

Statement of Preliminary Issues

Penguin/Random House

11 January 2013

Introduction

1. On 19 December 2012, the Commerce Commission (the Commission) received an application from Bertelsmann SE & Co. (Bertelsmann) and Pearson plc (Pearson) seeking clearance to form a new jointly-owned company to be called Penguin Random House, which will acquire the retail book publishing businesses of Random House and Penguin. Random House is owned by Bertelsmann and Penguin is owned by Pearson.
2. The public version of the application can be accessed on the Commission's website at:

<http://www.comcom.govt.nz/clearances-register/detail/780>
3. This Statement of Preliminary Issues outlines the key competition issues that the Commission currently considers will be important in deciding whether or not to give clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as the Commission's assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.
4. The Commission invites interested parties to comment on the likely competitive effects of the proposed merger. The Commission requests that parties who wish to make a submission do so by **1 February 2013**.

The transaction

5. Under the terms of the proposed merger, a new jointly-owned company will be formed called Penguin Random House. This company will acquire the retail book publishing businesses of Bertelsmann and Pearson. This is a global transaction.
6. Bertelsmann and Pearson both operate wholly owned subsidiaries in New Zealand. Pearson Education NZ (Penguin's business unit in New Zealand that publishes educational materials) is not included in the acquisition.

Relevant parties

7. Random House New Zealand Limited (Random House NZ) is a book publishing, importing and distribution business.
8. Pearson New Zealand Limited (Penguin NZ) also provides book publishing, importing and distribution services in New Zealand. Penguin NZ's distribution and warehousing services are performed on its behalf by United Book Distributors (UBD) from its distribution centre in Melbourne. UBD is a division of Pearson Australia.

Analytical framework

9. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition in any market. To assist the Commission's determination, the Commission determines the relevant market or markets likely to be affected by the acquisition. This provides a framework to isolate the key competition issues that arise from the acquisition. The Commission determines the relevant market or markets by identifying the areas where the businesses of the acquirer and the target overlap. The Commission then considers the relevant products and geographic regions that may be close substitutes from both a customer's and a supplier's point of view.
10. The Commission uses forward looking analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios; with the acquisition and without the acquisition.
11. The impact of the acquisition is the difference in competition between those two scenarios.
12. The Commission analyses the extent of competition in each relevant market for both the with and without scenarios in terms of the following.
 - 12.1 Existing competition – the degree to which existing competitors compete and their ability to expand their operations in the event that the merged firm raises prices.
 - 12.2 Potential competition – the ability of businesses to enter the market on sufficient scale in order to provide competitive constraint.
 - 12.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchasers' ability to exert influence on price, quality and/or terms of supply.
 - 12.4 Coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.
13. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, the Commission may not give clearance to the proposed acquisition.

Preliminary issues

14. The Commission intends to focus the investigation on the following areas.

Market definition

15. In its application, Bertelsmann and Pearson submitted that the joint venture would lead to aggregation in the markets for:

- 15.1 the publishing and supply [distribution] of books to retailers, including e-books (the book publishing market); and
 - 15.2 the acquisition of authors' rights.
16. The Commission will carefully consider substitutability of services in the book publishing market identified by the applicant. In particular, the Commission will consider possible distinctions between:
- 16.1 publishing, and distribution; and
 - 16.2 print books and digital.

Existing competition

17. Bertelsmann and Pearson submitted that the proposed merger does not raise any competition concerns because the merged firm would face competition from a large number of existing local and international competitors.
18. The Commission will consider:
- 18.1 the closeness of competition between Random House and Penguin;
 - 18.2 the degree of competitive constraint large and small competitors would place on the merged firm; and
 - 18.3 the extent to which overseas publishers would provide constraint on the merged firm.

Potential competition

19. Bertelsmann and Pearson submitted that barriers to entry and expansion are low and reducing due to technological advances and availability of low cost publishing methods.
20. The Commission will consider the extent to which the following would provide constraint on the merged firm:
- 20.1 authors self publishing their own print books or e-books;
 - 20.2 low cost publishing methods such as print on demand technology;
 - 20.3 sales through online platforms; and
 - 20.4 the increased popularity of e-books.

Countervailing Power

21. The Commission will consider the extent to which retailers and other customers have a degree of countervailing power that would constrain the merged firm.

Next steps

22. In line with the Commission's Merger and Acquisitions Clearance Process Guidelines (available on the Commission's website at www.comcom.govt.nz), the Commission has established a draft timeframe for consideration of Bertelsmann and Pearson's application. An extension of time has been agreed to by Bertelsmann and Pearson such that the Commission should make its final decision by **15 February 2013**. To keep up to date with changes in relation to timing and to find relevant documents, visit the public Clearance Register on the Commission's website at:

<http://www.comcom.govt.nz/clearances-register/>

23. The Commission will be contacting parties it believes will provide the best information to help it assess the preliminary issues identified above.
24. The Commission also invites submissions from any other parties that consider they have information relevant to the Commission's consideration of this matter. If you wish to make a submission, please send it to the Registrar, at registrar@comcom.govt.nz with the reference Penguin/Random House in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by 4pm **1 February 2013**. Please clearly identify any confidential information contained in the submission and provide contact details.