

Determination

Bertelsmann SE & Co. KGaA and Pearson plc [2013] NZCC 6

- The Commission:** Dr Mark Berry
Anita Mazzoleni
Dr Jill Walker
- Summary of application:** The application by Bertelsmann SE & Co. KGaA and Pearson plc seeking clearance for a yet to be incorporated entity (Penguin Random House or other nominee), to acquire the consumer book publishing businesses of Bertelsmann and Pearson.
- Determination:** Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission gives clearance for Bertelsmann SE & Co. KGaA and Pearson plc to form a yet to be incorporated entity (Penguin Random House or other nominee), to acquire the consumer book publishing businesses of Bertelsmann and Pearson.
- Date of determination:** 19 March 2013

Confidential material in this report has been removed. Its location in the document is denoted by [].

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The proposal

1. A notice under s 66(1) of the Commerce Act 1986 (the Act) was registered on 20 December 2012. Bertelsmann SE & Co. KGaA (Bertelsmann)¹ and Pearson plc (Pearson)² sought clearance for a yet to be incorporated entity (Penguin Random House or other nominee)³, to acquire Bertelsmann's and Pearson's "consumer book publishing businesses".⁴
2. The applicants have advised that the term "consumer book publishing" can be used interchangeably with the term "trade book publishing". "Trade publishing" is an industry term that refers to the business of publishing fiction and non-fiction books for a general audience (ie, books typically found in bookstores) as opposed to textbooks, or professional books, which are developed for professional or educational use. Trade book publishing is the term more commonly used in the industry in New Zealand. The Commission has therefore used the term 'trade books' in these reasons.

The decision

3. The proposed acquisition affects the markets for:
 - 3.1 the acquisition of trade book publishing rights from New Zealand authors (publishing rights market);
 - 3.2 the supply of printed trade book distribution services provided to third party New Zealand publishers (third-party distribution services market); and
 - 3.3 the supply of trade books to retailers (market for the supply of books).
4. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of these markets because:
 - 4.1 in the publishing rights market, the Commission considers that the merged entity would be constrained by existing competition from other publishers;
 - 4.2 in the market for third-party distribution services, the Commission considers that the aggregation in this market is negligible since Penguin only supplies

¹ Bertelsmann SE & Co. KGaA owns Random House New Zealand Limited (Random House NZ), a book publishing, importing and distribution business.

² Pearson plc owns Pearson New Zealand Limited (Pearson NZ), one of whose business units is Penguin Books NZ, also a book publishing, importing and distribution business.

³ The reference to "other nominee" is included as the parties may elect to conduct the acquisition through a different entity. The applicant has informed the Commission that if a different entity is used for the acquisition, ultimate ownership or control of that entity would remain as described in the clearance application. In all scenarios, Bertelsmann will own 53% of the entity, contributing five directors. Pearson will own 47% of the entity contributing four directors, one of which will be the Chairman. Bertelsmann will appoint the CEO and COO, and Pearson will appoint the CFO for the entity.

⁴ Penguin Random House will not acquire either Bertelsmann's or Pearson's publishing businesses that operate in the USA, Bertelsmann's German language trade publishing division, Verlagsgruppe Random House or Pearson's education publishing businesses.

these services to one independent publisher and because the merged entity would be constrained by a combination of existing competition and the potential for other publishers and agents to expand; and

- 4.3 in the market for the supply of books, the Commission considers that the merged entity would be constrained by existing competition from other suppliers, and to a degree by purchasers' countervailing power.

Procedure

5. Section 66(3) of the Act requires the Commission to either clear or decline to clear the acquisition referred to in a s 66(1) notice within 10 working days unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and Bertelsmann and Pearson. Accordingly, a decision on the application was required by 5 April 2013.

