
Completed acquisition by Smiths News Trading Limited of Certain Assets of Surridge Dawson Limited

ME/4179/09

The OFT's decision on reference under section 22(1) given on 21 August 2009. Full text of decision published 28 August 2009.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Smiths News Trading Limited (Smiths)** is active in the supply of wholesale newspaper and magazine distribution in the UK, with 44 distribution centres throughout England and Wales. It delivers newspapers and magazines to approximately 25,000 retail customers daily. Smiths is a wholly-owned subsidiary of Smiths News plc, which was created as a result of the de-merger of the WHSmith Group on 1 September 2006.
2. **Surridge Dawson Limited (Dawson)** was active in the supply of wholesale newspaper and magazine distribution in the UK, with 15 full branches and 14 sub-depots. Prior to the transaction, it delivered newspapers and magazines to approximately 14,000 retail customers daily. It is a subsidiary of Dawson Holdings plc, which has three other subsidiaries, including Dawson Media Direct (which supplies newspapers/magazines and other content to airlines), Dawson Books (which supplies books to libraries in the UK and worldwide), and Dawson Marketing Services (which supplies bulk distribution of sales literature worldwide). Dawson Holding plc's turnover for the financial year ending 27 September 2008 was £690.2 million. Separate figures for the UK turnover for Dawson during the same period are not available.

TRANSACTION, PROCESS AND TIMING

3. The transaction relates to the acquisition by Smiths of certain assets from Dawson, which took place on 3 August 2009. As part of the acquisition, Smiths took responsibility for leasing depots located in territories where it has been appointed by publishers as the chosen wholesaler from the expiry of Dawson's existing distribution contracts (see paragraph 8 below), together with related plant equipment and machinery, customer records and a number of Dawson employees (collectively referred to as 'the Dawson Assets').¹ The OFT is satisfied that the combination of assets being transferred to Smiths as a result of this transaction constitute an 'enterprise' for the purposes of section 23(1) of the Enterprise Act (the Act).
4. Smiths will enter into new distribution contracts with the publishers, on transitional terms, to distribute their titles in territories currently serviced by Dawson but which will transfer to Smiths, during the period between completion of the acquisition and the entry into force of Smiths' new contracts (on expiry of Dawson's existing contracts). Accordingly, the transaction will enable Smiths to distribute newspapers and magazines in territories for which it has already been appointed as the chosen wholesaler by the relevant publisher from the expiry of Dawson's existing distribution contracts (see paragraph 8 below).
5. The statutory deadline under section 24 of the Act is 2 December 2009. The administrative target date for the OFT to announce a decision in this case is Monday 7 September 2009.

JURISDICTION

6. As a result of this transaction Smiths and the Dawson Assets have ceased to be distinct. Both these entities overlap in the supply of newspaper and magazine distribution and at least one quarter of all services of that description in the UK will be supplied by Smiths following the transaction.² Therefore, the share of supply test in section 23 of the Act is met.
7. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

¹ See Smiths News plc press release:

www.smithsnews.co.uk/smithsnews/jsp/SN_PressReleases_Page.jsp

² In addition, the OFT has calculated that the turnover from Dawson's remaining contracts is approximately £[over 70] million. On this basis, the OFT considers that the turnover test in section 23(1)(b) of the Act would also be met.

BACKGROUND

8. To date, there have been three major wholesalers of newspaper and magazine distribution services to publishers in the UK (Smiths, Dawson and Menzies Distribution) accounting for approximately 90 per cent of the market.³ During 2008-2009, almost all of the major UK publishers of newspapers and magazines⁴ tendered for distribution services and almost all decided to appoint Smiths or Menzies Distribution (Menzies)⁵ on five year contracts to begin between July 2009 and January 2011.
9. The distribution contracts won by Smiths and Menzies include territories previously under contract to Dawson. Indeed, through the re-tendering process, Dawson lost almost all its distribution business. By losing a critical mass of titles required to operate efficiently as a distributor, the parties' submitted that Dawson rapidly became financially unviable and was at risk of being unable to service the distribution of its remaining existing titles, which could potentially have left retailers without supplies of these newspapers and magazines.
10. The transaction, in essence, involves the acquisition by Smiths of the physical assets required to supply newspaper and magazine distribution services in those territories in which Smiths has been awarded the future distribution contracts. In other words, the transaction has brought forward the date of the transfer of the wholesale distribution contracts from Dawson to Smiths in anticipation of the commencement of the awarded contracts by the publishers.

