

Statement of Preliminary Issues

AlphaTheta/Serato

26 October 2023

Introduction

1. On 10 October 2023, the Commerce Commission registered a clearance application (the Application) from AlphaTheta Corporation (ATC) seeking clearance to acquire 100% of the shares of Serato Audio Research Limited (Serato) (the Proposed Acquisition).
2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.¹
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **9 November 2023**.

The Parties

5. ATC and Serato (each a Party and together, the Parties) are both present in the DJ segment of the music industry. ATC supplies DJ hardware and DJ software. Serato supplies DJ software. DJ software can be used to create various effects when mixing different songs and for organising music ahead of mixing (for example, creating playlists and preparing tracks to be exported). DJs use software in conjunction with various forms of DJ hardware (such as mixers and controllers).

The Applicant – AlphaTheta

6. ATC is a global company headquartered in Japan. Relevant to the Application, ATC develops, manufactures and sells DJ hardware under the Pioneer DJ brand and DJ software under the rekordbox brand. Pioneer DJ hardware and rekordbox software are available worldwide. According to the Application, rekordbox software can be purchased on the following plans:²

- 6.1 Professional – allows users to sync their rekordbox library via the cloud with unlimited storage, provides full access to all music analysis features and

¹ The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

² The Application at [4.7].

allows software to be controlled with DJ hardware. The Professional plan can be activated on up to eight devices (for example, laptops, computers, mobiles, tablets).

- 6.2 Creative – allows users to sync their rekordbox library via the cloud (although with limited storage), provides full access to all music analysis features and allows software to be controlled with DJ hardware. The Creative plan can be activated on up to four devices.
 - 6.3 Core – allows limited use of cloud library sync and nearly all of the same music analysis features as Professional and Creative plans (although edited tracks and sequences cannot be saved) and allows software to be controlled with DJ hardware. The Core plan can be activated on up to two devices.
 - 6.4 Free – allows limited use of cloud library sync and standard beats-per-minute/key/phrase detection, however software cannot be controlled with DJ hardware.
7. ATC also supplies a mobile/tablet only DJ software app called WeDJ. WeDJ can be used by beginner DJs who want to start mixing tracks and mobile DJs who DJ on the go.³ WeDJ allows users to access downloaded tracks on their mobile or tablet, conduct music analysis and track mixing and allows users to record their performances.⁴

The Target – Serato

- 8. Serato is a DJ and music production software company that was founded in New Zealand. According to the Application, Serato’s DJ software products include:⁵
 - 8.1 Serato DJ Pro – Serato’s “flagship” professional DJ software used by hobbyist DJs through to professional DJs. The main features of Serato DJ Pro are music management, music analysis and playing and mixing music. Serato DJ Pro can be purchased outright or as a monthly subscription.
 - 8.2 Serato DJ Suite – an all-in-one suite of expansion packs for Serato DJ Pro that provide enhanced functionality, including Serato Video (which allows DJs to incorporate visual effects) and Serato FX (access to custom sound effects). Serato DJ Suite can be purchased outright or as a monthly subscription.
 - 8.3 Serato DJ Lite – a free version of Serato software “for learning”.
 - 8.4 Serato Remote – an iOS app designed to integrate with Serato DJ Pro, so that users can control specific functions from their mobile/tablet.
- 9. Serato also produces software for producing music called Serato Studio.

³ The Application at [4.10].

⁴ Ibid.

⁵ The Application at [4.27].

10. Serato's DJ software is available worldwide and is integrated with over 90 pieces of DJ hardware made by various brands, including Pioneer DJ.

Our framework

11. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.⁶ As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
12. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).⁷ This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
13. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
- 13.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
 - 13.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 13.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Market definition

14. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.⁸
15. In the Application, ATC submitted that the relevant markets for the purpose of assessing the Proposed Acquisition are:⁹
- 15.1 the supply of DJ software to end users; and

⁶ Commerce Commission, *Mergers and Acquisitions Guidelines*, May 2022. Available on our website at www.comcom.govt.nz.

⁷ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁸ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁹ The Application at [5.22].

- 15.2 the wholesale supply of DJ hardware.
16. ATC considers that the supply of DJ hardware and DJ software take place on a global basis. However, for the purposes of its assessment of the Proposed Acquisition in the Application it has focused on a national market (New Zealand).¹⁰
17. We will consider whether these are the most appropriate markets for assessing the competition effects of the Proposed Acquisition, or whether its impact is better assessed with reference to other markets. For example, we will consider whether the Proposed Acquisition is better analysed by reference to narrower product markets.
18. For DJ software we will consider whether there are separate markets for different:
- 18.1 devices, such as computer-based DJ software and DJ software apps that are used on a mobile/tablet;
 - 18.2 functionality, such as:
 - 18.2.1 software used for DJ performances; and
 - 18.2.2 software used for production; and
 - 18.3 customer segments (such as professional or hobbyist customers).
19. For DJ hardware we will consider whether there are separate markets for different:
- 19.1 hardware such as DJ players, controllers, mixers, all-in-one/standalone controllers, turntables and audio interfaces; and
 - 19.2 customer segments (such as professional or hobbyist customers).

Without the acquisition

20. We will consider what the Parties would do if the Proposed Acquisition does not go ahead, as well as the competitive position of each. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo or whether the Parties would seek alternative options.

Preliminary issues

21. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether horizontal unilateral, coordinated or vertical/conglomerate effects might result from the Proposed Acquisition. The questions that we will be focusing on are:
- 21.1 Vertical or conglomerate effects: would the Proposed Acquisition increase the merged entity's ability and/or incentive to foreclose rivals?

¹⁰ The Application at [5.30] and [5.41].