Statutory framework

6. Any person who proposes to acquire assets of a business or shares can apply for clearance of that acquisition under s 66 of the Act.
7. If the Commission is satisfied under s 66(3)(a) of the Act that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market, the Commission must give a clearance for the proposed acquisition.
8. The Court of Appeal in *Port Nelson v Commerce Commission*⁵ noted that for something to be "likely" it must be "above the mere possibility but not so high as more likely than not and is best expressed as a real and substantial risk that the stated consequence will happen".
9. The High Court in *Woolworths & Ors v Commerce Commission* observed that "...a substantial lessening of competition is one that is "real or of substance" as distinct from ephemeral or nominal. Accordingly a substantial lessening of competition occurs if it is likely that there will be a reduction in competition that is real or of substance."⁶

Analytical framework

10. The Commission's analytical framework for assessing a substantial lessening of competition in the context of an acquisition is described in the Commission's Mergers and Acquisitions Guidelines.⁷

⁵ *Port Nelson v Commerce Commission* [1996] 3 NZLR 554 at 562-563 (CA).

⁶ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁷ Commerce Commission Mergers and Acquisitions Guidelines (2004). The Commission has recently published for consultation revised Mergers and Acquisitions Guidelines. Until the revised Guidelines are adopted by the Commission, the Commission will continue to have regard to the 2004 Guidelines. The broad analytical framework proposed in the revised Guidelines remains the same as that outlined in the current Mergers and Acquisitions Guidelines.

11. A useful tool in the Commission’s assessment is determining the affected market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target, and then considers what, if any, products and geographic regions, constitute relevant close substitutes from both a customer’s and a supplier’s point of view.
12. The Commission uses a forward-looking analysis to assess whether a substantial lessening of competition is likely. This exercise “requires a comparison of the likely state of competition if the acquisition proceeds (the factual), against the likely state of competition if it does not (the counterfactual)”.⁸ This is also referred to as comparing the scenario with the merger, to the scenario without the merger.
13. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.⁹
14. A comparison of the extent of competition in the relevant markets in the factual and counterfactual scenarios enables the Commission to assess the extent of any lessening of competition under the proposed acquisition, and whether that contemplated lessening is likely to be substantial.
15. The High Court in *Air New Zealand v Commerce Commission (No.6)*¹⁰ accepted that an absence of market power would suggest there had been no substantial lessening of competition in a market but did not see this as a reason to forgo an analysis of the counterfactual as well as the factual. Justice Rodney Hansen stated that “a comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, that is, dominance has been attained”.
16. In addition to an analysis of existing competitors, the assessment may include an analysis of potential competitors. Potential competitors can act as a constraint on a business or businesses that might otherwise be able to exert market power. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from actual, or threatened, market entry.

Parties

Random House NZ

17. Random House NZ is a book publishing business that imports, publishes, and supplies books to retailers in New Zealand.
18. Random House NZ also provides distribution and sales services to other New Zealand and overseas publishers from its distribution centre and warehouse in Auckland.

⁸ *Commerce Commission v Woolworths Ltd* (2008) 8 NZBLC 102,336 (CA) at [63].

⁹ New Zealand Electricity Market (Commerce Commission Decision 277, 30 January 1996), at 16.

¹⁰ *Air New Zealand v Commerce Commission (No.6)* (2004) 11 TCLR 347 at [42].

Penguin NZ

19. Penguin NZ (a business unit of Pearson NZ) is a book publishing business that imports,¹¹ publishes, and supplies books to retailers in New Zealand.
20. Penguin NZ also provides distribution and sales services to other New Zealand and overseas publishers. Penguin NZ's distribution services are performed on its behalf by United Book Distributors (UBD), a business unit of Pearson Australia, from its distribution centre and warehouse in Melbourne.