MARKET DEFINITION

11. Smiths and the Dawson Assets overlap in the supply of wholesale newspaper and magazine distribution services to publishers and to retailers.

Product scope

Supply of services to publishers

12. Competition in newspaper and magazine wholesaling services to publishers involves bidding for a contract to deliver titles and handling returns in specific territories, in return for a proportion of the (newspaper or magazine) cover price. Contracts usually last for five years. Newspaper

³ Share of supply in 2007 was 37 per cent Smiths, 31 per cent Menzies, and 22 per cent Dawson. Independents accounted for the remaining 10 per cent.

⁴ Although it should be noted that magazine publishers appoint distributors who tender their contracts with wholesalers.

⁵ Menzies Distribution is the newspaper and magazine wholesaling division of John Menzies plc.

publishers and magazine distributors⁶ have tended to re-tender their contracts around six months before their expiry.⁷ Although publishers can award distribution contracts to different wholesalers within the same territory, it is generally regarded as being more efficient if all publishers award distribution contract to a single wholesaler (known as 'full sheet' supply, the alternative of multiple wholesalers in a territory being known as 'split sheet' supply). There may therefore be a 'tipping point' in the award of contracts whereby publishers awarding their contracts early may influence which wholesaler other publishers view as best placed to serve a territory. Publishers awarding contracts late may therefore be limited to the wholesaler that has already been awarded the earlier contracts.

13. Magazine and national newspaper wholesaling differ on the demand-side mainly in terms of delivery time, with newspaper delivery being much more time sensitive. There are also some important supply-side differences in terms of the more sophisticated systems required to process magazine orders. However, there appears to be scope for supply-side substitution, given that all major newspaper wholesalers also distribute magazines. However, the OFT notes that it is not necessary to conclude on this, as considering the frame of reference on a narrower basis (newspaper wholesaling and magazine wholesaling separately) would not alter the conclusions in this case. Therefore, for ease of analysis, the transaction is considered within the frame of reference of combined newspaper and magazine wholesaling services to publishers.

Supply of services to retailers

14. In addition to a proportion of the cover price that wholesalers receive from publishers, they also receive a carriage service charge paid by retailers. Where a retailer receives deliveries from more than one wholesaler, as with 'split sheet' supply, the retailer pays more than one set of carriage service charges. This will also be the case during any transition period between distribution contracts.
15. For newspaper distribution, retailers cannot currently choose between wholesalers as the publishers award exclusive territories (known as absolute territorial protection, ATP) to the wholesaler of their choice. ATP bans both active and passive sales between territories. The ban on active sales means that a wholesaler is prevented from actively marketing its products to retailers outside its allocated territory. The ban on passive sales means that the wholesaler supplying newspapers under these agreements is contractually barred from responding to any requests to supply those

⁶ Most magazine publishers use distributors to liaise with wholesalers. Magazine distributors tender for wholesale contracts for their whole portfolio of magazine titles.

⁷ In the recent round of contract awards, however, a number of newspaper publishers and magazine distributors tendered their contracts early.

products from retailers located outside its allocated territory, even if that request is unsolicited.

16. Wholesalers historically were also granted ATP for magazine distribution. However, the OFT understands that following the publications of the OFT's Opinion – guidance to facilitate the self-assessment of the compatibility with the Competition Act 1998 (CA98) of the ATP agreements – publishers⁸ have substantially completed the self-assessment of their wholesale agreements and have removed, or intend to remove, the provisions relating to ATP.⁹ In the Opinion, the OFT considered that there was greater possibility, in the absence of ATP, for competition in the market for magazine distribution to emerge through passive sales.¹⁰
17. The transaction is therefore considered under the frame of reference of magazine wholesaling services to retailers, as well as newspaper and magazine wholesaling services to publishers.

Geographic scope

18. As ATP contracts are awarded on the basis of regional territories defined by the newspaper and magazine publishers, the effects of the transaction should be considered at that level.
19. At the time of the transaction, Smiths and Dawson provided magazine and newspaper distribution in a large number of territories across the UK. The transaction, however, relates only to the acquisition of certain assets in some of the territories for which Smiths has been appointed as the chosen wholesaler by the relevant publisher from the expiry of Dawson's existing distribution contracts. The relevant geographic frame of reference is therefore each of these 21 territories.^{11,12}

Conclusion on market definition

20. Therefore, the OFT considers that the appropriate frame of reference in this case is newspaper and magazine wholesaling services to retailers, as well as newspaper and magazine wholesaling services to publishers in the 21 separate territories (as set out in footnote 11).

