.

6 The prohibition imposed upon wholesalers concerning passive sales is also included in paragraph 1.3 of the National Newspapers Code of Practice (see paragraph 1.12 below), which is typically incorporated into the newspaper Agreements by reference.
exclusive territories and bans on active and passive sales\(^7\) across
distribution territories results in absolute territorial protection (ATP).

1.3 This Opinion provides guidance to facilitate self-assessment by the
industry on whether the Agreements are likely to be caught by section 2
of the CA98 (the Chapter I prohibition), and the factors that are likely to
be relevant to an assessment of whether the Agreements satisfy the
exemption conditions set out in section 9(1) of the CA98.\(^8\)

1.4 This Opinion does not reach any definitive conclusions on the status of
any individual existing Agreement under the CA98. The parties to
Agreements are encouraged to use the framework provided in this
document to make an individual self-assessment of the compatibility of
their Agreements\(^9\) with the relevant provisions of the CA98.

\(^7\) In the European Commission Notice *Guidelines on Vertical Restraints* (2000) OJ C291/1,
‘active’ sales are interpreted (at paragraph 50) as ‘actively approaching individual customers
inside another distributor’s territory or exclusive customer group’ and ‘passive’ sales are
interpreted as ‘responding to unsolicited requests from individual customers including
delivery of goods or services to such customers’, the references to such customers being to
customers inside another distributor’s territory or exclusive customer group.

\(^8\) Anti-competitive agreements between undertakings may be prohibited by Article 81 of the
EC Treaty where they may affect trade between Member States. It is possible that some
Agreements may affect trade between Member States (for example, where there is cross-
border trade between Northern Ireland and the Republic of Ireland) and therefore be subject
to Article 81 in addition to the Chapter I prohibition. However, the OFT has not examined
any of the Agreements individually and is therefore not in a position to provide a view on
this issue. Parties to a particular Agreement wishing to establish whether it is subject to EC
law would therefore need to undertake an individual analysis of whether or not cross-border
economic activity inside the EU, and thus patterns of trade between Member States, are
capable of being appreciably affected by that Agreement. See Commission Notice,
*Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty* OJ C
101/94.

\(^9\) In general most publishers are likely to have Agreements with several wholesalers, and most
wholesalers are likely to have Agreements with several publishers, but it is possible that a
company could be party to a single Agreement (for example, an independent wholesaler that
distributes a single publisher’s titles).
Background

The Block Exemption Initiative

1.5 Until 1 May 2005, the Agreements benefited from an exclusion from scrutiny under the Chapter I prohibition by virtue of the Vertical Agreements Exclusion Order (VAEO). On 17 June 2003, the Department of Trade and Industry (DTI) proposed that the VAEO should be repealed in light of the ‘modernisation’ of the rules relating to the enforcement of competition law. The decision to repeal the VAEO was confirmed on 1 March 2004, to take effect on 1 May 2005.

1.6 Publishers, distributors and wholesalers within the newspaper and magazine industry in the UK expressed concern about the repeal of the VAEO, as it meant that the Agreements would cease to be automatically excluded from the scope of the Chapter I prohibition. They also expressed concern that the Agreements in their current form would not be protected by the EC block exemption for vertical agreements (EC

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11 In June 2007, the DTI became part of the then newly created Department for Business, Enterprise and Regulatory Reform (BERR).

Verticals Block Exemption)\textsuperscript{13} because they contain restrictions giving the appointed wholesaler absolute territorial protection.

1.7 On 7 May 2004, a group of publishers, distributors and wholesalers known as the Block Exemption Initiative (BEI) made a submission to the OFT putting forward its case as to why the OFT should recommend to the DTI that it grant an industry-specific block exemption under section 6 of the CA98 to remove the Agreements from the scope of the Chapter I prohibition. The request for a block exemption was subsequently followed by a request that, should the OFT decline to recommend such a block exemption, it should issue an Opinion instead. Given the background and the very specific circumstances of the case, the OFT considered it appropriate to provide guidance to the industry in the form of an Opinion.\textsuperscript{14}

Previous draft Opinions

1.8 The OFT published a draft Opinion for consultation in May 2005. Having taken account of the points raised in responses to that consultation, the OFT published a revised draft Opinion for consultation in May 2006.\textsuperscript{15} The Opinion published here, which concludes the OFT’s current work in this area, takes into account the responses to both these consultations.

\textsuperscript{13} Commission Regulation (EC) No. 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (1999) OJ L336/21. Where an agreement satisfies all of the conditions provided for by an EC block exemption regulation, the prohibition in Article 81(1) EC of anti-competitive agreements that may affect inter-state trade – on which the prohibition in section 2 of the CA98 is closely modelled – is automatically disapplied. By virtue of section 10 of the CA98, the agreement also benefits from a so-called ‘parallel exemption’ from the Chapter I prohibition.

\textsuperscript{14} See chapter 2 of this Opinion for the OFT’s reasoning for the appropriateness of an Opinion in this case.

\textsuperscript{15} The OFT is not under any obligation to consult on Opinions generally but did so previously in this case in the interests of transparency and given the high level of public interest in this matter. The OFT will not always undertake such public consultations before issuing any Opinion.
1.9 In addition, the OFT has also taken into account relevant matters arising from, and in the context of, its work on the review of the National Newspapers Code of Practice and its consideration of a request for a market investigation reference. These additional work-strands have enabled OFT to take a holistic view of the supply chains for newspapers and magazines and to gain a more detailed perspective on their operation.

The review of the undertakings relating to the National Newspaper Code of Practice

1.10 In 1993, the Monopolies and Mergers Commission (MMC) reported on the supply of national newspapers in England and Wales, following a reference by the then Director General of Fair Trading under the monopoly provisions of the Fair Trading Act 1973 (FTA73). The MMC concluded that newspaper publishers' adherence to exclusive distribution arrangements did not operate against the public interest. However, the MMC identified two wholesaler practices which it concluded operated or may be expected to have operated against the public interest:

- the refusal by the wholesalers to supply newspapers to new retail outlets where, in the wholesaler's view, the area was adequately served, reinforced by

- the imposition by the wholesalers of a condition that the retailers must sell the national newspapers supplied only by retail and from their own retail outlets.

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16 The reference was made under sections 9(1), 10(3), 10(4), 47(1), 49(1) and 50(1) of the FTA73.

17 The supply of national newspapers: A report on the supply of national newspapers in England and Wales, MMC, December 1993, Cm 2422 (MMC (1993)) paragraphs 1.8 – 1.10. The MMC Report was published under the former regime of the FTA73, well before the entry into force of the CA98 in March 2000. Under the FTA73, the MMC applied a public interest test and could not have taken account of the Chapter I prohibition.

18 MMC (1993), paragraphs 11.92 and 11.95.
1.11 The National Newspapers Code of Practice (the Code), underpinned by statutory undertakings given by the wholesalers then operating in the market, was accepted by the then Secretary of State for Trade and Industry to remedy or prevent the adverse effects specified in the MMC’s Report.\textsuperscript{19} Although due to the ambit of the MMC’s findings, the Code formally applies only in respect of the supply of national newspapers in England and Wales, the Code is also applied on a voluntary basis in relation to the distribution of national newspapers in Scotland and Northern Ireland.\textsuperscript{20}

1.12 Pursuant to the Code, wholesalers undertook to adhere to a number of obligations with respect to newspaper supply to new retail applicants. One of these obligations is that wholesalers must supply all new retail applicants within a territory who meet the Minimum Entry Level (MEL obligation).\textsuperscript{21} In addition, wholesalers are prohibited from accepting an application for the supply of newspapers from an applicant retailer located outside the wholesaler’s area of operation as defined by the newspaper publisher or distributor, and they are prohibited from permitting a retailer or sub-retailer to sell or transfer newspapers to locations outside of the wholesaler’s area of operation as defined by the newspaper’s publisher or distributor.\textsuperscript{22}

1.13 The OFT has a statutory duty to keep under review the carrying out of undertakings given under section 88 of the FTA73, such as those which

\textsuperscript{19} The undertakings were given under section 88 of the FTA73. In addition to the statutory undertakings, two additional parties signed voluntary undertakings to comply with the Code.

\textsuperscript{20} Magazine publishers have also noted that because of the joint distribution of newspapers and magazines, the Code, by facilitating the supply of newspapers to new retail outlets, also facilitates the supply of magazines to those retailers.

\textsuperscript{21} The MEL obligation is commonly referred to by industry participants as the universal service obligation. The MEL obligation was introduced to remedy the refusal to supply concerns mentioned in paragraph 1.10 above. The MEL was defined as being half of the average value of the newspapers invoiced weekly to all existing retailers in the wholesaler’s area, calculated as the average weekly newspaper invoice value for the six months ending 31 March 1994. Only those newspapers which the wholesaler was capable of supplying to the applicant were included in the calculation.

\textsuperscript{22} The Code, paragraphs 1.3 and 6.3.
underpin the Code, and from time to time to consider whether, by reason of any change of circumstances, an undertaking is no longer appropriate and whether either the relevant parties (or any of them) can be released from the undertaking, or the undertaking needs to be varied or superseded by a new undertaking. Where it appears to the OFT that any person can be released, or that an undertaking has not been or is not being fulfilled, or needs to be varied or superseded, it is the duty of the OFT to give such advice to the Secretary of State as it may think proper in the circumstances.23

1.14 The OFT announced a review of the Code alongside the publication of the second draft Opinion in May 2006. The OFT’s advice to the Secretary of State for Business Enterprise and Regulatory Reform on the Code, based on the Code Review, is published alongside this Opinion. The OFT’s advice to the Secretary of State is that, due to a number of changes of circumstances relating to the market for the supply of newspapers in England and Wales, the undertakings underpinning the Code are no longer appropriate to remedy or prevent the adverse effects specified in the MMC’s Report and that all of the parties which signed the undertakings should therefore be released from them. It is for the Secretary of State, who is the ultimate decision-maker on this matter, to determine whether or not the parties are to be released from the Code.

The request for a market investigation reference

1.15 In December 2006, the National Federation of Retail Newsagents (NFRN) submitted a formal request to the OFT for it to consider whether to make a market investigation reference (MIR) to the Competition Commission (CC) in relation to the supply of newspapers and magazines in the UK under section 131 of the Enterprise Act 2002, or to accept undertakings in lieu of a reference under section 154 of the Enterprise Act 2002 (the MIR request). The NFRN’s main concern was the degree to which publishers controlled the distribution of newspapers and

23 Section 88(4) of the FTA73, which continues to apply in respect of the Code by virtue of schedule 24, paragraph 14 of the Enterprise Act 2002.
magazines in the UK. This, it submitted, required the OFT to undertake a wide-ranging examination of the newspaper and magazine supply chains under the MIR reference test, in addition to its work on the Opinion and the Code Review. In its request, the NFRN highlighted a number of features which it considered prevented, restricted or distorted competition, including ATP which is the focus of this Opinion.

1.16 The OFT’s proposed decision on the MIR (the MIR proposed decision) is also published alongside this document. The OFT is currently minded to decide that there are reasonable grounds for suspecting that each of the following three individual features prevent, restrict or distort competition: ATP for newspapers and magazines, cover prices for newspapers and magazines and copy allocation for magazines. In addition, the OFT is currently minded to decide that a number of features in combination give magazine publishers a high degree of control over the magazine distribution process and that there are reasonable grounds for suspecting that these collective features also prevent, restrict or distort competition. However, having considered a number of relevant factors, the OFT proposes to exercise its discretion not to make an MIR to the CC at this time and, therefore, is not in a position to accept undertakings in lieu of a reference. Interested parties are invited to submit comments on the MIR proposed decision as provided for in the relevant consultation document.

The interrelationship between the Opinion, the Code Review and the MIR request

1.17 The OFT’s work on this Opinion, the Code Review and the request for an MIR, have differing central focuses in terms of the product and supply chain and geographical scope. In addition, each work-strand is undertaken under a separate and distinct legal framework. However, in

24 The Code Review relates to the supply of national newspapers in England and Wales, whereas the Opinion and the MIR request relate to the supply of newspapers and magazines in the UK. In summary, the Code focuses upon the wholesaler to retailer relationship, the Opinion focuses upon the publisher to wholesaler relationship and the MIR request considers the operation of the whole supply chain.
recognition of the close links between the three work-strands, and the overlap between some of the underlying issues raised, the OFT has approached the three work-strands holistically. In so far as it is relevant, information received and analysis conducted in relation to one work-strand has been shared with the others. This has reduced the burdens of information provision for stakeholders and ensured consistency and coherence across the three distinct areas of work.

1.18 The OFT has engaged extensively with stakeholders at each level of the supply chain, including individual parties and trade associations. This has involved meetings with a wide range of stakeholders, the consideration of submissions in response to consultations on the 2005 and 2006 draft Opinions, and the receipt and consideration of detailed responses to OFT questionnaires. The OFT has also visited a newspaper publisher, wholesaler and retailer and a magazine distributor to further its practical understanding of how the supply chains operate. The OFT has valued the constructive engagement it has had in this context with very many stakeholders.

1.19 Alongside this Opinion, the OFT has also published a paper setting out an introductory overview of the newspaper and magazine supply chains. This paper is supplementary to, and does not form any part of, the Opinion but may be of assistance to those less familiar with the industry.

25 The OFT sent information requests to the three major multiple wholesalers, Dawson News, Menzies Distribution and Smiths News in February 2008.

26 These visits were at the invitation of the parties.

27 The OFT will, in principle, evaluate a request for an opinion on the basis of the information provided but may use additional information available from public sources, former proceedings or any other source. The OFT can also undertake whatever fact-finding measures it thinks necessary, but is under no obligation to do so. See OFT guideline 442 Modernisation (December 2004), paragraph 7.11.
2 LEGAL FRAMEWORK FOR THE OPINION

Section 2 of the CA98

2.1 Section 2 of the CA98 prohibits agreements or concerted practices between undertakings or decisions by associations of undertakings which have as their object or effect an appreciable\textsuperscript{28} prevention, restriction or distortion of competition within the United Kingdom (or a part of it) and may affect trade within the United Kingdom (or a part of it), unless they fall within an excluded category or are exempt in accordance with the CA98. The prohibition imposed by section 2 is referred to as 'the Chapter I prohibition'. Any agreement that infringes the Chapter I prohibition is void and unenforceable.\textsuperscript{29}

No applicable exclusion

2.2 There are no statutory exclusions currently applicable in respect of the Agreements. As noted in paragraph 1.5 above, the exclusion under the VAEO – from which the Agreements previously benefited – was repealed with effect from 1 May 2005.

Exemption - section 9 of the CA98

2.3 Section 9(1) of the CA98 sets out four conditions which must all be met for an agreement to have the benefit of exemption. Section 9(1) provides that an agreement is exempt from the Chapter I prohibition if it:

\begin{itemize}
  \item An agreement will infringe Chapter I only if it has as its object or effect an appreciable prevention, restriction or distortion of competition (see OFT guideline 401, \textit{Agreements and concerted practices} (December 2004), at paragraph 2.15). There is no requirement to show that an effect on trade within the UK is appreciable: \textit{Aberdeen Journals v Director General of Fair Trading} [2003] CAT 11, at [459] and [460]. In practice, it is very unlikely that an agreement which appreciably restricts competition within the UK does not also affect trade within the UK: see OFT guideline 401, \textit{Agreements and concerted practices} (December 2004), at paragraph 2.25.
  \item Parties to an infringing agreement may also be subject to penalties. Third parties adversely affected by an infringing agreement may take action in the courts to stop the behaviour and/or seek damages.
\end{itemize}

\textsuperscript{28} An agreement will infringe Chapter I only if it has as its object or effect an appreciable prevention, restriction or distortion of competition (see OFT guideline 401, \textit{Agreements and concerted practices} (December 2004), at paragraph 2.15). There is no requirement to show that an effect on trade within the UK is appreciable: \textit{Aberdeen Journals v Director General of Fair Trading} [2003] CAT 11, at [459] and [460]. In practice, it is very unlikely that an agreement which appreciably restricts competition within the UK does not also affect trade within the UK: see OFT guideline 401, \textit{Agreements and concerted practices} (December 2004), at paragraph 2.25.

\textsuperscript{29} Parties to an infringing agreement may also be subject to penalties. Third parties adversely affected by an infringing agreement may take action in the courts to stop the behaviour and/or seek damages.
'(a) contributes to –

(i) improving production or distribution, or
(ii) promoting technical or economic progress,

while allowing consumers a fair share of the resulting benefit; and

(b) does not –

(i) impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or
(ii) afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.'

2.4 A 'legal exception' regime operates under the CA98. This means that an agreement that falls within the Chapter I prohibition but which satisfies the exemption conditions set out in section 9(1) of the CA98 shall not be prohibited, no prior decision to that effect being required. Such an agreement is valid and enforceable from the moment that the exemption conditions set out in section 9(1) of the CA98 are satisfied and for as long as that remains the case.

2.5 The burden of proving that the exemption conditions set out in section 9(1) of the CA98 are satisfied rests on the undertakings claiming the
benefit of exemption.\textsuperscript{30} The standard to which this must be proved is the civil standard of a balance of probabilities.\textsuperscript{31}

**Exemption - parallel exemption**

2.6 The Chapter I prohibition will not apply if an agreement falls within an EC block exemption regulation, by virtue of the parallel exemption conferred by section 10 of the CA98. In addition, an agreement is covered by a parallel exemption if it does not affect trade between Member States but would otherwise be covered by an EC block exemption regulation.

2.7 Given that the parties to the Agreements operate at different levels of the supply chain, that is the Agreements are vertical in nature, the parallel exemption that is available by virtue of the EC Verticals Block Exemption is potentially relevant.

2.8 The current EC Verticals Block Exemption creates a 'safe harbour' for a range of vertical agreements. Agreements that fall within the terms of the EC Verticals Block Exemption and meet all of the conditions of that block exemption are automatically exempt from the application of Article


\textsuperscript{31} *The Racecourse Association & others v Office of Fair Trading* [2005] CAT 29 at [134].
81(1) of the EC Treaty. One of these conditions is that the agreement must not contain any of the five black-listed clauses set out in Article 4 of the EC Verticals Block Exemption. Agreements that incorporate a black-listed clause cannot benefit from the 'safe harbour' provided by the EC Verticals Block Exemption, and therefore are not covered by the parallel exemption conferred by section 10 of the CA98. However, the fact that a block or parallel exemption does not apply to an agreement does not mean that the agreement cannot benefit from individual exemption pursuant to section 9(1) of the CA98.

Opinions

2.9 The OFT’s Modernisation guideline issued in 2004 provides that:

'Where a case raises novel or unresolved questions about the application of Article 81, Article 82 and/or the prohibitions in the CA98 in the United Kingdom, and where the OFT considers there is an interest in issuing clarification for the benefit of a wider audience it may publish written guidance in the form of an Opinion.'

2.10 The OFT has a discretion as to whether to issue guidance in the form of an Opinion and adopts a case-by-case approach in exercising its discretion. In considering the BEI’s request for an Opinion, the OFT has had particular regard to the circumstances in which giving an Opinion would be appropriate. The OFT’s guideline sets out the conditions which

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32 Article 81(1) of the EC Treaty prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect an appreciable prevention, restriction or distortion of competition within the common market. The provisions in Article 81(1) are, however, inapplicable in the case of agreements that satisfy the conditions for exemption set out in Article 81(3). Any agreements or decisions prohibited pursuant to Article 81 are automatically void.