Other Parties

International Publishers

21. Other than Penguin NZ and Random House NZ, there are five other large international publishing houses that operate in New Zealand, namely:
 - 21.1 Hachette New Zealand Limited (Hachette) is part of Hachette Book Group, a wholly owned subsidiary of Hachette UK Limited, a large international publishing house. Hachette imports, publishes, and supplies its own books to retailers in New Zealand. Hachette does not provide distribution and sales services to other publishers.
 - 21.2 Harper Collins Publishers (NZ) Limited (Harper Collins) is part of Harper Collins Publishing Group, a large international publishing house owned by News Corporation. Harper Collins imports, publishes, and supplies its own books to retailers in New Zealand. Harper Collins also provides distribution and sales services to other New Zealand and overseas publishers.
 - 21.3 Scholastic New Zealand Limited (Scholastic) is a wholly owned subsidiary of Scholastic Inc, the world's largest international publisher and distributor of books, magazines and educational material for children. Scholastic publishes, imports and supplies its own children's trade books to retailers in New Zealand. Scholastic does not offer distribution and sales services to New Zealand publishers but does distribute and sell children's books for some overseas publishers.
 - 21.4 Macmillan Publishers New Zealand Limited (Macmillan) is a wholly owned subsidiary of Macmillan Publishers Limited which is owned by Verlagsgruppe Georg von Holtzbrinck, a German publishing company. Macmillan imports, publishes, and supplies books to retailers in New Zealand. Macmillan does not offer distribution and sales services to overseas or New Zealand publishers.
 - 21.5 Allen & Unwin New Zealand Limited (Allen & Unwin) is a wholly owned subsidiary of Allen & Unwin Pty Limited in Australia. Allen & Unwin imports, publishes, and supplies books to retailers in New Zealand. Allen & Unwin's

¹¹ 'Imports' is the industry term for the local distribution of books published overseas by the local publisher's parent.

books are physically distributed and warehoused by UBD and sold in conjunction with Archetype Book Agents Limited.

Independent publishers

22. There are over sixty independent publishers that publish books in New Zealand. Some of the larger independent publishers include:
- 22.1 Craig Potton Publishing Limited (Craig Potton) which publishes and distributes its own books in New Zealand. Craig Potton has sold and distributed for New Zealand publishers in the past, but does not currently do so;
 - 22.2 David Bateman Limited (David Bateman) which publishes, distributes and sells books in New Zealand. David Bateman provides distribution and sales services to other New Zealand and overseas publishers; and
 - 22.3 Annabel Langbein Media Limited (Annabel Langbein), which publishes, distributes and sells cook books in New Zealand and internationally. Annabel Langbein does not provide distribution services to other New Zealand or overseas publishers.

Distributors and sales agents

23. There are book distributors and sales agents in New Zealand, which do not publish, but which supply books to retailers on behalf of independent New Zealand Publishers. These include:
- 23.1 South Pacific Book Imports Limited (South Pacific);
 - 23.2 Bookreps NZ Limited (Bookreps);
 - 23.3 Nationwide Book Distributors Limited (Nationwide Books);
 - 23.4 Books R Us Limited (Books R Us); and
 - 23.5 Archetype Book Agents Limited (Archetype).

Retailers

24. Bricks and mortar retailers¹² that sell books in New Zealand include:
- 24.1 The Warehouse Group Limited (the Warehouse)¹³;
 - 24.2 Whitcoulls 2011 Limited (Whitcoulls); and

¹² These retailers are primarily bricks and mortar stores but also have a limited online sales presence relative to their bricks and mortar sales. Hereafter all reference to 'bricks and mortar' will refer to both the print and online sales of retailers that are primarily engaged in bricks and mortar sales.

¹³ The Commission interviewed Complete Entertainment Services Limited (CES) which currently purchases books on The Warehouse's behalf []. Throughout these reasons we refer to The Warehouse instead of CES.

- 24.3 Paper Plus New Zealand Limited (Paper Plus).
- 25. There are also numerous independent book shops throughout the country which have few outlets such as Unity Books or a single outlet such as Parsons Books.
- 26. The main online retailers that sell books in New Zealand include:
 - 26.1 Amazon and The Book Depository;
 - 26.2 Fishpond Limited (Fishpond);
 - 26.3 Kobo; and
 - 26.4 Mighty Ape Limited (Mighty Ape).