⁸ Although it should be noted that magazine publishers appoint distributors who tender their contracts with wholesalers (see footnote 4).

⁹ Available to download at: www.offt.gov.uk/news/press/2008/122-08.

¹⁰ Although the OFT understands that, for a number of magazines with particularly compressed distribution timescales, some magazine distributors are continuing to consider whether to retain bans on passive sales in their distribution agreements with wholesalers.

¹¹ These territories include Aberystwyth, Barnstaple, Bournemouth, Bristol North, Brislington, Coventry, Exeter, Harlow, Heywood, Lancing, Lincoln, London Premier Park, Luton, Mansfield, Salisbury, Shrewsbury, Southampton, Swindon, Taunton, Warrington, and Yeovil.

¹² Although the OFT notes that the geographic market may be wider in the case of magazines, as there is the possibility of passive sales outside of the appointed territory.

COMPETITION ASSESSMENT

21. It should be noted that this decision analyses the acquisition by Smiths of certain assets from Dawson and does not consider the recent loss by Dawson to Smiths and Menzies of the majority of contracts for which it was the incumbent distributor of newspapers and magazines (as this occurred before the transaction).
22. The question for the OFT is whether there is a realistic prospect of a substantial lessening of competition arising from the acquisition itself (that is, from the transfer of depots, related plant equipment and machinery, customer records and employees forming the Dawson Assets).
23. In answering this question, the OFT notes that because of the nature of competition for newspaper and magazine distribution contracts (that is, through the bidding process), competition between wholesalers has, to date, taken place for the market and not in the market. The next tender round for newspapers and magazines is not due to occur until approximately 2014, when the recently-awarded contracts near completion. Accordingly, the 2014 tender round is the next point at which competition for the market can occur.
24. However, as noted above, following the OFT's Opinion there is a prospect that some degree of competition in the market may also emerge through passive sales in relation to magazines in the short term.

COUNTERFACTUAL

Introduction

25. In order to decide whether the duty to refer applies, the OFT must consider the transaction's impact relative to the situation that would prevail absent the transaction (that is, the counterfactual).
26. The OFT's general approach is to rely on the pre-acquisition conditions as the appropriate proxy for the counterfactual and 'test' the competitive impact of the transaction against such a standard before proceeding to consider whether another counterfactual should be substituted.
27. The OFT's Guidance and decisional practice notes that the OFT may, in certain circumstances, need to take into account likely and imminent changes in the structure of competition or the market in order to reflect as accurately as possible the nature of rivalry without the transaction.¹³

¹³Mergers – substantive assessment guidance, paragraph 3.24 and the draft CC/OFT Joint Merger Assessment Guidelines, paragraph 4.19. See also the OFT's decision in *Menzies/Grays* published on 3 August 2007.

28. The implication of the outcome of the most recent tender round is that the pre-acquisition conditions of competition, where Dawson is active in the relevant territories, can be expected to change such that Smiths (or Menzies) becomes the wholesale distributor for those territories currently served by Dawson. Accordingly, for the purposes of the counterfactual, this structural change can be regarded as sufficiently certain and 'imminent'.
29. However, even though the counterfactual should reflect the fact that Dawson will no longer hold certain distribution contracts, this does not in itself answer the question of what would have happened to the Dawson Assets in the absence of the transaction. In this respect, the OFT considers that the possible range of counterfactuals to the transaction might be the following:
- Dawson preserving the Dawson Assets until the next tender round
 - another entrant to the market acquiring the Dawson Assets and preserving them until the next tender round, or
 - the Dawson Assets exiting the market.
30. In considering the three questions above, the OFT has in essence applied the same criteria used in a failing (or exiting) firm case and to the same evidentiary standard to determine whether there is causation between the transaction itself and any potential lessening of competition.¹⁴
31. Each counterfactual is considered further below with a view to determining what should be regarded as the most cautious, but realistic, counterfactual (in terms of competition effects) against which the OFT should assess the transaction. The OFT will then be able to determine whether the transaction has impacted on the potential for competition in the next tender round in 2014.

I. Dawson's ability and incentive to preserve the Dawson Assets and re-enter in the next tender round in 2014

32. The OFT has first examined whether it was realistic for Dawson itself to retain the Dawson Assets such that it would be able to use them to compete in the next tender round in 2014.

¹⁴ This scenario could be regarded in some sense as similar to a 'failing or exiting division' case (it is not a 'failing firm' given that Dawson Holdings plc itself can continue notwithstanding the sale of the Dawson Assets), but it is important to remember that (as discussed in paragraphs 8 to 9 and 21 above) the removal of the current competitive pressure from the Dawson Assets is a result of the existing tender round, rather than the transaction itself. The question for the OFT is therefore whether the transaction removes the prospect of the Dawson Assets being a future competitive force in the next contract round in 2014. This prospective dynamic differentiates this case from a classic 'failing or exiting division' case.