33 See paragraphs 4.9 and 4.25 to 4.28 below.


35 OFT guideline 442, Modernisation (December 2004), paragraph 7.4.
must be fulfilled before the OFT will consider giving an Opinion. These are that:

- there is not sufficient precedent in EC or UK case law, or decisions, practice or previously published opinions given by the European Commission’s competition services or the OFT to answer the question posed
- the OFT considers that there is a need for a published Opinion, and
- the Opinion can be prepared on the basis of the information provided.

2.11 On the first condition, the OFT considers that notwithstanding the existence of a body of case law of the EC courts concerning the enforceability of exclusive distribution agreements (including those granting ATP), there is value in clarifying the principles to take into account when applying the exemption conditions set out in section 9(1) of the CA98 to the Agreements given the very specific characteristics of the UK newspaper and magazine supply chains.

2.12 As far as the second condition is concerned, the OFT considers that there is a need for an Opinion given:

- the economic importance to consumers of newspapers and magazines, with UK sales of newspapers and magazines amounting to approximately £7.5 billion per annum in 2006, and
- the Agreements currently have widespread usage throughout the industry.

2.13 On the final condition, the OFT has produced this Opinion on the basis of information provided voluntarily to it by industry parties through the OFT’s consultation process. Where relevant, the OFT has also had

36 See OFT guideline 442, Modernisation (December 2004), paragraph 7.5.
regard to the information provided to, and the analysis conducted by, the OFT in its work on the Code Review and the MIR request.

2.14 The OFT will only give an Opinion where there exists a material link between the agreement or conduct concerned and the UK.\textsuperscript{37} Given that the Agreements cover the whole of the UK and are almost entirely limited to the distribution of newspapers and magazines in the UK, it is self-evident that this link is present in this case.

2.15 For the reasons given above, the OFT considers that the conditions for giving an Opinion are met in the very specific circumstances of this case.

2.16 An Opinion cannot prejudge the assessment of the same question by the European Commission, the European Court, or the Competition Appeal Tribunal. Nor does it bind other national competition authorities or courts having the power to apply Articles 81 and 82 or the prohibitions in the CA98.\textsuperscript{38} An Opinion also cannot bind the subsequent assessment of the same or similar issues by the OFT, although the OFT will have regard to its Opinion when carrying out any such assessment.\textsuperscript{39}

\textsuperscript{37} OFT guideline 442, \textit{Modernisation} (December 2004), paragraph 7.7.
\textsuperscript{38} OFT guideline 442 \textit{Modernisation} (December 2004), paragraph 7.18.
\textsuperscript{39} OFT guideline 442 \textit{Modernisation} (December 2004), paragraph 7.19.
3 FACTUAL AND ECONOMIC BACKGROUND

3.1 This chapter places the Agreements in their factual and economic context. It provides an overview of the key features of the current arrangements for newspaper and magazine distribution in the UK and discusses how these may change in the absence of ATP. It also provides some comments on market definition in relation to each stage of the supply chain.

Current arrangements for newspaper and magazine distribution

Overview of the supply chain

3.2 The newspaper supply chain has three levels: publisher, wholesaler and retailer. UK newspaper publishers currently grant individual wholesalers the exclusive right to distribute a particular publisher’s titles to all retailers located in a particular territory for a specified period of time. The magazine supply chain works along similar lines but generally has an additional stage in the chain, a distributor, between the publisher and wholesaler stages. The role of magazine distributors is to aggregate magazines, usually from a number of different magazine publishers, to distribute on to wholesalers. The newspaper and magazine supply chains are illustrated in the diagram below.

40 Although some magazine publishers supply directly to wholesalers, the OFT understands that it is more usual for magazines to be distributed to wholesalers via appointed distributors (such as Marketforce, Frontline, COMAG and Seymour). These distributors tend to be owned by larger magazine publishers, either individually or through joint ventures with other publishers.
3.3 In 2007, there were daily deliveries of around 14 million national newspapers to approximately 54,000 retail outlets throughout the UK, including small and remote locations. Around 25 million copies of magazines were also delivered to retailers each week, typically alongside newspapers.\textsuperscript{41}

3.4 The newspaper industry handles a highly perishable product. Publishers print newspapers as late as possible so that the latest news can be included, particularly if there is a late breaking story or an evening football match on which to include a report. Deliveries are made to retailers in time for their opening so that, for example, they can be delivered to customers’ homes\textsuperscript{42} before breakfast or purchased by customers on their way to work. The majority (70 per cent\textsuperscript{43}) of newspapers are purchased before 10:00 and those copies left unsold at the end of the day are effectively worthless. This means that distribution

\textsuperscript{41} Source: ANMW website:\url{www.anmw.co.uk/anmw/jsp/theNightlyMiracle.jsp}.
\textsuperscript{42} Information provided by the NPA in its meeting with the OFT on 24 May 2007 suggests that approximately 25 per cent of newspapers are delivered to readers’ homes.
\textsuperscript{43} Statistic provided by the NPA in its meeting with the OFT on 24 May 2007.
has to take place within a very tight time frame. Newspapers are typically printed between 22:30 and 03:00, delivered to wholesalers between around 03:00 and 04:00, and delivered to retailers between around 05:00 and 07:00.

3.5 The OFT notes, however, that magazines are not characterised by the same degree of perishability as newspapers. Although the OFT recognises that there are certain types of magazines (such as TV listing guides) which cease to be in demand once their period of reference passes, this level of perishability does not necessitate overnight printing and delivery within the same narrow timeframe as in relation to newspapers. Information available to the OFT shows that weekly magazines typically take around 18 – 30 hours to pass through the supply chain, with fortnightly and monthly magazines taking significantly longer still, although there are some exceptional cases where timescales are more compressed than this. Where magazines have compressed timescales of a similar nature to newspapers, it may be more appropriate for the parties, in their self-assessment following the issue of this Opinion, to take account of the OFT’s guidance in relation to newspapers. The OFT considers, however, that such timescales are extremely unusual in the case of magazines.

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44 There are instances where delivery times to certain wholesalers do not fall within the typical time range above. This is because publishers are unable to trunk copies to each wholesaler at the same time, and therefore deliveries are staggered in a way that allows publishers to meet scheduled delivery times for all wholesalers.

45 Based on information provided by Smiths News and Dawson News, around 70 per cent of retailers have required delivery times between 06:00 and 07:30. Deliveries for some retailers will often need to be made considerably before the required time to ensure that the required times of all retailers on the route are met.

46 These figures are based on the time taken from collection of the magazine from the printer to the time of first delivery to retailers.

47 Fortnightly magazines can take between 2-3 days to pass through the supply chain, with monthly magazines taking up to eight days.

48 For example, the OFT understands that the timescale for certain classified advertising magazines is around six hours.
3.6 The OFT observes that the distribution arrangements in respect of newspapers and magazines are not conventional.\textsuperscript{49} Unlike supply chains for many other products, which are retailer-driven, the newspaper and magazine distribution supply chains are supplier-driven. In other words, publishers / distributors control the way in which supplies reach retailers and the quantities of the product supplied. In particular, they exercise a strong degree of influence over:

- pricing at all stages of the supply chains by printing a price on the cover (cover prices) and setting, or recommending, the margins earned by wholesalers and retailers
- the volumes of the product received by individual retailers, usually through setting the parameters used by wholesalers to allocate copies\textsuperscript{50} (copy allocation), and
- the nature of the service provided by wholesalers to retailers, through the system of prescribed performance standards which publishers require of wholesalers as part of the Agreements. These performance standards then influence the terms and conditions on which retailers are supplied.

3.7 The OFT considers that the 'publisher-led' nature of the supply chains largely arises from the particular characteristics of the market for the supply of national newspapers and magazines. In particular, the markets for national newspapers and magazines are 'two-sided', that is, the publications provide both editorial content and advertising space, and publishers receive revenue from both readers and advertisers. Publishers and retailers are therefore likely to face different incentives regarding

\textsuperscript{49} The unconventional arrangements for the distribution of newspapers were also recognised by the MMC (\textit{The supply of national newspapers: A report on the supply of national newspapers in England and Wales}, MMC, December 1993, Cm 2422, paragraph 1.2).

\textsuperscript{50} For example, publishers may indicate a range of dates (for example, the 'last six Mondays' or a date on which a similar promotion was run) for which previous sales should be taken into account as the basis for predicting the sales for a particular edition, or propose that a certain percentage of additional copies above the predicted level of sales should be supplied to take account of variability in sales.
prices and quantities, as publishers will take account of how changes in
circulation figures and readership profiles will affect both their cover
price revenues and advertising sales revenues, whereas retailers' incentives will relate only to how sales volumes respond to cover price changes.

3.8 Another key characteristic of newspapers and magazines is that each issue of a newspaper or a magazine is in some respects a new product in that the content will vary from issue to issue, albeit within a consistent 'product image' that publishers will seek to maintain. This means that demand can vary from issue to issue depending on the content (which could include promotional material such as cover-mounted DVDs). For example, there can be big increases in newspaper sales if they cover a significant and/or exclusive news story, and celebrity magazines have significantly higher sales when they feature weddings of high profile celebrities. Publishers may be better able to gauge these likely fluctuations in demand than retailers, particularly if there is little notice that the 'big story' or feature will be included.

3.9 It is also worth noting that, for both newspapers and magazines, the fixed costs involved in production and printing are substantial and the marginal costs are relatively low and producing editorial content involves significant fixed costs and zero marginal costs. This means that it is relatively cost effective for publishers to print more copies than they expect to sell to allow for variability in sales at individual outlets and to use availability as a form of promotion (that is to try to attract additional sales by being the newspaper or magazine that is on the shelf when others have sold out).

3.10 The OFT considers that these characteristics, and in particular how they result in differences in the principal incentives for publishers and retailers, are a key factor in explaining the following features of newspaper and magazine distribution:
• the use of cover prices - cover prices provide a disincentive for retailers to raise prices\textsuperscript{51} which would otherwise be likely to reduce circulation leading to falls in advertising revenues for publishers

• the supply of copies on a 'sale or return' basis (SOR) - SOR, by which retailers are given a credit on their invoices for any unsold copies returned to their wholesaler, enables publishers to take the revenue risk of supplying copies. Without this, retailers may be unwilling to take the additional copies that the publisher would like to supply, for example, if publishers wish to use availability as a promotional tool to boost circulation\textsuperscript{52} or to stock new titles that publishers may wish to launch, and

• the high degree of control over copy allocation - there are various reasons why publishers may seek control over copy allocation. First, as noted above, publishers are likely to have a better understanding than retailers of how overall demand for different titles is driven by the content of a particular issue. Second, with SOR, retailers may wish to take more copies given that they bear no revenue risk, and publishers may need to allocate copies between retailers to ensure that copies are distributed in such a way as to maximise the likelihood that they are sold. Third, publishers may wish to allocate copies between retailers in a certain way in order to target a particular customer demographic because of the impact this would have on their advertising revenue.

\textsuperscript{51} If retailers wish to raise prices above the cover price, they should ensure the new price is properly displayed and in such a manner as to avoid customer confusion as to the sales price. Given the tight timescales and potentially large quantities of copies involved with newspaper and magazine retailing (particularly in relation to newspaper retailing), the practical difficulties involved in 'over-stickering' the cover price are likely to act as a significant obstacle to retailers raising the price.

\textsuperscript{52} SOR also plays a role in generating the audited circulation figures published by the Audit Bureau of Circulations (ABC). On a monthly basis, a publisher's audit accountant or an ABC auditor will conduct an analysis of the publisher's print, distribution, invoicing and credit claims to reconcile them with cash paid to the publisher. This process helps to verify the accuracy of circulation figures.
3.11 There may also be a further reason why publishers seek control over copy allocation, in particular in relation to magazines. It is likely that there is a divergence of incentives between publishers and retailers in that publishers are interested in the performance of their own titles whereas retailers are interested in the performance of the category as a whole. Publishers use shelf-space as a way of advertising their titles and (particularly for magazines) have incentives to place their publication on the shelf in preference to rival publications. Retailers may not wish to stock an individual magazine because it would take away space from other publications from which they could earn higher revenues. Whereas the factors discussed in paragraph 3.10 suggest that publisher control over copy allocation may have efficiency benefits, this factor suggests that publisher control over copy allocation may also have adverse consequences. This issue does not appear likely to apply to newspapers, at least to the same extent, as virtually all outlets stock all newspaper titles.

3.12 Further details on the supply chains can be found in the introductory overview paper.

**Exclusive territories and the tender process**

3.13 The right to distribute newspapers or magazines for a publisher or distributor is put out to tender on a periodic basis. Wholesalers compete with each other to offer the most attractive bid to the publisher / distributor. Publishers / distributors award contracts at different times, although there are occasions where a number of contracts come up for tender over a short period. Contracts vary in length between publishers, but typically last for around three to five years, with most contracts awarded recently being for five years.

3.14 Although publishers and distributors tender their contracts independently, in the majority of territories the same wholesaler has been appointed by all the publishers/distributors, with the result that retailers across the UK generally obtain their supplies of all newspaper and magazine titles from a single wholesaler. A territory in which this situation exists is known as a 'full-sheet' territory. In some territories,
two or more wholesalers may operate, each distributing a different publisher’s / distributor’s range of titles. Consequently, retailers in these territories wishing to stock a full range of titles from every publisher have to take, and pay for, delivery from more than one wholesaler. A territory in which this situation exists is known as a 'split-sheet' territory. Of the 2,930 UK postcode areas, 2,085 are in 'full sheet' territories and 845 are in 'split sheet' territories.

3.15 The boundaries of territories have evolved over time. Although proposed boundaries are typically set by publishers in the requests for tenders, in some cases during the negotiation process changes to the boundaries that would reduce costs for both the wholesaler and the publisher are agreed. This means that the boundaries of territories, and subsequent changes to them, are not necessarily consistent among publishers.

3.16 Although publishers often seek bids for individual territories, as well as groups of territories, in some cases the share of the national supply of the wholesaler is a relevant element in the bargaining process. For example, a wholesaler may be prepared to offer or agree to discounts in the margins paid by publishers for a larger proportion of the national supply as there are economies of scale\(^{53}\) at a firm and regional level. For similar reasons, a wholesaler may also be willing to offer or agree to reduced margins to win a territory that is of particular benefit to its portfolio of territories because, for example, it enables the wholesaler to achieve a more efficient scale at a depot, or a more efficient network of depots in a region.

3.17 Further details of the tender and negotiation processes can be found in the introductory overview paper.

\(^{53}\) Economies of scale arise when the average cost of production falls as the quantity produced increases.
How newspaper and magazine distribution may operate in the absence of ATP

3.18 This section discusses how the distribution of newspapers and magazines may operate in the absence of ATP. Examining the situation that would be likely to prevail absent ATP assists in identifying the anti-competitive effects brought about by an Agreement and any efficiency benefits it generates in order to balance these purported positive and negative effects when assessing exemption under section 9(1) of the CA98.

3.19 The key issue in this connection is the extent to which competition may emerge 'in the market' if ATP were removed from the Agreement, in other words, the extent to which retailers would have a choice of wholesaler in the absence of ATP. This could arise either because publishers no longer appoint exclusive wholesalers for a territory or because retailers are able to obtain passive sales from wholesalers appointed in a neighbouring territory.

3.20 In determining the extent to which retailers would have a choice of wholesaler, three key issues are relevant:

- first, the extent to which retailers may be able to obtain supplies from alternative, existing wholesale depots in the absence of ATP
- second, the extent to which wholesalers may alter their network of depots in order to compete for new retailers in the absence of ATP, and
- third, the extent to which new entry into the wholesale market may occur, or new methods of distribution may emerge, in the absence of ATP.

3.21 Each of the above issues is considered below in relation to newspapers and magazines separately. This section also considers how the potential
for competition to emerge in the market for newspapers may be affected by developments in relation to magazine distribution, and vice versa.

3.22 The OFT has also considered whether, in the absence of ATP, there may be wider changes to the newspaper and magazine supply chains. At present, publishers have a significant degree of control, determining cover prices and margins throughout the supply chains and the volume of copies allocated to retailers. The OFT considers that these features are, however, largely driven by the specific characteristics of the products and their production, particularly in relation to newspapers. Therefore, absent ATP, a significant change to newspaper publishers’ control of the supply chains would appear to be unlikely. It is possible, however, that there may be more scope for change to publisher control over the supply chain in relation to magazines. In particular, it is possible that, in the absence of ATP, retailers may be able, through pressure on wholesalers, to exert a greater influence on the range of magazine titles and the number of magazine copies they receive and aspects of the service provided to retailers by wholesalers.

3.23 It is important to note the significant limits to the extent of the analysis that the OFT can undertake in respect of how the market may develop in the absence of ATP. Given that ATP has been used in newspaper and magazine distribution in the UK for many years, and the system used before this involved a substantially different distribution method, there is very little direct evidence upon which the OFT can draw in considering

54 As discussed in paragraph 3.11, magazine publishers may seek control over copy allocation because of a divergence between their incentives to obtain shelf space for their own titles and retailers’ incentives to fill their shelf space with the titles that will maximises the profitability of the category as a whole. This issue does not appear to apply to newspapers, at least to the same extent, as virtually all outlets stock all newspaper titles.

55 Exclusive distribution was introduced in the late 1980s. News International was the first to invite tenders in October 1987, followed by Mirror Group Newspapers, the Express, Mail, the Telegraph and the Observer in 1988 (see The supply of national newspapers: A report on the supply of national newspapers in England and Wales, MMC, December 1993, Cm 2422 MMC (1993) paragraphs 4.12 – 4.17).

56 Distribution from print centres to wholesalers was previously undertaken by rail rather than the current road-based system.
how the market may develop in the absence of ATP. Furthermore, ATP is used in newspaper and magazine distribution in other countries in Europe, which limits further the possibilities for obtaining direct evidence of a comparable functioning market absent ATP.

3.24 It is also likely that the way in which the market may develop in the absence of ATP will vary between Agreements and territories. For example, the extent to which retailers could be served by competing wholesalers is likely to vary between areas of the country, and the extent to which new entrants may emerge may vary depending on the publications involved. In the circumstances, it is not possible for the OFT to provide detailed guidance on the appropriate comparison to make in terms of individual Agreements in specific areas. Instead, this Opinion provides guidance on the broad issues that should be taken into account when parties self-assess their Agreements.

The Code

3.25 To the extent that the Code provides for ATP, those provisions must be assumed to be absent in order to compare the current situation to a situation in which ATP is absent.

3.26 This raises the question of whether other provisions in the Code could exist independently of its provisions on ATP. However, this issue is not considered further, since the OFT’s advice to the Secretary of State for Business, Enterprise and Regulatory Reform, published alongside this Opinion, is that the Code should be revoked.

3.27 In applying the principles covered in this Opinion when conducting their self-assessment, the parties may wish to take account of the Secretary of State’s decision on the Code.

Newspapers: extent of competition in the market absent ATP

3.28 It would appear that only relatively limited competition in the market in relation to newspaper wholesaling would emerge if ATP was removed. A key consideration in this connection is the short time window between
newspaper copies being printed and being purchased by consumers. This limits both the extent to which wholesale depots (given their limited geographic reach) would be able to compete for the business of retailers across territories, and the extent to which new entry into newspaper wholesaling or new methods of newspaper distribution are likely to arise.

3.29 The limited time window available for newspaper distribution (as set out above in paragraph 3.4) means that wholesalers’ depots have a highly restricted geographic reach. Wholesalers have suggested to the OFT that this reach is approximately the area that can be served within about a one hour drive time, or around 30 miles, although this will depend on the nature of the territory and the route in question (for example, the number of retailers on the route\textsuperscript{57} and, particularly in rural areas, the road conditions\textsuperscript{58}).