Background

The industry

- 27. Book publishing involves the acquisition of publishing rights, editing, printing, distribution, sales and marketing of books (typically to retailers although some publishers may sell directly to end users).
- 28. Books are differentiated products. No one book or author is perfectly substitutable with another, but certain books compete more closely than others. For example, a purchaser might be more likely to view two books on New Zealand rugby as closer substitutes than a sports book and a romance novel. Each publisher supplies a unique range of books to which they have exclusive rights, including book rights acquired in New Zealand and international rights acquired from the publisher's parent company by licence from another overseas publisher. Publishers compete to acquire the rights to titles that will appeal to consumers and then compete to promote those titles to consumers, including via book retailers.
- 29. Publishing rights are paid for by advance payments and/or royalties on book sales. Publishers either commission a book for which they see a market or may receive manuscripts from their existing stable of authors or literary agents who represent authors.¹⁴ New Zealand publishers typically source attractive book titles by first coming up with the idea for a book that they think would sell well, and then commissioning an author to write the book for them, rather than providing a suite of services to authors that approach them with titles.
- 30. Publishers work with the author to edit and design the book while the printing of physical books is outsourced.
- 31. Books are promoted through flyers, reviews, author interviews or other advertising and promotional activities. Importantly, consumers are exposed to books on the store floor and on the front page of a retailer's website and this retail positioning can be an important promotional tool.

¹⁴ It is rare for a publisher to publish an unsolicited manuscript from a new author.

32. All of the international publishers (except Allen and Unwin) have warehouses and sales teams to warehouse, distribute, promote and sell the books they publish.
33. Most independent publishers do not carry out sales and marketing functions themselves. Rather, both overseas and domestic independent publishers engage distributors to market and sell their print books. These distribution services are provided by international publishers, larger independent publishers or specialist distributors (hereafter referred to as distributors).
34. The range of services provided by distributors depends on the distribution contract. In the case of a distributor that also publishes, the distributor sells and markets independent publishers books alongside its own books. The key services provided by distributors are sales and marketing. These services can be critical to the success of a book because bricks and mortar retailers, in particular, try to limit the number of sales agents with which they must negotiate. Therefore the sales avenue through distributors is crucial for the exposure of an independent publishers books to retailers and, ultimately, to consumers.
35. There are a variety of retail sales channels for books in New Zealand including online retailers (eg, Fishpond), and bricks and mortar retailers (with different retailers having a differing emphasis on books within their range).¹⁵ Retailers tend to sell both e-books (via their websites) and print books. E-books are often sold through a platform, such as Kobo, for which the retailer acts as an agent receiving a commission or proportion of the revenue.
36. Publishers typically supply print books to bricks and mortar retailers on a sale or return basis. That is, should the book not sell, retailers have the option to return the book to the publisher. Online retailers order print books from the publisher on an on-demand basis and tend not to keep the stock that bricks and mortar retailers do. Publishers do not negotiate prices with retailers on a per book basis. A flat discount off the recommended retail price is negotiated as part of their pre-agreed terms of trade.¹⁶ This discount applies to all books on a publisher's list. However, there are some instances where a further discount may be negotiated on particular lead titles based on volume or firm sale.¹⁷

Previous Commission decisions

37. The Commission considered the book retailing industry when it granted clearance to A&R Whitcoulls Holding Group to acquire Borders New Zealand Limited in 2007.¹⁸ In that case, the Commission found the following markets:

37.1 the retail of books by bricks and mortar book retailers in the Auckland CBD, Albany, Wellington CBD, and Riccarton Shopping precincts; and

¹⁵ For example, The Warehouse, Whitcoulls and Paper Plus, and specialist bookstores (eg, Unity Books).

¹⁶ []

¹⁷ Firm sale is when books are purchased from publishers and cannot be returned.

¹⁸ *A&R Whitcoulls Holding Group Pty Limited and Borders New Zealand Limited* (Commerce Commission Decision 630, 20 November 2007).

- 37.2 the publishing and supply of books to retailers in New Zealand.
38. That decision focused on the retailing of books, and therefore the Commission did not need to fully consider the publishing markets which are relevant to the present decision.

Market definition

39. The Commission considers the markets relevant to this application are:
- 39.1 the publishing rights market;
- 39.2 third-party distribution services market; and
- 39.3 the market for the supply of books.