- 21.2 Unilateral effects: would the loss of competition between the Parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?¹¹
- 21.3 Coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?

Vertical or conglomerate effects: would the merged entity foreclose rivals?

22. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives the merged entity a greater ability and/or incentive to engage in conduct that prevents or hinders rivals from competing effectively (which we refer to as “foreclosing rivals”).¹²
23. ATC is a major supplier of DJ hardware, and the Proposed Acquisition will result in ATC increasing its market share for the supply of DJ software. We will test whether the Proposed Acquisition could result in vertical effects for both DJ hardware and DJ software.
24. In the Application, ATC submitted that the Proposed Acquisition would not be likely to substantially lessen competition in the supply of DJ hardware or DJ software due to vertical effects.¹³
25. ATC submitted that these effects would not arise for the supply of DJ hardware because:
- 25.1 the Proposed Acquisition would not give ATC the ability or incentive to foreclose competition in the DJ hardware market by refusing to allow Serato software to operate with rival DJ hardware;¹⁴
- 25.2 there is no incentive for ATC to refuse to partner with other DJ hardware brands and/or make Serato less attractive to rival DJ hardware brands;¹⁵
- 25.3 the terms of the SPA preclude refusing to allow Serato to partner with other DJ hardware brands or making Serato less attractive to partner with;¹⁶ and

¹¹ For ease of reference, we only refer to the ability of the merged entity to “raise prices” from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, ie, it could increase quality-adjusted prices.

¹² *Mergers and Acquisitions Guidelines* above n6 at [5.1]-[5.15].

¹³ The Application at [7.1].

¹⁴ The Application at [7.2]-[7.14].

¹⁵ The Application at [7.15]-[7.19].

¹⁶ The Application at [7.20]-[7.24].

- 25.4 the Proposed Acquisition would not give ATC the ability to undermine competitors by using their commercially sensitive information.¹⁷
26. ATC submitted that these effects would not arise for the supply of DJ software because the Proposed Acquisition would not give ATC the ability or incentive to foreclose competition in the supply of DJ software.¹⁸ For example, ATC submitted that as it already has its own software products, if it was profitable to prevent rival software products from being used with its hardware, it would do this absent the Proposed Acquisition.¹⁹
27. As part of our assessment of these issues, we will consider whether as a result of the Proposed Acquisition:
- 27.1 ATC would have the ability and/or incentive to foreclose DJ hardware or software rivals, through having control of an important input (ie, Serato software or Pioneer DJ hardware); and
- 27.2 competition lost due to any foreclosure of competitors would amount to a substantial lessening of competition.
28. We will also assess whether the Proposed Acquisition is likely to give rise to conglomerate effects, such as by giving the merged entity the ability to bundle (ie, provide products or services together at a discount) or tie (ie, only provide one product or service with another) complementary products, in circumstances where competitors are not able to provide the same range of products, and are therefore foreclosed from access to sufficient market demand to achieve competitive scale.

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

29. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger, without the profitability of that increase being thwarted by rival firms' competitive responses.²⁰
30. In the Application, ATC submitted that the Proposed Acquisition would not be likely to substantially lessen competition in the supply of DJ software (the area where the Parties overlap) due to unilateral effects because:
- 30.1 the market is dynamic and characterised by innovation;²¹

¹⁷ The Application at [7.25]-[7.33].

¹⁸ The Application at [7.34]-[7.38].

¹⁹ The Application at [7.35].

²⁰ *Mergers and Acquisitions Guidelines* above n6 at [3.62].

²¹ The Application at [6.12]-[6.16].

- 30.2 ATC will continue to be constrained by vigorous competition from other DJ software solutions (including DJ software apps and applications);²²
- 30.3 barriers to entry and expansion are low, particularly for music production software developers and DJ software apps;²³ and
- 30.4 ATC will continue to be constrained by other options that are available to users outside of the DJ software market.²⁴
31. We will consider the closeness of competition between the merging parties (that is, what competition would be lost due to the Proposed Acquisition if clearance is granted) in the market for DJ software. For example, we will look at the extent to which the parties compete closely.
32. To the extent that any constraint between the parties is material, we will assess the impact of the loss of competition having regard to:
- 32.1 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;
- 32.2 entry and expansion: how easily rivals could enter and/or expand; and
- 32.3 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

Coordinated effects: would the Proposed Acquisition make coordination more likely?

33. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to act in a coordinated way.²⁵
34. ATC submits that the Proposed Acquisition will not enhance the ability of ATC and its competitors to coordinate their behaviours in the DJ software market because:²⁶
- 34.1 DJ software offerings are not entirely homogenous;
- 34.2 there are a large number of DJ software competitors, and the Proposed Acquisition will not result in the removal of a particularly aggressive or destabilising competitor;

²² The Application at [6.17]-[6.24].

²³ The Application at [6.25]-[6.28].

²⁴ The Application at [6.29]-[6.30].

²⁵ *Mergers and Acquisitions Guidelines* above n6 at [3.84].

²⁶ The Application at [6.31].

- 34.3 there are limited interactions between competitors in the DJ software market and the number of DJs software users using a particular DJ software or app is fluid and not fully transparent; and
- 34.4 the market is characterised by a high degree of innovation (including the rapid advancement of AI).
35. We will assess whether the DJ software market is vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.
36. We will also consider whether the Proposed Acquisition will affect the ability of the market participants to coordinate their behaviours in the DJ hardware market. For example, the potential for coordination may increase if ATC gains access to its rivals' commercially sensitive information.

Next steps in our investigation

37. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **6 December 2023**. However, this date may change as our investigation progresses.²⁷ In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
38. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

39. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "AlphaTheta/Serato" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **9 November 2023**.
40. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
41. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

²⁷ The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.