3.30 The area that can be served from a depot by a newspaper wholesaler will also depend on commercial constraints. For example, it may be possible to serve some new areas relatively cost effectively by adding new retailers to an existing delivery run or establishing a new delivery run, whereas it may be prohibitively expensive to serve other new areas, perhaps because the distances involved result in very high costs for the newspaper wholesaler or there is insufficient sales volume in the area. The commercial viability of serving an area may also depend on being able to attract all or most of the retailers in order to make a new delivery run, or a change in route, profitable.

3.31 The commercial viability of newspaper wholesalers serving additional retailers may also vary depending on the size of the potential new retailer.\textsuperscript{59} Wholesalers have told the OFT that, absent ATP, it may be

\textsuperscript{57} Longer delivery routes require fewer drops of larger numbers of copies.

\textsuperscript{58} Congestion is not, however, typically a problem since deliveries are made in the early morning when there is little or no traffic.

\textsuperscript{59} It may be possible that on some routes it is easier to add a small retailer than a big retailer to an existing delivery run. However, if there is a significant additional cost incurred in extending a delivery run, this is more likely to be worthwhile if the volume of additional sales is significant.
advantageous for wholesalers to 'cherry pick' larger new retailers in other territories due to the size of their delivery requirements. In this regard, they have argued that, although it may be attractive to a wholesaler to pick off large retailers, it may not be attractive also to pick off the smaller retailers in the territory.

3.32 Given these constraints on the areas that can be served in relation to the supply of newspapers by depots, it would appear likely that the scope for wholesalers to compete to serve retailers in new areas, in the absence of ATP, using their existing depots would be limited to those areas of the country where the geographic reach of depots overlap, and in particular to large retailers. In addition, wholesalers have noted that some areas, which are geographically relatively close, cannot in fact be supplied as they would require a different regional edition of the newspaper (for example, to reflect different television schedules or local advertising).

3.33 Despite the limited geographic reach of wholesaler depots noted above, it is possible that significant levels of competition could hypothetically emerge following the removal of ATP if it were at all feasible for wholesalers to move from their existing network of depots to operating a larger number of smaller depots that competed for retailers' business. However, the information available to the OFT suggests that it would be unlikely that wholesalers would develop a larger number of smaller depots than are used currently due to the significant economies of scale and density60 which exist in newspaper wholesaling. These economies suggest that a wider network of smaller depots would not likely be competitive on cost compared with large incumbent wholesalers.

3.34 There are economies of scale in newspaper (and magazine61) wholesaling at a depot level (that is from operating larger depots), at a region level (that is from covering a larger contiguous area) and at a firm level (that

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60 Economies of density arise when average costs fall as the number of customers in an area increases.

61 The focus in this section is on potential developments in relation to newspaper wholesaling, but similar arguments relating to economies of scale also apply to magazine wholesaling.
is from having a greater overall scale of operations in the UK). At the depot level, the key factor appears to be new technology for the packing of newspapers (and magazines) and scanning of returns, which involves high fixed costs and enables larger volumes to be processed quickly. Wholesalers have over time sought to reduce the numbers of depots they operate where possible, subject to the time constraints noted above. At the region level, the key factor appears to be that a larger scale gives greater opportunities to optimise the size and location of the depots serving a region. Economies of scale appear to be particularly pronounced at the firm level and arise from the ability to centralise various functions such as copy allocation and customer call centres.

3.35 Economies of density in newspaper (and magazine) wholesaling arise because it is cheaper to serve a retailer when other retailers close by are also served because, for example, the delivery van can be filled closer to full capacity or the van has to drive a shorter distance to deliver a full load. Economies of density mean that it is likely to be cheaper for one wholesaler to serve all retailers in a locality than for the retailers to be served by two wholesalers that each operate a delivery run in the area. This is particularly likely to be the case where wholesalers operate distinct delivery runs to different areas. However, where the number of retailers in an area means that there are already two overlapping delivery runs, it may be more feasible for the area to be served by competing wholesalers.

3.36 It is important to note that the density of retail outlets and the volume of sales in an area will vary considerably. The OFT has not been able to assess in detail what proportion of the country has sufficiently high sales volume and density of retailers to sustain the emergence of competition in the market for newspaper wholesaling. It has received some information on delivery runs that suggests such competition in relation to

62 In 1992, as reported by the MMC, there were 251 wholesale depots for newspapers and magazines in England and Wales. In 2008, there are 129 depots for newspapers and magazines across the whole UK.

63 The focus in this section is on potential developments in relation to newspaper wholesaling, but similar arguments relating to economies of density also apply to magazine wholesaling.
the supply of newspapers (other than at the boundary of territories) may only be sustainable in highly dense urban areas, such as London.

3.37 Prior to the introduction of the ATP system for newspapers in the 1980s, there was extensive competition in market in relation to newspaper wholesaling. However, this does not appear likely to re-emerge absent ATP given that there have been significant changes in the method of distribution of newspapers. In particular, until the mid 1980s, rail rather than road was used for trunking copies of newspapers between print centres and wholesalers. This meant that the packing of copies (for which there are economies of scale) could take place on the trains. As a result, it was more feasible for large numbers of newspaper wholesalers to collect from the rail head and compete for deliveries to retailers, although this would still have resulted in the loss of the economies of density that would arise from having a single wholesaler in an area.

3.38 If wholesalers are unlikely to move to a network of smaller depots for the reasons noted above, it may still be feasible for further competition to emerge in relation to newspaper wholesaling through the relocation of some depots. However, the extent to which this is feasible may be limited if depots are already located in areas where population (and, therefore, demand) densities are at their highest.

3.39 Even if depots were to be relocated, or new depots were to be opened, this would only lead to competition in the market if depots of rival wholesalers were to have overlapping catchment areas. In some parts of the UK there are quite large areas which are served by just one wholesaler (a particular example of this is Scotland, where virtually the entire country is served by Menzies Distribution). In such cases, it may be less likely that rival wholesalers will have depots with overlapping catchment areas, thereby limiting the possibilities for competition in the market to emerge.
3.40 There may be greater potential for competition in the market to emerge in relation to newspaper wholesaling (at least in the short term), in those areas which are currently 'split-sheet' territories, as there is currently more than one depot serving the same area in relation to the supply of newspapers. However, in the long term, it would appear that in most cases such competition may well not be maintained for three reasons.

3.41 First, a significant proportion of split-sheet territories are currently served by an independent wholesaler, and it would appear that the consolidation of newspaper and magazine wholesaling through the exit of independent wholesalers is likely to continue, irrespective of whether ATP is removed. It seems that many independent wholesalers have found it difficult to retain contracts, for reasons such as:

- More stringent newspaper and magazine publisher demands relating to service standards and the amount of investments wholesalers are required to make in order to provide new services such as sales based replenishment.

- The determination of many newspaper and magazine publishers and distributors to deal with existing multiple wholesalers rather than independent wholesalers, which newspaper and magazine publishers and distributors consider facilitates transactional efficiencies, harmonised service levels and greater wholesaler incentives to invest.

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64 See paragraph 3.14 above.
65 Of the 845 postcode areas which are in 'split-sheet' territories, 440 are served by an independent wholesaler.
66 See for example, an article in Retail Newsagent, 20 January 2006, regarding the decision by Frontline to cease using independent wholesalers.
67 Based on the views of third parties in the context of an OFT merger decision, see Anticipated acquisition by Menzies Distribution Limited of Grays Newsagents (York) Limited (3 August 2007) at paragraph 22. See also Anticipated acquisition of Thos Swift (Wholesale Newsagents) Ltd and Chester Independent Wholesale Newsagent Ltd by Menzies Distribution Ltd (27 March 2006).
Consequently, there has been widespread exit of independent wholesalers from the market through either acquisition\textsuperscript{68} or bankruptcy.\textsuperscript{69}

3.42 Second, some current split-sheet territories exist due to the presence of News International’s wholesaling business, News Retail Services Limited (NRSL) which currently operates in Birmingham, Bristol, Leicester and London.\textsuperscript{70} From July 2009, NRSL will no longer directly provide wholesaling services, and News International will switch to either using other newspaper and magazine wholesalers or a 'direct-to-retail' (DTR) distribution model in these areas.\textsuperscript{71} Whereas NRSL previously bid for contracts from other publishers,\textsuperscript{72} under the DTR model it is less clear that News International would be willing or able to deliver other publishers’ titles, at least in any great numbers.

3.43 Third, some split-sheet territories have more than one multiple wholesaler already present.\textsuperscript{73} In this situation, it is possible that economies of scale and density would in fact lead to the market ‘tipping’ toward one wholesaler\textsuperscript{74} within that territory in the absence of ATP. Furthermore, publishers are likely to be reluctant to incur the costs of delivering their titles to more than one depot within a territory as would

\textsuperscript{68} See, for example, the OFT merger decisions: Anticipated acquisition by Menzies Distribution Limited of Grays Newsagents (York) Limited (3 August 2007) and Anticipated acquisition of Thos Swift (Wholesale Newsagents) Ltd and Chester Independent Wholesale Newsagent Ltd by Menzies Distribution Ltd (27 March 2006).

\textsuperscript{69} For example, DH Westrope (Wholesale Newsagent) Limited went into administration in early 2008. It also appears that financial distress has been a factor in prompting some mergers between independent and multiple wholesalers.

\textsuperscript{70} Of the 845 postcode areas which are in 'split-sheet' territories, 182 are served by NRSL.

\textsuperscript{71} See Retail Newsagent, 6 June 2008.

\textsuperscript{72} NRSL currently holds the wholesaling contract for the Telegraph in Birmingham and Enfield.

\textsuperscript{73} Of the 845 postcode areas which are in 'split-sheet' territories, 223 are served by more than one multiple wholesaler.

\textsuperscript{74} The term ‘market tipping’ is often used in competition analysis where there is a tendency for a dominant product, standard or firm to emerge due to feedback effects, that is the product, standard or firm’s attractiveness to consumers increases with the number of consumers using it. In this case, the more retailers in an area that use a wholesaler, the greater the economies of scale and density it is able to exploit, enabling it to reduce the costs of supply and hence be more attractive to further retailers in the area.
be necessary to allow for competition to emerge for newspaper wholesaling between the two incumbent wholesalers.

3.44 It would appear that the short time window between newspaper printing and delivery to retail outlets, and the need for very early deliveries, also means that alternative methods of distribution (such as regional or national distribution deals between multiple retailers and existing wholesalers, delivery to supermarkets through their regional distribution centres, or delivery alongside other products) are unlikely to be feasible in relation to newspapers.

3.45 It is possible that there may be opportunities for more radical alternatives for the wholesale supply of newspapers. The OFT is only aware of one such alternative, namely the DTR model to be introduced by News International, and this is intended (so far at least) to operate in a limited number of areas. For such a system to be feasible, the area would appear to require sufficient sales volume to make it cost effective for a publisher to distribute its titles directly and separately from others. This may mean that it is only a viable option for News International, which has a significantly greater volume of sales than other newspaper publishers. News International may also find a DTR system easier to implement than other publishers, given its previous experience of newspaper wholesaling (through NRSL) and because it currently handles copy allocation of its titles, a task that is performed by newspaper wholesalers for other newspaper publishers.

Magazines: extent of competition in the market absent ATP

3.46 The OFT has received evidence showing that the tight timescales that apply to newspaper distribution do not typically apply to magazine distribution. This means that the constraints on the extent to which

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75 News International will introduce DTR in London and Birmingham in 2009 (see Retail Newsagent, 6 June 2008).
76 News International accounts for around a third of the national newspaper market. The next largest national newspaper publisher is Associated Newspapers, publisher of the Mail and Mail on Sunday, which accounts for around a fifth of the market.
wholesale depots would be able to compete for the business of retailers, and the limited scope for new entry into wholesaling or new methods of distribution, which were identified for newspapers, appear unlikely to apply to the same extent to magazine distribution.

3.47 The information available to the OFT indicates that the area that can be served by a depot, which is a key factor regarding the potential for competition to emerge in relation to magazine wholesaling, is significantly widened if the time window for distribution and delivery is increased by just two or three hours. Magazines typically have time windows that are significantly longer than this: weekly magazine titles can take 18-30 hours to pass through the supply chain, with fortnightly and monthly magazines taking significantly longer still.\textsuperscript{77} This suggests that the potential geographic reach of depots appears considerably greater for magazines than for newspapers.\textsuperscript{78}

3.48 The longer timescales that apply to magazines are reflected in the current system of magazine distribution by the practice of having some 'hub' depots, where magazines are packed and transported to other 'spoke' depots for delivery to retailers with newspapers. For example, Menzies Distribution has spoke depots in Aberdeen, Inverness and Perth which are all served from a hub depot in Dundee, Smiths News operates its Northampton depot as a hub, serving its spoke depots in Bedford and Milton Keynes, and Dawson News serves its two spoke depots in Taunton and Yeovil from its hub depot in Brislington near Bristol.

3.49 Although there are fewer wholesaling depots used for magazine distribution than newspaper wholesaling depots, it would appear that the potential overlap in the geographic reach of depots in relation to magazine wholesaling is likely to be much more significant than in

\textsuperscript{77} This information was provided to the OFT by magazine distributors. It also shows that fortnightly magazines can take between 2-3 days to pass through the supply chain, with monthly magazines taking 8 days.

\textsuperscript{78} The OFT notes, however, the very exceptional cases discussed in paragraph 3.5 and footnote 48 above, involving classified advertising magazines, which appear to have very compressed timescales, similar to those for newspapers.
relation to newspapers. This is likely to mean that there is potential for competition to emerge for magazine wholesaling between depots, providing that it is commercially viable for the wholesaler to deliver magazines over the relevant extended distances and without newspapers. The size of the retailer may be an important factor here as, if there is a significant additional cost incurred in extending a delivery run, this is more likely to be worthwhile if the volume of additional sales which a new retailer represents is significant. It appears most likely to be commercially viable to deliver magazines and newspapers separately to large outlets such as supermarkets, but the density of retailers in an area is also likely to be a relevant factor.

3.50 It appears unlikely that there is scope for increasing such competition through existing magazine wholesalers changing their network of depots to one in which they have a larger number of smaller depots. As discussed above, economies of scale at a depot level appear to be significant for magazine wholesaling, arising in particular from investments in technology to replace manual packing and returns processing. However, as set out above, it would appear that, in any event, the geographic reach of depots in relation to magazine wholesaling is likely to be greater than that relating to newspapers.

3.51 The existence currently of a split-sheet territory also appears unlikely to increase the potential for competition in the market to emerge between magazine wholesalers. The information available to the OFT suggests that independent wholesalers no longer have any magazine distribution contracts, which significantly reduces the possibilities for competition to emerge for magazine wholesaling in split-sheet territories that are served by independent wholesalers. In any event, as discussed above in relation to newspaper wholesaling, it would appear that in the longer term in most cases such competition may well not be maintained.

79 It is possible that there may be some magazines for which the required distribution timescales are sufficiently tight for the potential for competition between wholesale depots to be extremely limited. In such a case, the considerations relevant to newspapers would more likely also apply to them.
3.52 In contrast, it would appear that the less critical timescales involved with magazines mean that there may be scope for new entry or new methods of distribution to arise.

3.53 One possibility is that, absent ATP, major retailers such as supermarkets and WHSmith would invite wholesalers to bid to supply them with magazines on a regional or national basis.\(^8\) Submissions from the BEI suggest that this option is plausible and likely to arise, noting that multiple wholesalers have concluded that supplying retailers with magazines on a regional or national basis would be feasible\(^8\) and that major retailers are supplied with other products on a regional/national basis.\(^8\) Indeed, in 2000, Tesco and WH Smith Retail attempted to switch to receiving magazine supplies from a single wholesaler on a nationwide basis but were prevented from doing so by the enforcement of the ATP provisions in the applicable Agreements.\(^8\) The OFT notes that this proposed arrangement did not include newspaper distribution and it is not aware of any attempts by retailers to receive newspapers on a regional or national basis.

\(^8\) The BEI’s submissions have referred to both national and regional distribution to major retailers. However, it appears that for national distribution a number of additional depots or transhipment points may be required. The European Commission has stated that the meaning of active sales includes ‘establishing a warehouse or distribution outlet in another distributor’s exclusive territory’ (Guidelines on Vertical Restraints, Commission Notice (2001) OJ C291/01, at paragraph 50). Therefore national distribution may constitute an active sale even where the retailer initiates the request for supply. As a result, regional distribution may be more likely than national distribution if publishers appoint exclusive wholesalers (without ATP) since under such contracts ‘active’ sales (including establishing new distribution points required for national distribution) into exclusive territories would not be permitted.

\(^8\) An economic assessment of the effects of removing absolute territorial protection in UK magazine wholesaling, P Dobson and P Muysert for BEI, June 2005, pages 52-58.

\(^8\) The BEI considers that regional/national distribution ‘would be very much in keeping with the distribution/logistics operations that the major [multiple retailers] use for most of their other product purchases’ An economic assessment of the effects of removing absolute territorial protection in UK magazine wholesaling, P Dobson and P Muysert for BEI, June 2005, page 51.

\(^8\) The economics of magazine distribution, PWC for Marketforce (UK) Limited, June 2005, footnote 19.
3.54 Possible new entrants to magazine wholesaling include general logistics firms or wholesalers of other products. The OFT is aware that publishers have invited tenders for wholesaling contracts from logistics companies in the past. Although such options have not been actively pursued, there may be more scope to examine these options for magazine wholesaling in the future absent ATP. This may be particularly the case if distributors were willing to take on some of the copy allocation role usually undertaken by wholesalers, allowing the potential new wholesalers to focus on transportation of copies to retailers.

3.55 It is also possible that new methods of distribution for magazines may emerge. For example, there may be scope for supermarkets, and perhaps certain other multiple retailers, to use regional distribution centres. However, the OFT understands that this would incur extra costs for these retailers as it would require increasing staff numbers in the retailers' respective buying operations, and therefore these retailers may prefer a supply chain that did not require their direct management.

3.56 Many of the alternatives to traditional magazine wholesaling which could be identified are likely to be particularly, or only, suitable for certain types of retailers. There may be less stimulus for such developments from magazine publishers, which may be interested in the efficiency of distribution overall, than from these certain types of affected retailers, which would be interested in the efficiency of distribution to them. This suggests that it may be less likely that these alternative methods of distribution would emerge within a system of exclusive territories without ATP (where competition in the market would be limited to passive sales) than if publishers no longer grant exclusive territories (where there may be greater scope for retailers to seek alternative methods of supply).

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84 Distributors generally make predictions of sales of magazines by outlet as part of the assistance they provide to magazine publishers on determining the number of copies they should print.
The relationship between newspaper and magazine distribution

3.57 This section considers how the potential for competition to emerge in the market for newspapers may be affected by developments in relation to magazine distribution, and vice versa.

3.58 There are significant synergies between newspaper and magazine distribution which underpin the current practice of delivering the products together. In particular, there are significant economies of scope from delivering newspapers and magazines together, since most retailers receive both newspapers and magazines.

3.59 There are also economies of scope from packing newspapers and magazines at the same depot. These arise because magazines can be packed during the day, allowing for more efficient utilisation of depots that would otherwise be used only for short periods in the early hours of the morning. However, the economies of scope in packing need to be balanced against economies of scale obtained from using more sophisticated equipment. As a result, as noted above, some wholesalers operate a 'hub and spoke' system, where magazines are packed in large 'hub' depots and transported to 'spoke' depots for delivery to retailers with newspapers, for some of their magazine distribution.