33. By way of background, Smiths has submitted that Dawson's exit from the 21 territories was inevitable following the loss of almost all of its major distribution contracts. The OFT notes that this has been confirmed by Dawson, which has made a public statement that it will have 'no viable alternative other than to seek to effect an orderly exit' in its Interim Results Statement issued on 28 May 2009.¹⁵ As Dawson had lost all its distribution contracts, it is inevitable that Dawson would have exited the relevant territories as a wholesale distributor until at least the next tender round in 2014.
34. In examining whether it was realistic for Dawson itself to retain the Dawson Assets (such that it would be able to use them to compete in the next tender round), the OFT considered whether:
- Dawson could have continued as a viable business through the generation of revenue through the distribution of magazines via passive sales. However, the OFT concluded that, given Dawson's very limited access to magazine titles, it would be unlikely to be able to continue to operate a viable business on this basis. This was also a view shared by Dawson itself, which ultimately went into administration on 3 August 2009.¹⁶
 - Dawson would have been able to maintain the Dawson Assets until the next tender round. However, given the specialised nature of the depots (which tend to have relatively small sheds and relatively large yards due to the special access requirements of newspaper and magazine wholesaling), and having spoken with Dawson's administrators, the OFT concluded that Dawson would not be able to profitably sub-lease the depots to third parties until the next tender round in 2014. Moreover, the fact that the Dawson Assets would be of no apparent use for approximately five years, reinforces the OFT's view that it would be unrealistic to expect Dawson to maintain those assets until the next tender round in 2014. Further, the OFT notes that Dawson's incentive to maintain the Dawson Assets may be further diminished in that there is no guarantee that it would be awarded distribution contracts in the next tender round in the territories where the Dawson Assets are located.
35. Accordingly, due to the Dawson's inability to continue servicing the remainder of the contracts, combined with its severe financial difficulties and lack of ability or incentive to maintain the Dawson Assets, culminating in its administration, the OFT considers it very unlikely that Dawson would have retained the Dawson Assets until the next tender round in 2014. On this basis, the OFT has dismissed this counterfactual.

¹⁵ www.dawson.co.uk/news-item?item=155467078700972.

¹⁶ www.dawson.co.uk/news-detail&item=1025989.

II. Alternative purchaser's ability and incentive to preserve the Dawson Assets

36. The OFT has considered whether, in the absence of the transaction, a new entrant to the market or an exiting alternative newspaper and magazine wholesaler may have acquired the Dawson Assets such that they could have used them to compete in the next tender round in 2014.
37. An alternative purchaser of the Dawson Assets could potentially service the remainder of the existing contracts (ranging from a few weeks duration to January 2011) – although publishers may need to consent to such a transfer of their contracts (and may not wish to). Moreover, as the remainder of unexpired time is so short, combined with the fact that new contracts for the territories have already been awarded to other distributors, the Dawson Assets would rapidly become unprofitable. The OFT spoke to all existing newspaper and magazine wholesalers on this point. They were all of the view that, given the fixed costs associated with ownership of the Dawson Assets, acquiring them five years in advance of the next tender round would not be a commercially sensible proposition, as it is highly likely that they would be loss making.
38. The unfeasibility of this proposition, in commercial terms, was accentuated by the fact there was no guarantee that the purchaser of the Dawson Assets would be successful in the next tender round in the territories where the assets are located. Third parties' views on the importance of already owning the assets required to distribute newspapers in a particular area (such as depots and/or staff) when tendering – as opposed to tendering on the basis of a plan to develop or acquire these assets – were mixed. A number of third parties stated that the ownership of territory specific assets, while it could be beneficial, did not appear to be the most important factor for publishers when selecting a distributor for a specific territory. Some suggested that they would be more likely to appoint a wholesaler that already owned the necessary assets in the territory. However, others suggested that this might vary and largely depended on the credibility of the wholesaler's commitment to develop or acquire the relevant assets in time for the commencement of the contract. As a consequence, the 'lead time' between the award and the commencement of the contract was noted to be important as the wholesaler would have to obtain the required assets in this time.¹⁷ Nevertheless, all publishers stated that previous experience of newspaper or magazine distribution is one of the most important factors in selecting a wholesaler to distribute newspapers and magazines. This is predominantly due to the need for the wholesaler to be able to demonstrate its ability to deliver to the high levels of service required.