3.60 Where the economies of scope of wholesaling the two products together are significant, one would expect a retailer’s newspaper wholesaler to be able to offer it the best deal for supplying magazines, and vice versa. Whether or not ATP is retained in contracts for newspapers may therefore affect the extent to which changes occur to magazine distribution, and vice versa. For example, where ATP remains in place for newspapers, retailers may be less willing or able to switch their magazine supplier.

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85 Economies of scope arise when average costs fall as the number of different products that a firm supplies increases.
3.61 Even if the other alternative methods of distribution for magazine distribution\(^{86}\) cannot fully compete on cost when compared with distribution via the traditional model alongside newspapers, the OFT considers that the presence of these options may be sufficient to drive some further investment and innovation by the current newspaper and magazine wholesalers.

3.62 It is also possible that the availability of these options may enable magazine publishers to negotiate a lower share of the common costs of distributing both products\(^{87}\) in the future. This may, in turn, reduce magazine prices to consumers. However, it may also increase the cost of newspaper distribution, in turn leading to rises in newspaper prices.

**Market definition**

3.63 Market definition provides a framework for competition analysis and is a key step in identifying the competitive constraints acting on a supplier of a given product or service.\(^{88}\) The Chapter I prohibition only applies to agreements which have as their object or effect an 'appreciable' prevention, restriction or distortion of competition. The appreciability test usually requires definition of a relevant market and demonstration that an agreement would have an appreciable effect on competition within that market. An exception is where agreements have as their object the prevention, restriction or distortion of competition, in which case market definition is not necessarily a prerequisite for finding an infringement.\(^{89}\)

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\(^{86}\) As noted above, the options for alternatives to traditional newspaper wholesaling appear to be limited.

\(^{87}\) Common costs are costs that arise when two or more products are produced together, even though they could be produced separately, and that vary to some degree with the quantity of production of each product, even though they are not directly attributable to a single product. For example, when a van is used to deliver both newspapers and magazines, the cost of running the van is a common cost.

\(^{88}\) OFT guideline 403, *Market definition* (December 2004), paragraph 2.1.

3.64 A market definition should normally contain two dimensions: a product market and a geographic market. The relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products’ characteristics, their prices and their intended use. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.\(^\text{90}\)

3.65 In considering both the relevant product and geographic market, the possibilities for substitution on both the demand and supply sides of the market are considered. Demand-side substitution arises where, following a price rise, customers may switch some of their purchases from the product or service in question to other substitute products or services.\(^\text{91}\) Supply-side substitution arises where, if prices rise, undertakings that do not currently supply the product or service in question might be able to supply it at short notice and without incurring substantial sunk costs.\(^\text{92}\)

3.66 Albeit that a detailed market definition is not necessarily essential where ATP in relation to the Agreements is categorised as a restriction by object, this section of the Opinion nonetheless covers the key issues that would need to be taken into account in defining the relevant market in relation to ATP in the Agreements. It deals with the publishing, wholesaling and retailing levels in the supply chain, with particular focus on the wholesaling segment as this is where ATP has its most immediate impact.

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\(^{91}\) See OFT guideline 403, *Market definition* (December 2004), paragraph 3.4.

\(^{92}\) See OFT guideline 403, *Market definition* (December 2004), paragraph 3.13. Sunk costs are costs that are incurred on entering a market that are not recoverable on exiting a market. These could, for example, include investments in product placement, distribution and production technology.
Newspaper and magazine publishing

Product market

3.67 In relation to the publication of national newspapers, it appears likely that 'national newspapers' would constitute the relevant product market. On the demand side, there are numerous other methods by which people can find out about news items and the other editorial content included in national newspapers, including radio and television broadcasts and internet news websites. However, there are significant variations in how these alternative channels transmit the news and other content. For example, it is often possible for newspapers to cover more of the background to a news story than can be covered in a TV or radio news broadcast. Regional newspapers may be complements to, rather than substitutes for, national newspapers, given the different content and advertising they contain. In terms of supply-side substitution, there appear to be very few firms that could easily begin producing national newspapers at short notice and without incurring significant sunk costs.

3.68 In relation to the publication of magazines, on the demand side, there is an array of different types of magazines covering a wide range of different subjects, and it would seem unlikely that consumers would substitute, for any given title, another title that had very different content. This would suggest that it is unlikely that there is a single product market for magazines and instead, consumers may view magazines as forming a number of product markets based on the content, target audience and frequency of their publication. In terms of supply-side substitution, there may be some opportunities for substitution between different categories or types of magazine, which may broaden the definition of the relevant product market in some

93 For example, in Anticipated acquisition by Magicalia Publishing Limited of Good Woodworking magazine from Future Publishing Limited (16 March 2007) the OFT took 'a cautious view and considered woodworking magazines alone for the purpose of assessing this transaction'.
cases. There appear to be very few firms, however, that could easily begin producing magazines at short notice and without incurring significant sunk costs so the product market is unlikely to be broader than magazines.

3.69 As noted above, publishers of newspapers and magazines typically have two demand relationships. In addition to readers paying for the editorial content, advertisers pay to have their adverts printed. Adverts appear in a wide variety of media, including newspapers, magazines, radio, television and the internet, as well as other static and mobile advertising locations. In order to consider whether these different forms of media are substitutable from an advertiser’s point of view, it would be necessary to consider the ability of the medium or publication to reach and influence consumers of a certain type or group. The OFT does not provide any further guidance on this issue as it is not clear that it is necessary to consider this market for the purposes of the parties’ self-assessment of their Agreements.

Geographic market

3.70 The geographic market for national newspaper publication may be the UK since the content will typically be targeted at a UK audience, although the OFT notes that a wider range of titles is published in Scotland. National newspapers typically publish regional editions and it is possible that the geographic market may be narrower on this basis.

94 However, in Anticipated acquisition by Future plc of Highbury House plc (14 April 2005) the OFT found that, although supply-side substitution may be relatively easy within certain segments (such as motoring and motorcycling), the ease of substitution was less clear across segments, where publishers would only be able to extract very limited benefit from existing advertising contacts and expertise, and there was a mixed picture of past attempts at such supply-side substitution.

95 Although readers are likely to be primarily interested in the editorial content, they are also likely to value the advertising content. For example, in travel supplements readers may be interested in adverts for hotels as well as editorial material on a featured destination.

96 The OFT also notes that there are national newspapers for Wales, such as The Western Mail.
3.71 The geographic market for magazine publication is also likely to be the UK, since the content will typically be targeted at a UK audience.

Newspaper and magazine wholesaling

Product market

3.72 Current practice in the supply chains would suggest that the relevant product market is likely to be the wholesaling of both national newspapers and magazines. However, it is possible that there are limits to the extent that some wholesalers that currently handle just national newspapers may be substitutable for magazine wholesalers, and that there is scope for new entry into magazine wholesaling by operators who would not also be substitutable for newspaper wholesalers. This may mean that the market should be defined more narrowly.

3.73 In relation to current practice, newspapers and magazines are typically distributed together (although as noted above, independent wholesalers do not currently distribute magazines). This is likely to be largely driven by the economies of scope from joint distribution. In particular, there are significant economies of scope from delivering newspapers and magazines together since most retail outlets receive both newspapers and magazines.\(^98\) There are also economies of scope from packing newspapers and magazines at the same depot. These arise because magazines can be packed during the day, allowing for more efficient utilisation of depots that would otherwise be used only for short periods in the early hours of the morning.

3.74 In addition to the economies of scope, there is a significant degree of similarity in terms of the tasks that need to be performed in relation to newspaper and magazine wholesaling (for example, copy allocation,\(^97\)

\(^{97}\) The main differences between these regional editions relate to television listings, although there are also variations in some other editorial content (such as which football matches are reported) and some advertising.

\(^{98}\) Information provided by multiple wholesalers suggests that over 90 per cent of outlets receive both newspapers and magazines.
packing, delivering and processing returns). There is, however, some variation in terms of the equipment used, with magazine wholesaling generally requiring more sophisticated and expensive equipment for packing and returns processing.\textsuperscript{99}

3.75 However, it is possible that not all newspaper wholesalers would be substitutable for magazine wholesalers, and vice versa. First, as discussed above, information provided to the OFT suggests that independent wholesalers may well not be able to provide magazine distribution services due to their inability to make the substantial investments in the systems and infrastructure required to meet the stringent service requirements necessary to obtain major publisher / distributor contracts.\textsuperscript{100}

3.76 Second, as discussed above, there appear to be few practical alternative methods of distribution other than using existing traditional wholesalers that would be substitutable for national newspaper wholesalers. In particular, the need for early morning deliveries means that there are few opportunities for economies of scope for delivering newspapers with other products. For example, economies of scope for delivering national newspapers with regional newspapers is limited to morning titles, whereas regional and local newspapers are predominantly evening titles.\textsuperscript{101} In addition, newspaper wholesaling requires additional tasks, in particular in relation to copy allocation and processing returned products, which are not typically required of wholesalers of products other than newspapers and magazines. OFT understands that publishers have sought to attract bids from new entrants but with little or no success to date.

\textsuperscript{99} This is illustrated by the significant additional investments that have been made by multiple wholesalers specifically in relation to magazine packing and returns processing equipment.
\textsuperscript{100} PPA response to consultation on the draft 2006 Opinion, page 84.
\textsuperscript{101} The Newspaper Society has informed the OFT that the majority of regional newspaper publishers undertake their own delivery of their titles to the door of retail outlets. Some titles are distributed via wholesalers, and anecdotally, the OFT has been informed that publishers of morning regional newspapers and weekly regional newspapers in remote or rural areas are the likeliest users of newspaper wholesalers.
In contrast, as discussed above, the timescales for distributing magazines are typically substantially longer than those for national newspapers, so deliveries could be made at different times of the day to achieve economies of scope of distribution with other products. This suggests that publishers of magazines could in theory consider a wider selection of possible wholesalers than newspaper publishers, and may consider the wholesaling and delivery of magazines being undertaken together with retail products other than newspapers (for example, wholesale suppliers to record stores could also supply magazines), or possibly by general logistics firms.\textsuperscript{102}

**Geographic market**

The geographic scope of the wholesaling market is likely to vary depending on whether or not publishers award exclusive contracts, and if so, whether those contracts include ATP, and, in the absence of ATP, may vary between different areas, and between newspapers and magazines.

In the absence of ATP, retailers would be able to seek passive sales from wholesalers who could provide the deliveries they require. As discussed above, the choices the retailers would have are likely, subject to any potential new entry, to be limited to a small number of newspaper and magazine wholesalers who have a depot reasonably close, and this would vary between different areas. For newspapers, given the tight timescales for distribution, it is likely that the choice would be extremely limited, and it is likely that there would be a significant number of retailers for whom there was no such choice at all. For magazines, the longer timescales may mean that wider choices would be available to retailers, particularly for supermarkets or other multiples which may be able to negotiate a regional or national supply arrangement. It is possible that these wider choices would be sufficient for there to be a 'chain of

\textsuperscript{102} The OFT understands that this possibility may depend on there being sufficiently large territories to serve.
substitution\textsuperscript{103}\ leading to a wider regional or national geographic market, even if regional or national supply arrangements do not arise.

3.80 At the time publishers tender contracts for exclusive territories, the choice of wholesalers available to them may be wider. When contracts are tendered, it is possible that publishers would be able to:

- choose between two competing wholesalers that could serve a particular territory from their existing depots, or
- induce wholesalers to make changes to their depot locations that would enable them to compete for additional territories, or
- induce new entry by firms which do not currently wholesale newspapers or magazines.

3.81 If contracts include ATP, it may be easier for publishers to induce changes in depot locations or new entry if, for example, the wholesaler were guaranteed that only it would serve all or most of the customers in an area thereby indicating that the wholesaler's investment would likely be worthwhile. In this way, although ATP restricts sales across territory boundaries, it does not prevent the geographic market for newspaper and magazine wholesaling in specific territories being wide.

\textsuperscript{103} Two products do not have to be direct substitutes to be included in the same market, since there may be a chain of substitution between them. The concept of a chain of substitution refers to a situation where two or more products can be regarded as belonging to the same product market, without being direct substitutes for each other, because their pricing may be constrained by another product, which is a substitute for the first product: see, for example, Commission Decision 2003/176/EC \textit{Pirelli/BICC} (2003) OJ L70/35, paragraph 17. In the context of the geographic scope of the wholesaling market, customers of wholesaler A might only be able to switch to wholesaler B, but the ability of customers of wholesaler B to switch to wholesaler C might mean that wholesalers A and C are in the same geographic market further to a chain of substitution. See also OFT guideline 403, \textit{Market definition} (December 2004), paragraph 3.11.
Newspaper and magazine retailing

Product market

3.82 There is a wide range of different types of retailers of newspapers and magazines in the UK. Typically, retailers sell both newspapers and magazines, although some only sell either newspapers or magazines, or a small group of titles.\textsuperscript{104}

3.83 In terms of demand-side substitution, it is relevant to consider whether consumers find all types of retailer to be substitutable, or whether there are distinctions between different retailer types, such that they would not be easily substitutable. This may differ between newspapers and magazines. As noted above, newspapers are highly perishable, with the majority of copies purchased before 10:00. Customers are generally likely to purchase from a convenient local outlet (for example, one on their route to work, or one that will deliver to their home).

3.84 Customers may have greater flexibility in terms of where they purchase magazines given the longer time available for purchases, for example delaying their magazine purchase until they do their weekly shop at a supermarket. These differences appear to be reflected in the trends in purchases from different outlet types over time. Figures provided to the OFT illustrate that the proportion of total magazine sales through supermarkets has risen from 19 per cent in 1995 to 31 per cent in 2005.\textsuperscript{105} The proportion of newspaper sales through supermarkets appears to be significantly lower (around 15 per cent), although sales can be higher at weekends.\textsuperscript{106}

\textsuperscript{104} Retailers that offer a limited range of titles are referred to as niche or specialist outlets. Such outlets stock a limited range of titles, usually to complement other product categories within their business. Examples of niche outlets are HMV and Virgin Retail, which stock NME.

\textsuperscript{105} These figures were provided to the OFT by the PPA in January 2006. The information provided did not indicate whether these are shares by value or by volume.

\textsuperscript{106} Based on information provided by Dawson News on 10 September 2007 and Smiths News on 12 February 2007.
3.85 On the supply side, the OFT is aware that newspaper publishers are seeking to address the general decline in newspaper circulation by seeking to make newspapers available in a wider range of retail outlets.\textsuperscript{107} For example, The Times is supplied to Starbucks, the Mail on Sunday is supplied to Boots the Chemist, and the Express is supplied to British Home Stores and Debenhams. This implies that there are further possibilities for supply-side substitution beyond the current range of retailers. However, such possibilities appear limited. One case study provided to the OFT showed that this form of expansion, in respect of one publication, only generated increased sales of 1 million copies per annum (around 3,000 copies per issue). This suggests that, although this may be an alternative, new channel of supply for national newspapers in a declining market, it still represents an extremely small proportion of total newspaper sales.

Geographic market

3.86 In terms of the geographic market, this is likely to be highly localised, in particular for newspapers, given the consumers’ need for convenient local purchases.

\textsuperscript{107} Magazine publishers have also tested selling a range of titles through alternative routes to market other than traditional retailers (for example, placing computer magazines in computer shops). However, the PPA estimates that sales through these ‘niche’ outlets account for less than 0.1 per cent of total sales.
4 GUIDANCE ON THE LEGAL AND ECONOMIC ASSESSMENT

4.1 In order to assist parties in assessing for themselves the likely status of their Agreements under the Chapter I prohibition, the OFT provides guidance on the factors that are likely to be relevant to an assessment of whether an Agreement: (i) prevents, restricts or distorts competition under section 2 of the CA98, and (ii) benefits from a parallel exemption conferred by section 10 of the CA98, and/or (iii) satisfies the exemption conditions set out in section 9(1) of the CA98.

4.2 The Opinion does not reach any definitive conclusions on the status of any individual existing Agreement under the CA98. The Opinion also cannot prejudge the assessment of the same question by the European Commission, the European Court, or the Competition Appeal Tribunal. Nor does it bind other national competition authorities or courts having the power to apply Articles 81 and 82 or the prohibitions in the CA98. An Opinion also cannot bind the subsequent assessment of the same or similar issues by the OFT, although the OFT will have regard to its Opinion when carrying out any such assessment.

Prevention, restriction or distortion of competition under section 2 of the CA98

4.3 As set out in paragraph 2.1, section 2 of the CA98 prohibits agreements or concerted practices between undertakings or decisions by associations of undertakings which have as their object or effect an appreciable prevention, restriction or distortion of competition within the United Kingdom (or a part of it) and may affect trade within the United Kingdom (or a part of it), unless they fall within an excluded category or are exempt in accordance with the CA98.

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108 OFT guideline 442 *Modernisation* (December 2004), paragraph 7.18.
109 OFT guideline 442 *Modernisation* (December 2004), paragraph 7.19.
Rule of reason

4.4 Some parties have submitted that the Agreements might fall outside the scope of section 2 of the CA98 on account of what is often referred to as the 'rule of reason' line of case law. In these cases, such as Metro (No 1)\textsuperscript{110} and Wouters,\textsuperscript{111} the EC courts\textsuperscript{112} have found that agreements which at first sight appear to restrict some aspect of competition nonetheless fall outside the scope of Article 81(1) because the restrictions are necessary for, and proportionate to, the promotion of some legitimate objective.

4.5 The EC Courts and European Commission have adopted this approach in these cases only in respect of a limited number of objectives and contexts. These have included, for example, where agreements were necessary for entry into a new product or geographic market,\textsuperscript{113} or to protect the dignity and rules of conduct of a profession,\textsuperscript{114} or to safeguard the integrity of, and ethical values in, competitive sport.\textsuperscript{115} The objectives and contexts in which this approach has been applied are limited, since the approach is an exception to the general rule that the benefits flowing from an agreement should be considered and weighed up against the anti-competitive aspects of a restriction only in the framework of the exemption conditions.\textsuperscript{116}

\begin{itemize}
\item \textsuperscript{110} Case 26/76 Metro SB-Grossmarkte GmbH & Co KG v Commission [1977] ECR 1875.
\item \textsuperscript{111} Case C-309/99 Wouters v Algemene Raad van de Nederlandse Orde van Advocaten (Wouters) [2002] ECR I-1577.
\item \textsuperscript{112} Under section 60 of the CA98, when determining a question arising under Part I of the CA98, the UK authorities are under a dual obligation. First, they must ensure that there is no inconsistency with the principles laid down by the EC Treaty and the European Court, and any relevant decision of the European Court. Second, they must have regard to any relevant decision or statement of the European Commission.
\item \textsuperscript{113} See, for example, Case 258/78 LC Nungesser KG and Kurt Eisele v Commission [1982] ECR 2015.
\item \textsuperscript{114} As in Wouters, cited above.
\item \textsuperscript{115} As in Case C-519/04P David Meca-Medina and Igor Majcen v Commission [2006] ECR I-6991.
\item \textsuperscript{116} Case T-112/99 Metropole Television (M6) v Commission [2001] ECR II-2459.
\end{itemize}
4.6 The main types of objectives identified by the parties to the OFT in relation to newspaper and magazine distribution are ensuring the existence of a strong and robust distribution system and the achievement of economic goals such as ensuring the widest possible product availability, and ensuring that the correct regional version of a title is available in each territory. However, these proposed objectives appear to relate to improving the distribution of newspapers and magazines through, for example, increases in the efficiency of the system employed. On the basis of the principles outlined above, they are therefore benefits of a sort typically considered in the context of the exemption conditions.\footnote{See, for example, Commission Notice, \textit{Guidelines on the application of Article 81(3) of the Treaty} (2004) OJ C101/97, at paragraphs 64 to 68, discussing cost efficiencies arising from matters such as new production technologies and methods, synergies from the integration of existing assets, economies of scale and scope, and better planning of production.}

4.7 Some parties have also argued that the Agreements ensure the achievement of social goals through promoting the circulation of newspapers, which they argue are a 'merit good'.\footnote{A merit good is a good that is typically under-consumed, for example because the consumer does not take account of the wider benefits to society from that consumer’s consumption or underestimates the benefits that consumer receives from consumption.} However, it would appear that any benefits to society are not the primary motivation for the Agreements. As such, it would appear unlikely that this would constitute a legitimate objective for the purposes of the 'rule of reason' line of case law.

4.8 Consequently, it would appear unlikely that any of the Agreements would fall outside the scope of section 2 of the CA98 on the basis of the 'rule of reason' line of case law. However, any benefits produced by the Agreements would fall to be considered in the framework of the exemption conditions.
Prevention, restriction or distortion of competition by object

4.9 Section 2 of the CA98 refers to agreements which have as their object or effect the prevention, restriction or distortion of competition. Under the case law of the EC Courts, vertical agreements are not generally regarded as having the restriction of competition\(^{119}\) as their object. The only exceptions to date are agreements for resale price maintenance and agreements which partition markets, including those that confer ATP by preventing passive sales.

4.10 Several parties have submitted that the key consideration behind the classification of ATP as an object restriction under European case law is the single market objective,\(^ {120}\) and that this is not a relevant consideration in relation to an assessment of ATP under national law.

4.11 In many cases, the EC Courts have referred expressly to the single market objective when concluding that ATP agreements had the restriction of competition as their object.\(^ {121}\) However, in some cases, no such express reference has been made to the single market objective, although it appears that the single market objective was undermined on the facts.\(^ {122}\)

4.12 The policy of the European Commission is that passive sales must always be permitted. Where agreements seek to prevent passive sales,

\(^{119}\) For ease of reference, the use of ‘restriction of competition’ includes the prevention or distortion of competition.

\(^{120}\) That is to say, the EC Treaty objective of ensuring that competition in the internal market is not distorted (see Article 3(1)(g) of the EC Treaty).

\(^{121}\) See, for example, Case 56/64 Consten and Grundig v Commission [1966] ECR 299 at 340.

\(^{122}\) See for example, of Case C-70/93 BMW AG v ALD Auto Leasing D GmbH [1995] ECR 3439. The ECJ appears to have based its conclusion that an agreement with ATP ‘has as its object and effect the restriction to an appreciable extent of competition within the common market’ (at paragraph 21) on its analysis of the restrictive nature of ATP (see paragraph 19, beginning ‘As regards the requirement that competition be restricted’). However, the ECJ’s analysis of the compartmentalisation of markets on a national basis (at paragraph 20), appears to relate only to its conclusion that the agreement ‘may affect trade between Member States’ (at paragraph 21).
the European Commission has found that the agreements have the object of restricting passive sales, resulting in a severe restriction of intra-brand competition and the partitioning of the single market. For example, in *Video Games, Nintendo Distribution* the agreements in question conferred ATP on the distributors concerned. The European Commission held that these agreements had the object of restricting competition, stating that:

‘The infringement had the object of restricting all passive sales ... Contrary to the Commission’s policy in respect of exclusive distribution that passive sales are always to be allowed, the territorial protection awarded to exclusive distributors was thereby enhanced to a state of absolute territorial protection and in each territory all competition facing the distributor of the products in the territory was eliminated. As a result, intra-brand competition was severely restricted and the single market was partitioned.’ (emphasis added)

4.13 It would appear likely that a national court would not import the single market objective into an analysis of ATP under national law. However, this would not appear to preclude a finding that ATP agreements have as their object the restriction of competition.

4.14 In considering whether the Agreements have the object of restricting competition, the parties should be guided by the general relevant principles of European case law in this respect. These general principles are considered in outline below.

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4.15 The 'object' of an agreement is determined by reference to an objective analysis of its aims, rather than solely by reference to the parties' subjective intentions when they enter into it. Although proof of subjective intention is not a necessary factor, its existence can be taken into account in finding that an agreement has the 'object' of preventing, restricting or distorting competition.

4.16 According to the case law of the EC Courts, the objective analysis of the aims of an agreement assesses:

- the primary 'purpose' or 'function' of the agreement by reference to its economic context, and / or
- whether the agreement has an inherent anti-competitive quality so that, by its very nature, all or some of its terms have the potential of producing sufficiently deleterious effects on competition, to the detriment of the final consumer.

4.17 The fact that an agreement does not have the sole aim of restricting competition but simultaneously pursues other legitimate objectives will not affect a finding that it is restrictive by object. For example, parties may enter into an agreement with the legitimate objective of improving the efficiency of distribution of their products but this does not mean

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128 See, for example, Case 19/77 Miller v Commission [1978] ECR 131, at paragraph 7.


that the agreement cannot be found to be restrictive by object at this stage of the analytical framework.

4.18 In applying the 'object' analysis, the agreement must be assessed within the legal and economic context in which it is to be applied.\textsuperscript{131} In \textit{CRAM}, the ECJ held:

'In order to determine whether an agreement has as its object the restriction of competition, it is not necessary ... to verify that the parties had a common intent at the time when the agreement was concluded. It is rather a question of examining the aims pursued by the agreement as such, in light of the economic context in which the agreement is to be applied.'\textsuperscript{132}

4.19 It is also instructive to note that the European Commission \textit{Guidelines on the application of Article 81(3) of the Treaty}\textsuperscript{133} (the Article 81(3) Guidelines) provide that:

'The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market... In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object. The way in which an agreement is actually implemented may reveal a restriction by object even where the


formal agreement does not contain an express provision to that effect. Evidence of subjective intent on the part of the parties to restrict competition is a relevant factor but not a necessary condition.

Non-exhaustive guidance on what constitutes restrictions by object can be found in Commission block exemption regulations, guidelines and notices. Restrictions that are black-listed in block exemptions or indentified as hardcore restrictions in guidelines and notices are generally considered by the Commission to constitute restrictions by object... As regards vertical agreements the category of restrictions by object includes, in particular, fixed and minimum resale price maintenance and restrictions providing absolute territorial protection, including restrictions on passive sales’.134

4.20 In applying these principles in respect of the Agreements, the parties should take account of the considerations set out below.

4.21 Agreements that grant wholesalers exclusive territories and prevent them from making passive sales to other territories would, by their very nature, prevent wholesalers from entering into arrangements to supply any retailer that they choose in those other territories. Furthermore, where it is not possible for retailers to switch between wholesalers, or use the threat of switching, so as to get better terms from wholesalers, competition at the retail level is in turn likely to be restricted.

4.22 It is also important to take account of the actual context in which the Agreements operate. In this regard, it is relevant that each Agreement exists alongside similar Agreements entered into by the same publisher in respect of other territories and also by other publishers. Agreements entered into by the same publisher would be mutually reinforcing where the exclusive territory awarded to one wholesaler is protected by restrictions in the Agreements with other wholesalers which prevent them from engaging in passive sales into areas outside their own

territories. The consequence of similar Agreements also being entered into by other publishers would be that virtually all newspapers and magazines\textsuperscript{135} are distributed under arrangements where the wholesalers benefit from exclusivity and ATP. In such circumstances, virtually the entire newspaper and magazine market in the UK would be characterised by a restriction in relation to the retailers that wholesalers serve.

4.23 However, it would not detract from the existence of a restriction of competition that the scope for intra-brand competition may already be impacted by the strong degree of publisher control over the newspaper and magazine supply chains resulting from the very specific features of the products (in particular the two-sided markets). The ability of retailers to switch between different wholesalers in the absence of ATP may lead to relatively limited changes in prices (given the use of cover prices) and quantities (given publisher control over copy allocation). However, it would not be appropriate to argue that if competition is already restricted by some elements of the conduct of the participants in the supply chains (for example, the use of cover prices and copy allocation), agreements entered into by the participants in the supply chains (for example, including the use of ATP) do not have the object of restricting competition.

**Appreciability**

4.24 Where the parties have identified that their Agreements have the object of restricting competition, the issue is then whether such a restriction should be regarded as appreciable. In this regard, it is relevant to assess the proportion of the market that is restricted by each publisher’s and wholesaler’s Agreements. The ECJ has, for example, found that an agreement was capable of infringing the EC competition rules where the company that was party to it had around 5 per cent of the market.\textsuperscript{136} Commentators have suggested that this case was regarded as

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\textsuperscript{135} As noted above in chapter 3, there are some instances of newspapers and magazines being distributed via different methods, for example by postal subscriptions and the DTR service to be provided by News International.

establishing a presumption that an undertaking with 5 per cent of the market is of sufficient importance for its agreements to fall within Article 81(1).\footnote{Bellamy & Child \textit{European Community Law of Competition} (6th Edition) OUP (2008), at 2.122.}

**The EC Verticals Block Exemption and the UK Parallel Exemption**

4.25 As explained in chapter 2 of this Opinion, the Agreements are vertical in nature, and therefore the parallel exemption that is available by virtue of the EC Verticals Block Exemption is potentially relevant. The EC Verticals Block Exemption creates a 'safe harbour' for vertical agreements that fall within its terms, automatically exempting from the application of Article 81(1) agreements that meet all of the conditions of that block exemption. By virtue of the parallel exemption conferred by section 10 of the CA98, such agreements are also automatically exempt from the Chapter I prohibition.

4.26 One of the conditions in the EC Verticals Block Exemption is that an agreement must not contain any of five clauses which are black-listed in Article 4. One of the black-listed clauses relates to passive sales, and is defined as follows:

‘The exemption provided for in Article 2 shall not apply to vertical agreements which, directly or indirectly, in isolation or in combination with other factors under the control of the parties, have as their object –

...'

(b) the restriction of the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except –

- the restriction of active sales into the exclusive territory ... allocated by the supplier to another buyer, where such a
restriction does not limit sales by the customers of the buyer’.

4.27 Agreements incorporating a black-listed clause cannot benefit from the ‘safe harbour’ provided by the EC Verticals Block Exemption and, therefore, are not covered by the parallel exemption conferred by section 10 of the CA98. As a matter of law, however, the fact that a block or parallel exemption does not apply to an agreement does not mean that the agreement cannot benefit from individual exemption under section 9(1) of the CA98 and this is discussed below.

4.28 As noted in paragraph 4.22 above, the OFT understands that almost all the Agreements contain restrictions granting ATP to wholesalers. Accordingly, they fall outside the scope of the EC Verticals Block Exemption and, therefore, do not benefit from the parallel exemption conferred by section 10 of the CA98. The OFT, therefore, provides guidance on the factors that are likely to be relevant to an assessment of whether an Agreement satisfies the exemption conditions in section 9(1) of the CA98.

Exemption under Section 9(1) of the CA98 - general principles

4.29 This section addresses general principles in relation to exemption. In providing this guidance, the OFT has drawn in particular on the European Commission Guidelines on the application of Article 81(3) of the Treaty (the Article 81(3) Guidelines), since those guidelines are a matter to which the OFT or a court would be required to have regard in the event that it were to determine a question arising in the application of section 9(1) of the CA98 to the Agreements.139

4.30 The Article 81(3) Guidelines state that the assessment of restrictive agreements is to be made within the actual context in which they occur.

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139 See section 60(3) of the CA98 and the OFT guideline 442, Modernisation (December 2004), paragraph 4.11.
and on the basis of the facts existing at any given point in time. The assessment will be sensitive to material changes in facts, meaning that exemption will only apply for as long as all four conditions are fulfilled.\footnote{40}{Article 81(3) Guidelines, paragraph 44.}

4.31 Although severe restrictions of competition are unlikely to fulfil the exemption conditions, as a matter of principle, all restrictive agreements that fulfil the four conditions will benefit from exemption.\footnote{41}{Article 81(3) Guidelines, paragraph 46. Case T-17/93 \textit{Matra Hachette SA v Commission} [1994] ECR II- 595, at paragraph 85. (See also Commission Decision, \textit{Reims II} (1999) OJ L275/17, where the European Commission held that an agreement fixing terminal dues (a form of price-fixing) satisfied the exemption conditions in Article 81(3)). At a UK level, see Case CP/0642/00/S Competition Act 1998 Decision of the Director General of Fair Trading, \textit{LINK Interchange Network Limited}, 16 October 2001, which concerned a centrally set multilateral interchange fee; see also Case CP/1730-00/S, \textit{Memorandum of Understanding on the Supply of fuels in an emergency}, 25 October 2001: a memorandum of understanding to preserve the supply of oil fuels and, in the event of unavoidable supply disruption, to protect supplies to essential users, which was found to have the object and effect of preventing, restricting or distorting competition within the UK but was nonetheless granted an individual exemption from the Chapter I prohibition subject to certain conditions and obligations.}

Consequently, in exceptional circumstances, even hardcore or black-listed restrictions may still satisfy the exemption conditions in individual cases.

4.32 The Article 81(3) Guidelines also state that the assessment of any benefits flowing from restrictive agreements is in principle made within the confines of each relevant market to which an agreement relates. In this regard, ‘[n]egative effects on consumers in one geographic market or product market cannot normally be balanced against and compensated by positive effects for consumers in another unrelated geographic or product market. However, where two markets are related, efficiencies achieved on separate markets can be taken into account provided that the group of consumers affected by the restriction and benefiting from the efficiency gains are substantially the same’.\footnote{42}{Article 81(3) Guidelines, paragraph 43.}
4.33 The issue of related markets is relevant in this case, as the newspaper and magazine markets can be said to be related in the following respects:

- There are significant synergies between newspaper and magazine distribution which underpin the current practice of delivering the products together.
- Where retailers need to obtain their newspapers and magazines from the same wholesaler, if ATP is present in Agreements regarding newspaper distribution, retailers may have no choice of magazine wholesaler whether or not there is ATP in Agreements regarding magazine distribution, and vice versa.143

4.34 However, notwithstanding the above the OFT considers that it would not be appropriate for the effects of the Agreements in one market to be balanced against, and potentially compensated by, the effects in the other, if the consumers in these markets are not substantially the same. As the supply chains currently operate, the benefits of the Agreements appear to relate primarily to publishers and are then passed on to final consumers, or relate directly to final consumers. A key question, therefore, is whether final consumers of newspapers and magazines are substantially the same. In conducting their self-assessment, any parties that wished to rely on this point would therefore need to consider whether this is the case and the evidence that they would be able to present if called upon to support their judgement.

4.35 The following sections provide guidance in relation to each of the exemption conditions set out in section 9(1) of the CA98, setting out the general approach and providing specific guidance, but without reaching any definitive conclusions, for newspaper Agreements and then for magazine Agreements. Agreements relating to newspaper and

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143 These issues are discussed in more detail in the section above on how newspaper and magazine distribution may operate in the absence of ATP (see paragraphs 3.57 to 3.62 above).
magazine distribution are discussed separately as the assessment may vary given certain key differences between these different products.

4.36 The parties should be aware, when self-assessing their Agreements, that the four exemption conditions set out in section 9(1) of the CA98 are cumulative. Therefore, if an Agreement does not satisfy one of these exemption conditions, exemption would not be available and it would not be necessary to examine whether the remaining conditions were satisfied. It may be the case, therefore, that it would be appropriate for the parties to consider the four conditions in a different order from that set out in section 9(1).

First condition: contribution to improving production or distribution, or promoting technical or economic progress

Framework for assessment

4.37 Section 9(1) of the CA98 provides that the first condition that must be fulfilled is that an agreement must contribute to improving production or distribution, or promoting technical or economic progress. The first condition, therefore, sets out the types of efficiency gains that may be taken into account and which will be subject to the further tests of the second and third conditions, namely that consumers receive a fair share of the benefit resulting from the agreement and that the agreement does not impose restrictions that are not indispensable to the attainment of those objectives. The types of efficiencies that justify exemption are broadly intended to cover all objective economic efficiencies.

4.38 In assessing an agreement under the first condition, only objective benefits can be taken into account, meaning that efficiencies are not

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144 See Article 81(3) Guidelines, paragraph 50.
145 See Article 81(3) Guidelines, paragraph 59.
assessed from the subjective point of view of the parties.\textsuperscript{147} For example, cost reductions that come about from parties restricting output or lowering marketing expenditure as a result of reduced competition in the market cannot be taken into account.\textsuperscript{148}

4.39 The efficiencies arising must be quantifiable, in order to assess whether the efficiency gains outweigh the anti-competitive effects of an agreement. Given that this Opinion merely provides guidance to the parties in relation to the applicable principles, the OFT has not quantified the potential benefits of any individual Agreement. When parties self-assess their Agreements, in addition to considering the nature of any claimed efficiencies and the link between an Agreement and the efficiencies, they should consider the likelihood and magnitude of each claimed efficiency and how and when each claimed efficiency would be achieved.\textsuperscript{149}

Guidance on newspaper Agreements under the first condition

4.40 There would appear to be two key potential efficiency benefits from ATP. First, it may make 'competition for the market' more effective, enabling publishers to achieve reduced margins and improved service quality from wholesalers and providing a stimulus to wholesalers to innovate. Second, ATP may enable publishers to include in their contracts with wholesalers an obligation to supply all retailers (within reason) in a territory.

4.41 This section considers these potential efficiency benefits and also discusses arguments submitted by some parties that ATP provides for the wide availability of newspapers, in particular that ATP supports cross-subsidy and prevents waterbed effects.


\textsuperscript{148} Article 81(3) Guidelines, paragraphs 49.

\textsuperscript{149} See Article 81(3) Guidelines, paragraphs 51 - 58.
'Competition for the market'

4.42 As discussed in the section on how newspaper distribution may operate in the absence of ATP, it appears unlikely that 'competition in the market' would develop for a significant proportion of retailers given the limited areas that can be served by depots due to the time constraints and the economies of scale, scope and density in newspaper wholesaling. There are, therefore, likely to be benefits for publishers in establishing a system of 'competition for the market' through exclusive distribution agreements.\(^{150}\)

4.43 ATP appears likely to make this 'competition for the market' more effective, reducing costs to publishers and, in turn, prices to consumers,\(^ {151}\) by allowing publishers to exploit more effectively the potential for competition between wholesalers at the tendering stage.\(^ {152}\) A key factor here is that bids for individual territories do not appear to be independent of what happens in other territories - wholesalers appear to be prepared to reduce their bids across a range of territories they bid for in order to win an increase in the size of their territory, a neighbouring territory or a bigger national share of newspaper wholesaling.

4.44 In particular, ATP appears likely to make 'competition for the market' more effective as it allows publishers to gain the benefit of wholesalers competing, during the bidding process, for territories where the depot 'catchment areas' overlap. ATP provides an incentive for the wholesaler to reduce its margins in order to secure the contract for what is effectively a territory protected from competition from other wholesalers.

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\(^{150}\) It may well be that an efficient method of wholesaling (which exploits economies of scale, scope and density) would arise in any event. Under 'competition in the market', this may generate wholesaler market power. With 'competition for the market', publishers are able to benefit from these economies and pass these benefits on to consumers.

\(^{151}\) The extent to which the benefits of reductions in distribution cost may be passed on by publishers to consumers is discussed below in the section on the second exemption condition.