¹⁷ Responses suggested that this lead time needed to be at least four to six months.

39. The OFT notes that while there are no examples of new entry into newspaper and magazine wholesaling in recent years, there have been some examples of existing wholesalers moving into new territories before owning the assets necessary to supply those territories. Indeed, the OFT noted that both Smiths and Menzies have in this contract round successfully won tenders to supply newspapers and magazines in territories in which they did not have any assets in place (meaning that Dawson held little or no incumbency advantage).
40. Based on this evidence, the OFT believes that it is unrealistic to expect that an alternative entrant would purchase the Dawson Assets and maintain them until the next tender round in 2014.

III. Exit of the assets

41. Given that neither Dawson nor an alternative entrant to newspaper and magazine distribution would be expected to maintain the Dawson Assets until the next tender round, then, given its financial situation, the only realistic option for Dawson would have been to realise the Dawson Assets for as much as possible, for example by transferring the leases of the depots to other entities or surrendering the leases to the landlords. Indeed, Dawson's administrators have confirmed that any assets not acquired by Smiths are in the process of being disposed, either to realise capital, or, where there is no value, surrendering leasehold properties back to the landlord.

Conclusion on counterfactual

42. Given the evidence above the OFT believes that the only realistic counterfactual to the transaction is that the Dawson Assets would have exited the market. This is therefore the scenario against which the effects of the transaction should be judged.

COMPETITION EFFECTS

43. On the basis of the above, the OFT considers that the situation created by the transaction is no different in competition terms than the outcome achieved under the appropriate counterfactual, as there is no causation from the transaction to the Dawson Assets exiting the market.
44. Indeed, the transaction may even bring benefits in this regard. For example, if the Dawson Assets were to have exited the market, Smiths would have had to invest in or acquire alternative distribution assets in order to service its distribution contracts. However, had Dawson failed before the transfer date of the contracts then it is possible that Smiths (and Menzies) would not have been in a position to service those contracts if the transfer had to be brought forward at short notice. It is entirely possible that some retailers

would have been left without any supplies of newspapers and magazines for a (possibly prolonged) period of time (see Third Party Views below).

THIRD PARTY VIEWS

45. The overwhelming majority of third parties stated that the transaction would have no impact on competition as it would merely have the effect of bringing forward the contracts that Smiths had already won in the most recent tender round.
46. In addition, several of Dawson's customers noted that the transaction would lead to numerous benefits. In particular, the transaction would benefit publishers and retailers as it would ensure continuity of the supply chain and would reduce the risk of supply failures were Dawsons to no longer be able to supply its customers. In addition, for those retailers that would have been supplied by both Dawson and Smiths during the transition period, it will remove an interim period of dual carriage service charges. Finally, several publishers stated that it would result in improved terms in relation to the newly awarded Smiths contracts being brought forward.
47. Accordingly, third parties were all of the view that Dawson's imminent exit from the affected territories was due to the loss of its wholesaling contracts in the recent tender rounds, as opposed to as a result of the transaction.
48. Nevertheless, the OFT notes that concerns were expressed by a number of third parties regarding the level of consolidation in the wholesaler sector in general (that is, approximately 90 per cent of the market will split between the remaining duopoly: Smiths and Menzies). The OFT considers that these concerns are not relevant to the analysis of this particular transaction for the reasons set out in the counterfactual analysis above. However, the OFT has assessed the issue of regional consolidation as part of its proposed decision on a request for a market investigation reference of this sector.¹⁸ As part of its consultation with industry parties on this proposed decision, the OFT is also considering the impact of the recent tender round and contract awards on the degree of consolidation in this sector, and the effect that this may have on the features of the markets that it has analysed.

ASSESSMENT

49. The parties overlap in the supply of wholesale newspaper and magazine distribution services to publishers and to retailers. The transaction relates to the acquisition by Smiths of certain Dawson Assets in territories where it has been appointed by publishers as the chosen wholesaler from the

¹⁸ www.of.gov.uk/news/press/2009/42-09.

expiry of Dawson's existing distribution contracts. Although the OFT normally relies on the pre-acquisition conditions as the appropriate proxy for the counterfactual, in this case, given the structural changes in the market, the OFT considers that the only realistic counterfactual to the transaction is that the Dawson Assets would have exited the market. Accordingly, in light of this counterfactual, the acquisition by Smiths of the Dawson Assets would have no effect on competition in the next tender round in 2014.

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

DECISION

51. This transaction will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.