\(^{152}\) The impact of ATP on the effectiveness of competition for the market is discussed in relation to newspaper distribution in this section. As discussed below (paragraph 4.64) similar considerations are likely to apply in relation to magazine distribution.
that are appointed by the publisher in neighbouring territories. Without ATP, there would be little incentive to reduce the margin, since the wholesaler would risk losing retailers in the catchment overlap areas to its rivals despite having won the exclusive contract and also because the wholesaler could compete with its rivals to serve retailers in the catchment overlap areas anyway by responding to requests for passive sales.

4.45 The benefits of securing any one contract in the overlap area may be limited, since the wholesaler will not benefit from the economies of scale that would be achieved by distributing all publishers’ titles. However, it might nevertheless be attractive to a wholesaler as it may give it a foothold to compete for further contracts tendered by other publishers. Similarly, a wholesaler is likely to want to avoid giving a foothold in its territory to rival wholesalers.

4.46 Further, ATP appears likely to make 'competition for the market' more effective as it allows publishers to gain the benefit of wholesalers’ competing to win a larger region or a larger national share of newspaper wholesaling. Wholesalers are likely to have incentives to reduce their margins in order to secure additional territories because of economies of scale at a regional and firm level. For example:

- Winning neighbouring territories in order to serve a larger region gives more flexibility to the wholesaler about where its depots are located and how they are used - it may be possible to open a new depot to serve an additional area and close an existing depot and serve the territories it covered from other depots in the region.

- Winning a larger national share of newspaper wholesaling may enable the wholesaler to benefit from greater economies of scale at a firm level, for example through greater utilisation of centralised facilities, such as copy allocation and customer call centres.

4.47 As discussed above, without ATP there would be little incentive to reduce the margin to secure these territories since the wholesaler would risk losing retailers that fall in the catchment overlap areas to
neighbouring rivals despite having won the exclusive contract.\textsuperscript{153} The incentive to reduce margins to win a larger share of national supply in order to better exploit economies of scale at a national level suggests that, even if there are small areas in which the density of retailers is such that there may be scope for more significant competition in the market to develop (as discussed in paragraph 3.36 above), it may be preferable instead for competition for the market to apply also to these areas in order to enable publishers to exploit the potential for competition to the greatest extent possible. Parties will need to consider whether such arguments apply in relation to their Agreements, and the evidence that they would be able to present if called upon to support their judgement.

4.48 In addition, it is possible that ATP allows wholesalers to reduce their margins, given that they have greater certainty about the numbers of retailers they will supply and the volume of copies they will handle, and therefore do not need to build as significant a risk premium in the margins they require. It is also possible that the greater certainty provided by ATP may provide greater incentives to wholesalers for investment, since wholesalers may be more willing to make investments in new depots and equipment that involve sunk costs if they have security that they will have a sufficiently large market to recover these costs. However, such arguments do not appear to be particularly relevant in this case as the investments required do not appear to involve any significant sunk costs.

4.49 Some parties have submitted that, absent ATP, wholesalers may be deterred from bidding for a territory by the risk of losing sales to some of the retailers located in that territory to rival wholesalers. The uncertainty over the potential loss of sales, they have submitted, may undermine the profitability of the wholesaler’s Agreement with the publisher, for example through being unable to recover its fixed costs (and also to sink\textsuperscript{153} Without ATP, it may also be possible for the wholesaler to compete to serve those retailers that fall within the catchment areas of the wholesaler’s existing depots anyway, without needing to agree to reduced margins from publishers, by responding to requests for passive sales.)
any start-up costs if a new entrant). It is not clear, however, why such issues would deter wholesalers from bidding for territories rather than raising the margins that wholesalers would seek from publishers (as noted above).

4.50 It is also possible that publishers may be better placed than retailers to induce service quality improvements. Some publishers may have a degree of buyer power on the basis of the share of the wholesalers’ business that they represent. ATP provides publishers with a greater degree of buyer power because of the control it gives publishers over which retailers the wholesaler does and does not serve. It is not clear that, in the absence of ATP, any individual retailer would have a similar degree of influence, although this may be the case for some large multiple retailers.

4.51 It is also possible that ATP provides stronger incentives for wholesalers to innovate than would otherwise arise. In the absence of ATP, in areas which rival wholesalers could serve they would compete by providing better terms to retailers. With ATP, the wholesalers compete by providing better terms to publishers. Giving greater control to publishers over the incentives faced by wholesalers will provide stronger impetus for innovation if publishers have stronger, more compelling motivations to improve the speed and efficiency of the supply chain than retailers. This appears likely to be the case, given the tight distribution timescales in relation to newspapers. An example of publishers prompting changes in wholesaling because of the distribution timescales is the proposed changes to the News International contracts, which will come into effect in 2009, following a recent tender round. These changes, which appear likely to require investment in new depots by at least some wholesalers, are largely designed to allow later printing of News International’s titles to make it easier to cope in the event of a printing

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154 See, for example, The economics of magazine distribution, PWC for Marketforce (UK) Limited, June 2005, paragraph 3.50.

155 For example, the wholesaler Dash (which currently operates in Cornwall) will expand its operations to cover a large area of southwest England, for which it proposes opening a new depot in Taunton (see Retail Newsagent, 26 September 2008).
press problem and to cover late-breaking sports news.\textsuperscript{156} It is difficult to envisage similarly significant changes motivated by changes in retailer requirements.

4.52 In addition, it is possible that, in the absence of ATP, wholesalers would compete only for certain types of retailers that it would be commercially attractive for them to serve. In turn this could mean that wholesalers' incentives to innovate would focus on those types of retailers only. In contrast, with ATP, wholesalers compete for the business of publishers which have incentives to ensure wide availability. It is possible that this competition would provide incentives for wholesalers to innovate in ways that would benefit all retailers in the area served.

4.53 Evidence that would support the arguments above to suggest that ATP has made 'competition for the market' more effective could include evidence that publishers have been able to secure cost reductions or improvements in service quality as a result of the Agreements, or that there have been incentives to innovate as a result of the Agreements. The publishers and wholesalers have submitted that wholesalers' margins have reduced over time,\textsuperscript{157} that performance standards have risen due to increased use by publishers of 'key performance indicators' (KPIs) and monitoring of the quality of wholesaler service provision,\textsuperscript{158}

\textsuperscript{156} See Retail Newsagent, 6 June 2008.
\textsuperscript{157} The parties provided examples of tendering rounds that have taken place over the last 6 years, with details of the margins paid previously and those negotiated in the tender round, which were consistent with this trend.
\textsuperscript{158} One publisher has provided information to the OFT on the contents of its Service Level Agreement (SLA) that it agreed with its wholesalers following a recent tender round. This SLA includes three KPIs and 22 primary performance indicators (PPIs), which amongst other things, relate to timeliness and accuracy of delivery to retailers, timely collection of returns from retailers and a requirement to maintain a constant level of retailers across the territory served. This can be contrasted with historic SLAs provided by wholesalers to the OFT: in the late 1990s, one SLA contained no KPIs or quantitative performance targets. The OFT has been informed that persistent or serious failure by wholesalers to meet these performance standards can result in contractual penalties, or even the loss of an area or the wholesale contract in its entirety.
and that wholesalers have invested in new technology.\textsuperscript{159} In conducting their self-assessment, the parties will need to consider whether and how far the above apply as a result of their Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Obligation to supply

4.54 The second potential efficiency benefit of ATP would appear to be that it may enable publishers to include in their contracts with wholesalers an obligation on wholesalers to serve all retailers (within reason) in a territory. Wholesalers have submitted that they would not be willing to accept such an obligation in the absence of ATP as the ability of rival wholesalers in neighbouring areas to respond to requests for passive sales may enable such wholesalers to 'cherry pick' those outlets that it is most desirable to serve (for example, large outlets) leaving the incumbent wholesaler who is under contract to supply the entire territory with 'residual' retailers that cannot be served economically. Even if wholesalers were willing to accept such an obligation providing they were appropriately remunerated for this risk, this would be likely to increase significantly the margins that publishers would have to pay and/or the carriage service charges levied by wholesalers on retailers, given the increased costs of serving these retailers.

4.55 At present, the obligation on wholesalers to supply retailers is embodied within the Code, through the MEL obligation.\textsuperscript{160} As noted above (see paragraph 1.14), the OFT has provided advice to the Secretary of State that the Code should be revoked. The absence of the Code (should the Secretary of State accept the OFT's advice) would not prevent newspaper publishers from including in their individual contracts with wholesalers an obligation on wholesalers to serve all retailers (within

\textsuperscript{159} Wholesalers (particularly multiple wholesalers) have introduced a greater degree of automation to the newspaper wholesaling process through investments in new technology and wholesaling processes. This includes significant investments in packing technology, returns scanning, allocation systems and information systems.

\textsuperscript{160} See paragraph 1.12 above.
reason) in a territory where this was compatible with the CA98. The parties will need to consider whether this would apply in relation to their Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Cross-subsidy

4.56 Some parties have submitted that ATP supports the cross-subsidy of the costs of delivering newspapers to small and remote retailers, whom it would not otherwise be cost effective for wholesalers to supply, thereby improving distribution.\textsuperscript{161}

4.57 One way in which supply to small and remote retailers can be supported is by ensuring that they can be served alongside other retailers, thereby minimising the cost of serving them. This may be facilitated by publishers including an obligation to supply in their contracts with wholesalers, as discussed above in paragraphs 4.54 and 4.55.

4.58 It is also possible that supply to small and rural retailers could be supported by these smaller and rural retailers making a lower contribution to the wholesalers' fixed costs than is made by larger and less remote retailers. Such a price structure may be an efficient way of recovering fixed costs and may expand demand.\textsuperscript{162} Charging small and rural retailers less in this way may result in them being supplied when they otherwise wouldn’t, which in turn may enable the wholesaler to benefit from greater economies of scale, which in turn may enable the

\textsuperscript{161} See, for example, \textit{The economics of magazine distribution}, PWC for Marketforce (UK) Limited, June 2005, paragraphs 3.30-3.36. Similarly, the BEI has stated that large retailers cross-subsidise smaller retailers: \textit{The economic case for a block exemption for UK newspaper and magazine distribution}, P Dobson for BEI, April 2004, footnote 89.

\textsuperscript{162} For example, train operators often set different fares for peak and off-peak travel. Recovering a higher proportion of fixed costs from peak-time travellers may allow the train company to reduce the share of these costs recovered from off-peak travellers. This may increase output overall, since if both categories of customers were charged the same, off-peak travellers may switch to another mode of transport or not travel at all, leaving peak travellers to bear more of the fixed costs.
wholesaler to also charge the larger and less remote retailers less than it would otherwise need to.

4.59 A cross-subsidy in the strict economic sense arises where the price charged to a retailer (or group of retailers) does not cover the wholesaler's incremental cost\(^{163}\) of supplying them. A subsidy can be efficient when it corrects what economists refer to as a 'market failure'.\(^{164}\) As discussed above (paragraph 4.7), some parties have argued that the Agreements ensure the achievement of social goals through promoting the circulation of newspapers, which they argue are a merit good.

4.60 The OFT does not know what proportion, if any, of retailers are served at below incremental cost. Wholesaler submissions to the OFT indicate that it is not possible to isolate the incremental costs of supplying any one retailer in the distribution network. This is understandable given the high common costs and the fact that the incremental costs of supplying a retailer (such as additional fuel and labour) will depend to a significant extent on how a delivery run is sequenced between retailers. Nevertheless, one wholesaler was confident that the incremental costs of supply were met for the vast majority of retailers that it serves. This is consistent with evidence examined in the Code Review that many retailers are supplied at volumes below the MEL. Since wholesalers are not obliged by the Code to supply these retailers, their decision to do so suggests that the incremental costs of supply are met.

4.61 If parties consider that a cross-subsidy is being provided, then in order to determine if it could be considered a benefit under the first condition of section 9(1), it would be necessary to consider the extent of the under-

\(^{163}\) The incremental cost of supplying a retailer is the cost that the wholesaler could avoid if it did not supply that retailer.

\(^{164}\) In economic terms, market failure arises when the allocation of goods and services by a free market is not efficient. One example is traffic congestion, where too many cars use the roads as individual drivers do not take account of the impact of their use of the road on other road users. One potential solution to this problem is to provide a subsidy for public transport.
consumption of newspapers and whether the cross-subsidy is set at the right level and is targeted correctly. It would also be necessary to explain why it would be appropriate for the subsidy to be provided from, for example, urban retailers to rural retailers when this could discourage the provision of newspapers in urban areas.

Waterbed effects

4.62 Some parties have submitted that, without 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 (the so-called 'waterbed effect'). As a consequence, the parties submit, large numbers of retailers would exit the market. To rely on this argument, the parties would need to consider whether they can provide evidence that the very strong and specific assumptions that waterbed effects rely on are met in this case.

Summary of guidance on newspaper Agreements under the first exemption condition

4.63 In light of the above, it would appear that there are several factors that may demonstrate that ATP in newspaper Agreements satisfies the first exemption condition in relation to the newspaper supply chain. The parties will need to consider whether the arguments discussed above apply in relation to their newspaper Agreements, and the evidence that they would be able to present if called upon to support their judgement.

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166 For example, in RBB Economics (January 2007) The competitive effects of buyer groups, OFT Economic Discussion Paper (OFT863), paragraph 6.27, it is argued that 'Robust models of waterbed effects are relatively difficult to derive. This is due to a simple intuition: if suppliers could charge other buyers more, why are they not already doing it?'
Guidance on magazine Agreements under the first condition

4.64 In relation to magazine Agreements, it is likely that similar arguments that ATP makes competition for the market more effective could be made as discussed above in relation to newspapers (see paragraphs 4.43 to 4.52). However, it should be noted that it is necessary for the Agreement to be the direct cause of the potential efficiency. A key difference between the newspaper supply chain and the magazine supply chain is that a greater degree of competition in the market would be likely to arise for magazines in the absence of ATP. If the efficiency benefits would also result from competition in the market, it cannot be said that ATP is the direct cause of the efficiencies.

4.65 In relation to newspapers, as previously explained, it would appear that the incentives to innovate may be greater for publishers than for retailers. However, the longer timescales for magazine distribution, are likely to mean that publisher incentives for innovation are less strong (for example, they may have more limited incentives to drive reductions in the time taken to distribute magazines than was identified for News International in the example given at paragraph 4.51 above). The longer timescales are also likely to allow for greater flexibility in terms of how wholesalers interact with retailers, and retailers may be better placed to drive innovations than publishers. For example, although there are likely to be advantages for both retailers and publishers in developing systems for sales based replenishment, retailers may have stronger incentives to drive the development of such systems, particularly if there is strong competition between retail outlets. Retailers' experience of, and infrastructure for, other supply chains may also reveal innovation possibilities that magazine publishers would not be aware of. Retailers may also be able to propose innovations that allow supply to be better

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167 Sales based replenishment (SBR) is a process through which the wholesaler agrees with the publisher not to distribute 100 per cent of the copies supplied direct to retailers, but instead withholds a percentage in order to meet future demand for more copies. By better matching supply to demand, SBR is likely to have advantages for publishers in that it may reduce wastage and advantages for retailers in reducing the levels of stocks they need to carry and increasing sales of titles that would otherwise have sold out.
targeted to local demand conditions, about which they are likely to be better informed than publishers.

4.66 It would appear also that the second key efficiency benefit of ATP that was identified for newspapers, that is the ability of publishers to place wholesalers under an obligation to supply all retailers (within reason) in a territory, is likely to be less important for magazines than for newspapers. This is because, as magazines are less perishable, purchasers have greater flexibility in where and when they purchase. For newspapers, it is possible that, if consumers are unable to obtain a copy from a convenient local retail outlet, they will no longer purchase a newspaper. For magazines, it may be more likely that, if a copy is unavailable at a local retail outlet, the purchase would be deferred until the customer was able to visit a different retail outlet (for example, a supermarket when undertaking a weekly grocery shop or a city centre newsagent when purchasing other products).

4.67 It would appear likely, therefore, that the extent to which ATP contributes to producing efficiencies in relation to the magazine supply chain is not as significant as it is in relation to the newspaper supply chain such that it may be difficult to demonstrate that magazine Agreements satisfy the first exemption condition. The parties will need to consider whether the arguments discussed above apply in relation to their magazine Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Second condition: allowing consumers a fair share of the resulting benefit

Framework for assessment

4.68 Under the second condition of section 9(1), the parties must demonstrate that consumers are allowed a fair share of the benefits (efficiencies) brought about by an agreement. The Article 81(3) Guidelines state that the second condition incorporates a ‘sliding scale’. 
This means that the greater the restriction of competition, the greater the efficiencies and the consumer pass-on must be.\textsuperscript{168}

4.69 The Article 81(3) Guidelines state that:

'The concept of 'fair share' implies that the pass-on of benefits must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition … [T]he net effect of the agreement must at least be neutral from the point of view of those consumers directly or likely affected by the agreement. If such consumers are worse off following the agreement, the second condition of Article 81(3) is not fulfilled. The positive effects of an agreement must be balanced against and compensate for its negative effects on consumers.'\textsuperscript{169}

This statement does not mean that consumers must receive a share of each and every efficiency gain identified under the first condition. It is sufficient that the benefits that are passed on are sufficient to compensate for the negative effects of the restrictive agreement, thereby providing consumers a fair share of the overall benefits.\textsuperscript{170} Furthermore, the decisive factor is the overall impact on consumers of the products within the relevant market, not the impact on individual members of that group of consumers.\textsuperscript{171}

4.70 For the purposes of the analysis under the second condition, the Article 81(3) Guidelines state that the concept of a 'consumer' encompasses:

\textsuperscript{168} Article 81(3) Guidelines, paragraph 90. Paragraph 91 notes that if the restrictive effects are substantial and the cost savings are relatively insignificant, it is very unlikely that the second condition of Article 81(3) will be met. Paragraph 92 notes that if the agreement has both substantial anti-competitive effects and substantial pro-competitive effects, a careful analysis is required.

\textsuperscript{169} Article 81(3) Guidelines, paragraph 85. See also the reference made there to Joined Cases 56/64 and 58/66, \textit{Etablissements Consten SARL and Grundig-Verkaufs-GmbH v Commission} [1966] ECR 299.

\textsuperscript{170} Article 81(3) Guidelines, paragraph 86.

\textsuperscript{171} Article 81(3) Guidelines, paragraph 87.
all direct or indirect users of the products covered by the agreement, including producers that use the products as an input, wholesalers, retailers and final consumers ... In other words, consumers within the meaning of Article 81(3) are the customers of the parties to the agreement and subsequent purchasers.172

4.71 The assessment of consumer pass-on of efficiency gains can be measured in terms of cost efficiencies and other types of efficiencies.173 In assessing the extent to which cost efficiencies are likely to be passed on to consumers and the outcome of the requisite balancing test under the second condition, the following factors are particularly relevant:

- the characteristics and structure of a market
- the nature and magnitude of the efficiency gains
- the elasticity of demand,174 and
- the magnitude of the restriction of competition.175

4.72 Qualitative, non-cost efficiencies (such as new and improved products) may also provide sufficient compensation to consumers for the restrictive effects of an agreement.176 Although it is difficult to assign precise values to efficiencies of this nature, the assessment of these efficiencies under the second condition remains the same, namely an assessment of the overall impact of an agreement on the consumers of the products within the relevant market.177

4.73 Finally, it is important to note that the positive effects of the agreement that are to be balanced against its negative effects, should not include

172 Article 81(3) Guidelines, paragraph 84.
173 Article 81(3) Guidelines, paragraph 93.
174 Elasticity of demand measures the rate at which demand for a product changes when its price goes up or down.
175 Article 81(3) Guidelines, paragraph 96.
176 Article 81(3) Guidelines, paragraph 102.
177 Article 81(3) Guidelines, paragraph 103.
the effects of any restrictions that fail the indispensability test (the third condition for exemption) and which for that reason are prohibited.\textsuperscript{178}

Guidance on newspaper Agreements under the second condition

4.74 Under the second condition, the parties will need to consider whether the benefits of the efficiencies identified under the first condition will be passed on to consumers and retailers. Relevant considerations in this connection are: first, whether publishers have incentives to pass the benefits they receive in terms of reduced costs\textsuperscript{179} to consumers in the form of lower prices and/or improved product quality; second, whether consumers benefit from the obligation to supply in publisher-wholesaler contracts by having copies more readily available to them; and third, whether retailers (in particular those that would have limited scope to switch wholesaler in the absence of ATP) benefit from the ability of publishers to exercise control over wholesaler service standards or from the obligation to supply in publisher-wholesaler contracts by having copies more readily available to them.

Publisher incentives to pass on benefits to consumers

4.75 The extent to which publishers have an incentive to pass on cost reductions in the form of lower prices and/or improved product quality will depend on the intensity of competition between newspaper publishers. Although this is not an issue that the OFT has considered extensively, it has received no evidence to suggest that there are any significant impediments to competition between newspaper publishers. The OFT has also seen some evidence of various promotional activities and increases in product quality that are consistent with active competition in the market. Several titles have engaged in regional price reductions (for example, the Independent on Sunday reduced its price

\textsuperscript{178} Article 81(3) Guidelines, paragraph 39.

\textsuperscript{179} Cost reductions could arise from reduced margins negotiated with wholesalers or improvements in cost efficiency through innovation by wholesalers.
from £1.80 to £1 in selected regions in late 2007 and 2008) and other price promotions such as subscription voucher schemes (offered by, among others, the Telegraph) and special offers (such as free or discounted linked purchases, used extensively by the Mail). Promotions involving cover-mounts, for example DVDs and CDs, are also common. Examples of newspaper publishers competing on quality include increases in the amount of colour and adding pages, especially supplements.\textsuperscript{180}

4.76 It may be possible, where all publishers use Agreements with ATP and appoint the same wholesaler in a territory, that this may dampen competition between publishers, for example by making it easier to coordinate prices. However, concerns about coordination of pricing may be more likely to arise where the wholesaler is able to control or influence prices. In the case of newspapers, publishers exercise a strong degree of control over margins through the supply chain and the retail price, and this suggests that the use of the same wholesaler is unlikely to impact significantly on the ability of publishers to coordinate prices.

4.77 There are also factors which suggest that publisher incentives to pass on benefits in terms of lower prices may be stronger than the incentives of retailers. There are two possible factors here: the two-sided nature of the newspaper market and the limited ability of readers to switch their newspaper purchases between retail outlets.

4.78 First, in relation to the two-sided nature of the market, as noted above, retailers would only take account of the cover price margin they would lose from a reduction in sales if they increased price, whereas this would also have an adverse effect on newspaper publishers’ advertising revenues. This suggests that newspaper publishers would have stronger incentives to reduce prices than retailers as newspaper publishers would seek to maximise their profits taking into account the revenues they earn

\textsuperscript{180} From the 1990s onwards the number of newspaper supplements increased significantly including titles on personal finance, travel, education, sport, food and entertainment listings. These tend to appear weekly or monthly, although the \textit{Guardian} and the \textit{Times} carry daily supplements \textit{G2} and \textit{T2}, respectively.
from both readers and advertisers. This is consistent with submissions from certain parties which suggest that cover prices act as a constraint on retailers. The comments the OFT has received from retailers on cover prices typically focus on concerns that they discourage retailers from raising prices. The OFT has only had accounts of very rare occasions where retailers have initiated price reductions, and these have typically been very small reductions for a short period by new retail outlets in order to attract new customers.

4.79 Second, retailers will have limited incentives to pass on cost reductions in the form of price cuts if customers have limited ability to change where they buy their newspaper in response to such price cuts. In relation to the ability of readers to switch their purchases between retail outlets, the timing of newspaper purchases (with 70 per cent occurring before 10:00, including the home delivery of approximately 25 per cent of copies) means that there is likely to be relatively limited flexibility in where readers purchase their newspapers. In particular, although it is likely to be supermarkets or other multiples that would be able to gain better terms from wholesalers if ATP were removed, consumers may nonetheless be limited in the extent to which they are able to switch their purchases to these outlets. This is supported by the figures provided to the OFT illustrating that the proportion of total magazines sold through supermarkets has risen from 19 per cent in 1995 to 31 per cent in 2005, whereas the proportion of newspaper sales through supermarkets (while it has grown from a very low base of

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181 If retailers raise prices above the cover price, they should ensure the new price is properly displayed and in such a manner as to avoid customer confusion as to the sales price. Given the tight timescales and potentially large quantities of copies involved with newspaper retailing, the need to 'over-sticker' the cover price is likely to act as a significant obstacle to retailers raising the price.

182 Figures provided by the NPA in its meeting with the OFT on 24 May 2007.

183 Figures provided by the NPA in its meeting with the OFT on 24 May 2007.

184 These figures were provided to the OFT by the PPA in January 2006.
less than five per cent in 1995) appears to remain significantly lower (around 15 per cent, although sales can be higher at weekends).\textsuperscript{185}

**Consumer benefits from an obligation on wholesalers to supply**

4.80 As noted in paragraph 4.54 above, the second potential benefit of ATP would appear to be that it may enable publishers to include in their contracts with wholesalers an obligation to supply all retailers (within reason) in a territory. To the extent that this encourages widespread availability in terms of an increase in the number of retail outlets served, this is likely to be of direct benefit to consumers since it will reduce the ‘costs’ they incur in purchasing their newspapers.\textsuperscript{186} If the more widespread availability also enables publishers to achieve higher circulation figures, then this is likely to reduce the costs of producing the title (since newspapers have high fixed costs and low marginal costs), which may in turn result in lower cover prices. Widespread availability leading to higher circulation may also increase advertising demand, which may also enable publishers to reduce cover prices.

**Retailer benefits from ATP**

4.81 The extent to which retailers are likely to benefit from the Agreements will vary between retailers. In general, ATP would be expected to have detrimental effects on retailers as it denies them the opportunity to switch wholesaler if they are not satisfied with the terms of supply of their existing wholesaler. However, the extent to which retailers are able to switch in the absence of ATP will depend on the location of the retailer, that is whether or not the retailer is in an area that can be served from competing depots. It is also likely to vary between different types of retailer, with the scope for large retailers and multiple retailers to switch being greater than that for small independent newsagents.

\textsuperscript{185} These figures are based on information provided by Dawson News on 10 September 2007 and Smiths News on 12 February 2007.

\textsuperscript{186} These costs are likely to be in the form of the time taken (rather than the financial cost incurred) of locating an outlet from which they can purchase their desired title.
Retailers, in particular those that would have little scope to switch wholesaler in the absence of ATP, may benefit from the Agreements where these enable publishers to exercise effective control over wholesaler service standards. However, the extent to which publisher control over service standards results in benefits to retailers will depend on how closely aligned the interests of publishers and retailers are. In relation to service standards regarding newspaper wholesaling, it is possible that that publisher and retailer interests may be reasonably closely aligned. For example, it is possible that the primary interests in relation to service quality of both publishers and retailers are to ensure that the right number of copies are delivered to the right retailers at the right time.¹⁸⁷

Those retailers that would not be supplied in the absence of ATP would also benefit from the Agreements where these enable publishers to include in their contracts an obligation on wholesalers to serve all retailers (within reason) in a territory. This benefit would not be at the expense of other retailers if:

- supply to small and remote retailers is supported by ensuring that they can be served alongside other retailers, thereby minimising the cost of serving the former, or

- supply to small or remote retailers is supported by these retailers making a lower contribution to the wholesaler’s fixed costs than is made by larger and less remote retailers, and this represents an efficient way of recovering fixed costs and expands demand.

Summary of guidance on newspaper Agreements under the second condition

In light of the above, it would appear that for newspapers there are several factors which may demonstrate that consumers receive a fair

¹⁸⁷ Publishers and retailers will, of course, have diverging financial interests in that retailers are likely to be interested in increasing the margins they receive from selling newspapers whereas publishers’ incentives are likely to be to reduce retailer margins.
share of the benefits which, in the event that the first exemption condition is satisfied, result from the newspaper Agreements.

4.85 Since the second condition incorporates a 'sliding scale', the parties will need to take into account the extent of the restriction of competition in relation to their newspaper Agreements and assess whether the consumer pass-on of any efficiencies generated by their newspaper Agreements is sufficient to at least compensate consumers and retailers for any actual or likely negative impact caused to them by the restriction of competition, such that the net effect of the newspaper Agreements is at least neutral from the perspective of those consumers and retailers directly or likely affected by the newspaper Agreement.

4.86 The parties will need to consider whether the arguments discussed above apply in relation to their newspaper Agreements, and the evidence that they would be able to present if called upon to support their judgement.

**Guidance on magazine Agreements under the second condition**

4.87 Since the second condition is that consumers must be allowed a fair share of the benefit resulting from an agreement, if the agreement does not produce benefits (that is the first condition is not met), then the second condition is also not met. If the first condition is met in relation to a magazine Agreement, then the following considerations are relevant to a consideration of the second condition.

4.88 It would appear that magazine publishers are likely to have incentives to pass the benefits they receive in terms of reduced costs to consumers in the form of lower prices and/or increased quality, for similar reasons to those set out above in relation to newspapers. However, advertising typically accounts for a lower share of revenue for magazines than it does for newspapers. This may mean that the two-sided nature of magazine markets provides less incentive for magazine publishers to pass on cost reductions than for newspapers.
4.89 As discussed above, the extent of the incentive for publishers to pass on benefits depends on the intensity of competition between publishers. The OFT has been provided with examples of competition between magazine publishers, for example publishers have informed the OFT about price discounts (particularly at the time a magazine is launched), discounts for bundled purchases, and the widespread use of covermounts such as books and bags on women’s magazines. However, in order to consider whether the second exemption condition is satisfied in relation to an individual Agreement, it would be necessary to consider the extent of competition between publishers in the context of the appropriate market for an individual title.

4.90 As discussed above, the extent to which publisher control over service standards results in benefits to retailers will depend on how closely aligned the interests of publishers and retailers are. In relation to service standards regarding magazine wholesaling, it is possible that publisher and retailer interests may diverge significantly. For example, in relation to copy allocation, publishers may have incentives to supply their magazines to retailers in order that they are displayed alongside their competitors, whereas retailers may not wish to stock particular titles in order to maximise the profitability of their shelf-space, or to differentiate their outlet from those of competing retailers through the range of titles they offer.

4.91 In addition, it is relevant to note that customers are likely to have greater flexibility about when and where they purchase magazines, creating greater incentives for retailers to pass on any cost reductions than would appear to be the case for newspapers. For example, if some retailers (such as supermarkets and other multiple retailers) are able to negotiate better terms from wholesalers in relation to the supply of magazines if ATP is removed, these retailers may have a greater incentive to reduce their retail prices if customers are likely to switch their purchases of magazines to these outlets.

4.92 Overall, therefore, it would appear that there are likely to be fewer objective efficiency gains regarding ATP for magazines than for
newspapers, and that the incentives for publishers to pass a fair share of any such benefits on to consumers may be weaker.

4.93 Applying the 'sliding scale' test, these considerations should also be assessed by reference to the fact that there is greater potential for 'competition in the market' in the absence of ATP, and thus a greater restriction of competition under section 2, in relation to magazine Agreements than there is for newspaper Agreements. As such, it may be difficult to demonstrate that magazine Agreements satisfy the second exemption condition.

4.94 The parties will need to consider whether the arguments discussed above apply in relation to their magazine Agreements, and the evidence that they would be able to present if called upon to support their judgement.

**Third condition: the indispensability of the restrictions**

**Framework for assessment**

4.95 The third exemption condition requires that the agreement does not impose restrictions which are not indispensable to the attainment of the efficiencies\(^\text{188}\) created by an agreement. This implies 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\(^\text{189}\).

4.96 It is important to note that the decisive factor under the third condition is whether or not the restrictive agreement and individual restrictions make it possible to perform the activity in question more efficiently than would likely have been the case in the absence of the agreement or the restriction concerned. The assessment must determine whether more

\(^\text{188}\) Article 81(3) Guidelines, paragraph 73. The reference in section 9(1)(b)(i) of the CA98 to the indispensability of restrictions to the attainment 'of those objectives' is a reference to the efficiencies set out in section 9(1)(a)(i) and (ii).

\(^\text{189}\) Article 81(3) Guidelines, paragraph 73.
efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction.\textsuperscript{190}

4.97 The first test under the third condition requires that the efficiencies identified be specific to the agreement in question, in the sense that there are no other economically practicable and less restrictive means of achieving those efficiencies. It is important to note that in considering this question, the market conditions and business realities facing the parties to the agreement must be taken into account.\textsuperscript{191} The parties to the agreement are not required to consider hypothetical or theoretical alternatives, but need only demonstrate that seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient.\textsuperscript{192} In considering this, it is relevant to examine whether the efficiencies identified could have been achieved by a less restrictive agreement or even by the parties on their own with no agreement at all.\textsuperscript{193}

4.98 Once an agreement has been found to be necessary in order to produce the efficiencies identified, each restriction of competition flowing from the agreement must be assessed to determine whether it is indispensable (in the sense that it is reasonably necessary) to the attainment of those efficiencies. The necessity of each restriction must be substantiated in relation to both its nature and intensity.\textsuperscript{194}

4.99 A restriction will be indispensable 'if its absence would eliminate or significantly reduce the efficiencies that follow from the agreement or make it significantly less likely that they will materialise.'\textsuperscript{195} The more

\textsuperscript{190} Article 81(3) Guidelines, paragraph 74. The assessment is not as to whether in the absence of the restriction the agreement would not have been concluded.

\textsuperscript{191} Article 81(3) Guidelines, paragraph 75.

\textsuperscript{192} Article 81(3) Guidelines, paragraph 75.

\textsuperscript{193} Article 81(3) Guidelines, paragraph 76. For example, if the efficiencies identified are cost reductions resulting from economies of scale or scope, it would be necessary to substantiate why the same efficiencies would not be likely to be attained through internal growth and price competition.

\textsuperscript{194} Article 81(3) Guidelines, paragraph 78.

\textsuperscript{195} Article 81(3) Guidelines, paragraph 79.
restrictive the restraint, the stricter the test under the third condition.\textsuperscript{196} In this regard, restrictions that are black-listed in block exemption regulations or identified as hardcore restrictions in European Commission guidelines and notices are unlikely to be considered indispensable.\textsuperscript{197} However, as a matter of principle, all restrictive agreements that fulfil the four exemption conditions will benefit from exemption. Consequently, in exceptional circumstances, even hardcore or black-listed restrictions may still satisfy the exemption conditions in individual cases.\textsuperscript{198}

4.100 As set out above, the assessment of the indispensability of a restriction must be made within the actual context in which an agreement operates. In particular, consideration must be given to the structure of the market, the economic risks related to the agreement and the incentives facing the parties. In relation to risks, for example, the more uncertain the success of the product covered by the agreement, the more a restriction may be required in order to ensure that the efficiencies identified will materialise. Restrictions may also be indispensable in order to align the incentives of the parties and ensure that they concentrate their efforts on the implementation of the agreement (for example, in order to avoid hold-up problems once a substantial sunk investment has been made by one of the parties to the agreement or where a substantial investment is made that is specific to the relationship with one party).\textsuperscript{199}

4.101 In some cases, a restriction may only be indispensable for a certain period of time. Where that is the case, the exemption under section 9(1) of the CA98 will only apply during that period. In order to make the relevant assessment in this connection, due account should be taken of the period of time required for the parties to achieve the efficiencies that justify the application of the exemption under section 9(1) of the CA98. In cases where the benefits cannot be achieved without considerable

\textsuperscript{196} Article 81(3) Guidelines, paragraph 79.
\textsuperscript{197} Article 81(3) Guidelines, paragraph 46.
\textsuperscript{198} See paragraph 4.31 and footnote 141 above.
\textsuperscript{199} Article 81(3) Guidelines, paragraph 80.
investment, account must, in particular, be taken of the period of time required to ensure an adequate return on such investment.200

Guidance on newspaper Agreements under the third condition

4.102 In the section above dealing with the first exemption condition, it was noted that there would appear to be two key potential factors which may demonstrate that ATP in newspaper Agreements satisfies the first exemption condition in relation to the newspaper supply chain: first, that it may make 'competition for the market' more effective, enabling publishers to achieve reductions in the wholesale margins they pay and to incentivise improvements in the quality of service provided by wholesalers and to motivate greater innovation by wholesalers; and, second, that it may enable publishers to achieve wide distribution of their newspapers, in particular by including in their contracts with wholesalers an obligation to supply all retailers (within reason) in a territory.

4.103 In assessing whether the newspaper Agreements and the relevant ATP restriction in particular are reasonably necessary to achieving these efficiencies, it is relevant to consider two potential alternatives: first, a system of competition in the market with no exclusive territories; and second, a system of competition for the market with exclusive contracts but without ATP.

4.104 In assessing the indispensability of the Agreement, the relevant alternative to ATP is a system of competition in the market with no exclusive territories. As discussed above (paragraphs 3.28 to 3.45), it is likely that there would be areas of the country in which retailers can only be served by one newspaper wholesaler. In these areas, there would be no scope for competition between wholesalers in the market in relation to newspaper supply to emerge to drive reductions in the margins paid by publishers or the cost of supply to retailers, or improvements in the quality of service provided and/or innovation by wholesalers. In these

200 Article 81(3) Guidelines, paragraph 81.
circumstances, competition for the market is likely to provide better incentives to distribute newspapers more efficiently. As such, agreements providing for exclusive territories are likely to be indispensable to the attainment of efficiencies in distribution.

4.105 In assessing the indispensability of the ATP restriction, the relevant alternative to exclusive territories with ATP is that publishers appoint wholesalers to exclusive territories but without ATP. In this case (as discussed above) there are arguments that may suggest that, without ATP, publishers would be less able to exploit the potential for competition for the market between wholesalers to reduce margins. As noted in paragraph 4.44, without ATP, newspaper wholesalers would be able to compete to serve retailers in territories that fall within the 'catchment' area of their existing depots by responding to requests for passive sales. There would be less incentive for newspaper wholesalers to reduce their bids, therefore, during tender rounds to win only the exclusive right to active sales in these territories. Similarly, when bidding to serve new territories for which they would need to establish a new depot, incentives to reduce margins to win only the exclusive right to active sales in the territory will be reduced by the threat that other wholesalers could make passive sales into that territory. On this basis, it would appear likely that the margins that publishers would pay to wholesalers would rise in the absence of ATP. Therefore, to the extent that the absence of ATP would eliminate or significantly reduce the efficiencies that follow from the newspaper Agreement, or make it significantly less likely that they will materialise, ATP is likely to be indispensable.

4.106 In a similar way, ATP may also enable publishers to achieve improvements in service quality. The control that ATP gives publishers over which retailers the wholesaler does and does not serve provides publishers with a stronger sanction in the event of poor performance or reward for good performance. As discussed above (paragraph 4.50), it is not clear that, in the absence of ATP, any individual retailer would have a similar degree of influence, although this may be the case for some large multiple retailers.
In considering the indispensability of ATP, it is also important to take account of the effectiveness of competition for the market. Competition for the market will only provide incentives for wholesalers to reduce margins or improve service quality if there is genuine competition to serve the particular territory, or if wholesalers are willing to reduce their bid for the territory in order to serve another territory for which there is effective competition. The OFT notes in this regard that in a number of recent tender rounds there was a significant number of territories for which there was a single bidder, but that publishers and wholesalers have submitted that margins in these territories have been constrained by competition for other territories. Parties will need to consider whether such arguments apply in relation to their newspaper Agreements, and the evidence they could provide if called upon to support their judgement.

An additional relevant consideration is the frequency with which competition for the market takes place. The incentives to improve distribution of newspapers will be weaker, and therefore the efficiencies that flow from ATP more limited or less likely to arise, if competition for the market only takes place infrequently. Parties should, therefore, consider the period for which wholesalers are granted exclusive territories in determining whether ATP is indispensable. In exercising this judgement, parties will need to balance the need for regular competition for the market against the costs of such competition (such as the costs involved for publishers in inviting and considering bids, and for wholesalers in providing them) and the period of time required to ensure an adequate return on investments that are necessary to achieve the efficiencies.

Wholesalers may be willing to reduce their bid for a combination of a territory in which they face competition and one in which they do not if, for example, it enables them to increase their share of the national market, or to increase the size of a particular area they serve, and therefore to benefit from greater economies of scale at a firm, or region, level.
4.109 In terms of incentives to promote innovation within the supply chain, as noted in paragraphs 4.51 to 4.52, the incentives may be stronger for publishers than for retailers, and the ability of publishers to bring about such innovation may be greater if distribution is conducted through a system of exclusive territories with ATP. If parties consider that such arguments are likely to apply to their Agreements, they should consider:

- why the motivation for innovation would not be shared to the same extent by retailers - for example, it may be the case (as suggested in paragraph 4.51) that the innovation is prompted by a desire by publishers to be able to print copies later or from a reduced number of print centres, and

- why a system of exclusive territories is required, and in addition why those exclusive territories require ATP, in order to achieve the innovation - for example, it may be difficult to encourage wholesalers to invest in new depots without exclusivity and ATP because of the possibility that retailers may instead be served by passive sales from other wholesalers.

4.110 The second potential benefit from ATP is that it may enable publishers to impose on wholesalers an obligation to supply all retailers (within reason) in a territory. As discussed in paragraph 4.54 above, newspaper wholesalers have submitted that they would not be willing to accept such an obligation in the absence of ATP as the ability to respond to requests for passive sales may enable newspaper wholesalers in neighbouring territories to 'cherry pick' those retail outlets that it is desirable to serve (for example, large retail outlets) leaving the wholesaler who is under contract to supply the territory with 'residual' retailers that cannot be served economically.

4.111 In principle, these arguments appear to be plausible. However, parties would need to consider whether they would be able to demonstrate that

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202 This includes new equipment and processes introduced by newspaper wholesalers. A key issue is whether the incentives for newspaper wholesalers to make such investments are stronger when wholesalers are responding to the demands made by publishers or retailers.
'cherry picking' is likely to occur in relation to the areas covered by their newspaper Agreements and that 'residual retailers' are likely to be uneconomical to serve. In this regard, it would be necessary to demonstrate that there is a clear risk that the issue of 'cherry picking' would be significant enough to make it impossible or significantly less likely for newspaper wholesalers to accept an obligation to supply, and therefore that the absence of ATP would eliminate or significantly reduce the benefits arising from an obligation to supply or make it significantly less likely that they would be achieved.

4.112 As noted in the framework section above, other factors that may be relevant to an assessment under the third condition include whether uncertainty as to the success of the product covered by an agreement requires a restriction in order to ensure that the efficiencies materialise (see paragraph 4.100), and whether a restriction may only be indispensable for a certain period of time (see paragraph 4.101). The OFT is not aware of any arguments that are likely to be relevant for these purposes, but this is something that parties may wish to consider further.

4.113 In light of the above, it would appear that there are several factors which may demonstrate that an ATP restriction in a newspaper Agreement is indispensable to the attainment of the efficiencies created by the newspaper Agreement. The parties will need to consider whether the arguments discussed above apply in relation to their newspaper Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Guidance on magazine Agreements under the third condition

4.114 ATP appears likely to make competition for the market in relation to magazine wholesaling more effective, for the reasons discussed above in relation to newspaper wholesaling, enabling publishers to achieve reductions in the wholesaling margins they pay and increases in service quality. However, as identified in the analysis of how magazine distribution may operate in the absence of ATP, the longer distribution timescales that apply to magazines mean that competition in the market
appears more likely to be viable. Where, in the absence of ATP, efficiencies in the magazine supply chain would be likely to materialise, or would not be significantly reduced, it would appear that an ATP restriction is unlikely to be indispensable.

4.115 As discussed in relation to magazines under the first condition, it is also questionable whether the incentives for innovation are stronger where magazine Agreements involve ATP than they would be in the absence of ATP. Without ATP, wholesalers appear likely to be more responsive to retailer requirements than they would be under an ATP system, where they may be more responsive to publisher requirements. It is possible that the incentives to innovate in relation to features such as SBR may be greater for retailers than publishers. This suggests that ATP is not likely to be indispensable to achieving these efficiency benefits.

4.116 For the other benefits that have been identified in relation to newspapers, it is questionable how relevant they are to magazines. For example, as discussed in paragraph 4.66 above, 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. If the absence of ATP in magazine Agreements would not eliminate or significantly reduce the wide distribution of magazines, or would not make it significantly less likely that it will materialise, it would appear that an ATP restriction is unlikely to be indispensable.

4.117 In light of the above, it would appear that it may be difficult to demonstrate that a magazine Agreement and the ATP restriction are indispensable to the attainment of the efficiencies created by the Agreement in relation to magazines and therefore that they satisfy the third exemption condition. The parties will need to consider whether the arguments discussed above apply in relation to their magazine Agreements, and the evidence that they would be able to present if called upon to support their judgement.
Fourth condition: no possibility of eliminating competition in respect of a substantial part of the products in question

Framework for assessment

4.118 The fourth exemption condition requires that the agreement in question does not 'afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.'

4.119 Whether competition is being eliminated within the meaning of the fourth condition will depend on the impact of a restrictive agreement on competition relative to the degree of competition existing prior to the agreement. The greater the reduction of competition brought about by an agreement, the greater the likelihood of a risk of eliminating competition within the meaning of the fourth condition. In addition, the weaker the level of competition is prior to the agreement, the lesser the further reduction required by the agreement for competition to be eliminated. Assessing this question requires, therefore, the consideration of the competition prevailing under the status quo (that is, with the Agreement in place) against the competition prevailing in the counterfactual at the different levels of the supply chain.

4.120 The application of the above assessment requires a realistic analysis of the various sources of competition in the market, both actual and potential, the level of competitive constraint they impose on the parties to an agreement and the impact of an agreement on this competitive

203 Section 9(1)(b)(ii) of the CA98.
204 Article 81(3) Guidelines, paragraph 107.
206 Article 81(3) Guidelines, paragraph 108.
constraint. In making this assessment, the following factors should be considered:

- market shares
- the capacity and incentives of actual competitors to compete (for example, competitors facing capacity constraints or relatively higher costs will necessarily produce a more limited competitive response than those that do not)
- whether an agreement eliminates important aspects of competition (for example, price competition or innovation and development of new products)
- the actual market conduct of the parties (for example, if the parties, upon concluding their agreement, implement and maintain substantial price increases then this would indicate a lack of competitive pressure and an elimination of competition)
- past competitive interaction (for example, an undertaking may conclude an agreement with a competitor that may change the competitive incentives and capabilities of that competitor, removing an important source of competition in the market), and
- barriers to entry (for example, the cost of entry, including sunk costs).  

Guidance on newspaper Agreements under the fourth condition

4.121 One of the main effects of ATP is that it prevents retailers from switching between wholesalers. The fact that retailers are unable to use the threat of switching to get better terms from wholesalers is in turn likely to restrict intra-brand competition at the retail level.

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207 Article 81(3) Guidelines, paragraphs 109 – 115.
4.122 The impact of the existence of ATP in most supply chains in other industries would likely be very significant and result in the elimination of intra-brand competition such that the fourth exemption condition is highly unlikely to be satisfied. However, an assessment under the fourth condition must be made in the light of the conditions relating to the particular agreement in its actual context. The parties therefore 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 in respect of a substantial part of the products in question.

4.123 As regards the issue of competition at the wholesale level, it appears that competition would remain in terms of competition for the market, providing such competition is effective. In this regard newspaper publishers should consider the frequency with which they tender their Agreements and factors such as the number of bidders. In addition, publishers may also be able to discipline the quality of wholesaler service provision during the life of a contract through the use of financial incentives related to performance and/or the threat to terminate contracts. In such circumstances, any inability by retailers to switch wholesaler that arises from the Agreements would not create the possibility of eliminating competition at the wholesale level in respect of a substantial part of the products in question.

4.124 As regards the issue of competition at the retail level, it appears that in some cases newspaper publishers work directly with individual retailers on promotions, so it is possible that intra-brand competition may arise through this channel rather than through competitive pressure at successive levels of the supply chain. In any event, it is not clear that intra-brand price competition would be significantly greater in the

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208 See paragraphs 4.107 and 4.108 above.
absence of ATP given the use of cover prices. Moreover, there is also competition between retailers in terms of service provision, for example through the delivery of newspapers to customers’ homes. In such circumstances, any inability by retailers to switch wholesaler that arises from the Agreements would not create the possibility of eliminating competition at the retail level in respect of a substantial part of the products in question.

4.125 It is also worth considering whether there is the possibility of eliminating inter-brand competition. The OFT has not considered this in detail but has some evidence to suggest that competition between newspaper publishers is effective under the current system with ATP. This is something that the parties to newspaper Agreements should be well placed to assess. It is also worth noting that, except in a few unusual circumstances, all retail outlets receive all national newspapers. This may serve to promote inter-brand competition because, in each outlet, customers will be able to choose between each newspaper title.

4.126 In light of the above, it would appear that there are factors that may demonstrate that a newspaper Agreement containing an ATP restriction satisfies the fourth exemption condition. The parties will need to consider whether the arguments discussed above apply in relation to their newspaper Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Guidance on magazine Agreements under the fourth condition

4.127 As discussed in paragraphs 4.121 to 4.122, the existence of ATP in most supply chains in other industries would usually be expected to eliminate competition in respect of a substantial part of the products in question by preventing intra-brand competition at a wholesale level,

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209 As noted above, the two-sided nature of the market gives publishers incentives to hold down cover prices to increase advertising revenues, and this incentive is not shared by retailers. As such, it is possible that publishers would have greater incentives to stimulate intra-brand price competition in the presence of ATP than retailers would in the absence of ATP.
thereby restricting it at a retail level. However, the assessment of this issue must take account of the conditions relating to the particular agreement in its actual context. The parties therefore need to take into account the various specific features of the magazine supply chain in determining whether a magazine Agreement affords the possibility of eliminating competition in respect of a substantial part of the products in question.

4.128 With regard to the potential application of the fourth exemption condition, the analysis in relation to the magazine supply chain would appear to be the same in material respects as for the newspaper supply chain.

4.129 In respect of competition at the wholesale level, magazine publishers should consider the effectiveness of competition for the market (including a consideration of the frequency with which they tender their Agreements and factors such as the number of bidders) and the extent to which they are able to discipline the quality of wholesaler service provision during the life of a contract through the use of financial incentives related to performance and / or the threat to terminate contracts.

4.130 In respect of competition at the retail level, publishers should consider the extent to which intra-brand competition arises through magazine publishers working directly with individual retailers on promotions, and whether intra-brand competition would be greater in the absence of ATP given the use of cover prices.

4.131 In relation to competition at the publisher level, parties should consider whether there is effective inter-brand competition, and the extent to which competing titles are sold at the same outlet may be relevant to this issue.

4.132 In light of the above, it would appear that there are factors that may demonstrate that a magazine Agreement containing an ATP restriction satisfies the fourth exemption condition. The parties will need to consider whether the arguments discussed above apply in relation to
their specific magazine Agreements, and the evidence that they would be able to present if called upon to support their judgement.

Exemption under Section 9(1) of the CA98 - summary of guidance

4.133 The guidance above sets out, for the supply of newspapers, a number of factors that may demonstrate that the Agreements benefit from exemption under the CA98. For the supply of magazines, however, these factors appear less likely to apply, such that it may be difficult to demonstrate that magazine Agreements benefit from exemption.

4.134 In relation to the first exemption condition, that is that the agreement contributes to improving production or distribution, or promoting technical or economic progress, this Opinion sets out the following potential objective efficiency benefits that may be relevant to the newspaper supply chain:

- ATP may make 'competition for the market' more effective, enabling publishers to achieve reduced margins and improved service quality from wholesalers and providing a stimulus to wholesalers to innovate, and

- ATP may support the wide availability of newspapers, in particular by enabling publishers to include in their contracts with wholesalers an obligation to supply all retailers (within reason) in a territory.

4.135 In relation to the Agreements between magazine publishers / distributors and wholesalers, however, it would appear likely that the potential objective efficiency gains regarding ATP in Agreements relating to magazine distribution are not as significant as for newspaper distribution as there is greater scope for 'competition in the market' to emerge in the absence of ATP. In addition, there is less likely to be a need for an obligation to supply since consumers are likely to be able to purchase from a range of retail outlets. Consequently, it may be difficult to demonstrate that magazine Agreements satisfy the first exemption condition.
4.136 In relation to the second exemption condition, that is that consumers are allowed a fair share of the benefits resulting from the agreement, this Opinion sets out two key considerations in relation to the Agreements between newspaper publishers and wholesalers regarding pass on to final consumers, namely:

- **whether publishers have incentives to pass the benefits they receive in terms of reduced costs to consumers in the form of lower prices and/or improved product quality** - this will depend on the intensity of competition between publishers. In addition, publisher incentives to pass on benefits in the form of lower prices may be stronger than the incentives for retailers because of the two-sided nature of the markets (which gives publishers an incentive to hold down prices because of the impact this has on circulation volumes which in turn affects advertising revenues) and the limited ability of newspaper purchasers to switch between retail outlets (which gives retailers limited incentives to cut prices in order to induce purchasers to switch to their outlet), and

- **whether consumers benefit from the obligation to supply in publisher-wholesaler contracts** - this is likely to be of direct benefit to consumers since it will reduce the 'costs' they incur in purchasing their newspapers. If wider availability increases circulation and reduces the costs of producing the title, it may also enable publishers to reduce cover prices. Wider availability leading to higher circulation may increase advertising demand, which may also enable publishers to reduce cover prices.

4.137 In relation to the Agreements between magazine publishers / distributors and wholesalers and pass on to final consumers, it would appear that magazine publishers are likely to have incentives to pass on any benefits they receive in terms of reduced costs to consumers in the form of lower prices and/or increased quality, for similar reasons to those set out above in relation to newspapers. However, these considerations should be assessed by reference to the fact that there is greater potential for 'competition in the market', which is restricted by ATP, in relation to magazines than there is for newspapers.
4.138 It is also relevant to note that there are two differences between newspapers and magazines in terms of publisher versus retailer incentives to pass on benefits:

- **advertising typically accounts for a lower share of revenue for magazines than it does for newspapers** - this may mean that the two-sided nature of the markets provides less incentive for magazine publishers to pass on cost reductions than for newspapers, and

- **customers are likely to have greater flexibility about when and where they purchase magazines because magazines are not as extremely perishable as newspapers** - this would create greater incentives for retailers to pass on any cost reductions in relation to magazines than would appear to be the case for newspapers.

4.139 The extent to which retailers are likely to benefit from the Agreements will vary between retailers. Those retailers that would be able to switch wholesaler are likely to receive little or no benefits from the Agreements if, by switching, they would be able to, for example, discipline wholesaler service quality. However, for those retailers that are likely to have little scope to switch between wholesalers in the absence of ATP, there may be benefits from the Agreements if publishers / distributors are able to ensure high quality of service provision to retailers by wholesalers, provided publishers / distributors and retailers have common interests in the nature of wholesaler service provision. Where the Agreements contain an obligation to supply, this will also be of benefit to retailers that would otherwise not be supplied.

4.140 Overall therefore, it would appear that for newspapers there are several factors that may demonstrate that consumers receive a fair share of the benefits which, in the event that the first exemption condition is satisfied, result from the newspaper Agreements. Since the second condition incorporates a 'sliding scale', the parties will need to take into account the extent of the restriction of competition in relation to their newspaper Agreements and assess whether the consumer pass-on of any efficiencies generated by their newspaper Agreements is sufficient to at least compensate consumers and retailers for any actual or likely
negative impact caused to them by the restriction of competition, such that the net effect of the newspaper Agreements is at least neutral from the perspective of those consumers and retailers directly or likely affected by the newspaper Agreement.

4.141 In relation to magazine Agreements, however, it would appear that there are likely to be fewer objective efficiency gains regarding ATP for magazines than for newspapers, and that the incentives for publishers to pass a fair share of any such benefits on to consumers may be weaker. Applying the 'sliding scale' test, these considerations should also be assessed by reference to the fact that there is greater potential for 'competition in the market' in the absence of ATP, and thus a greater restriction of competition under section 2, in relation to magazine Agreements than there is for newspaper Agreements. As such, it may be difficult to demonstrate that magazine Agreements satisfy the second exemption condition.

4.142 In relation to the third exemption condition, that is that the agreement does not impose restrictions which are not indispensable to the attainment of the efficiencies created by an agreement, this Opinion sets out the following guidance. In relation to:

- **Newspapers** - where there are limits to the scope for competition 'in the market', the third exemption condition is likely to be satisfied provided that efficiency of distribution is increased by exclusive territories, and ATP makes competition for these territories more effective. In addition, this condition is likely to be met if, in the absence of ATP, it would be impossible, or significantly less likely to be possible, to include an obligation to supply.

- **Magazines** - since the scope for competition in the market is likely to be more significant, it may be difficult to demonstrate that this condition is satisfied, since efficiencies in distribution may be achieved through competition in the market.

4.143 In relation to the fourth exemption condition, that is that the agreement does not afford the undertakings concerned the possibility of eliminating
competition in respect of a substantial part of the products in question, this Opinion provides guidance that there are factors that may demonstrate that this condition is met in relation to both newspaper and magazine Agreements, notwithstanding the impact of ATP on the ability of retailers to switch between wholesalers, and given the particular characteristics of these supply chains. These factors include the extent to which competition would remain at each level of the supply chain, with ATP. In this regard parties will need to consider:

- in relation to wholesaling, the effectiveness of competition for the market and the ability of publishers to discipline the quality of wholesaler service provision during the life of a contract,

- in relation to retailing, the extent to which publishers work with retailers to facilitate competition, for example through retailer specific promotions, and retailers compete on the level of service they provide, and

- in relation to publishing, the effectiveness of inter-brand competition.

4.144 The parties will need to consider whether the arguments discussed above apply in relation to their Agreements, and the evidence that they would be able to present if called upon to support their judgement. As noted in paragraph 4.36, the parties should be aware, when self-assessing their Agreements, that the four exemption conditions set out in section 9(1) of the CA98 are cumulative. Therefore, if an Agreement does not satisfy one of these exemption conditions, exemption would not be available and it would not be necessary to examine whether the remaining conditions were satisfied. It may be the case, therefore, that it would be appropriate for the parties to consider the four conditions in a different order from that set out in section 9(1).