Commission's approach to market definition

40. The Act defines a market as:¹⁹
- ...a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
41. In general, the more closely substitutable two products or sources of supply are, the closer the competition and the greater the competitive constraint between those products or sources of supply.
42. As part of defining the relevant markets, the Commission looks to evidence that serves to identify appropriate markets in accordance with commercial common sense and uses the internationally accepted SSNIP test as an analytical tool to aid the market definition exercise.
43. In general, the SSNIP test assesses substitutability by identifying the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry would impose at least a **small yet significant and non-transitory increase in price (SSNIP)** on at least one product, assuming all other terms of sale remain constant. Under the SSNIP test, the smallest space in which such market power may be exercised is considered to be the relevant market.²⁰

Bertelsmann and Pearson's views on market definition

44. Bertelsmann and Pearson submitted that the relevant markets affected by this transaction are the national markets for:
- 44.1 the publishing and supply of books to retailers; and
- 44.2 the acquisition of authors' rights.²¹

¹⁹ Section 3(1A) of the Act.

²⁰ Merger and Acquisitions Guidelines, above n 7 at p 29.

²¹ Application, para 12.1.

45. Bertelsmann and Pearson also submitted that:
- 45.1 print books and e-books ought to be considered within a single market for similar reasons as the Commission considered the wholesale supply of physical and digital music together in *Universal/EMI*;^{22 23} and
 - 45.2 publishers and distributors should be considered in the same market as found by the ACCC when they considered Pearson Australia and REDGroup Retail in 2011.²⁴
46. Following the Commission's approach in *A&R Whitcoulls*, Bertelsmann and Pearson also submitted that the book publishing market is national in scope as typically all publishers distribute books to retailers located throughout New Zealand.²⁵

The Commission's market definitions

47. The Commission agrees with the merging parties that there are separate markets for the acquisition of publishing rights and the supply of books (book publishing).
48. However, in addition to the areas of close competition identified in these two markets, the merging parties also supply distribution services to independent publishers. Therefore, the Commission has also assessed the impact of this merger on the third-party distribution market.²⁶
49. The Commission also considered whether the markets should be divided by genre or category. The Commission found that it was not necessary to identify separate markets for different book genres because:
- 49.1 international publishers all publish books across the various genres; and
 - 49.2 retailers do not have a target proportion of books from each genre that they stock – they consider each book on its own merits.

Publishing rights market

50. The acquisition of trade book publishing rights from New Zealand authors includes various services such as the commissioning, editing and designing of a book.

²² Ibid at para 12.2.

²³ We note that the Commission did not find physical and digital music to be in the same market in *Universal/EMI*. Rather the Commission found that these formats may constitute separate markets but were considered together for the purposes of that transaction because of the similarities in the competitive constraints and because that consideration did not make any difference in the competition analysis.

²⁴ Application para 12.3.

²⁵ Ibid at para 12.4.

²⁶ The Commission did not consider the impact of this merger on the printing of books as the merging parties outsource the printing of books and therefore no overlap exists in the supply of this service. [

] Similarly, while Random House NZ sells books through its online website in New Zealand, Penguin NZ does not. Therefore there is no overlap in the retail market.

51. In buying markets, the relevant question for determining the breadth of a market is whether a hypothetical monopsonist would profitably impose a price decrease or whether the sellers – in this case the New Zealand authors – have sufficient alternatives to render such a price decrease unprofitable.
52. Most books of New Zealand origin are commissioned by local publishers from a particular author with whom the publisher may have a previous relationship. Such books are most commonly non-fiction books focused on local topics such as New Zealand sports and cooking personalities or photo essays highlighting New Zealand's scenery.²⁷ Authors are paid for these book rights by way of royalties from book sales and advances.
53. The Commission considers that both independent and international publishers located within New Zealand compete to acquire book publishing rights from New Zealand authors.[

28]

54. Independent publishers either individually or collectively look to acquire the same range of publishing rights as that considered by the international publishers, and represent a real alternative to authors.[

29]

55. The Commission further assessed whether the market for the acquisition of New Zealand owned trade book publishing rights extends to include overseas publishers, particularly Australian publishers.
56. Books written by New Zealand authors are often locally focused and the New Zealand market for these books is often small. This makes them unlikely to appeal to an overseas independent publisher. As such, books with a local focus tend to require a publisher with a local presence to promote them. There are exceptions. For example, Text Publishing Australia Pty Limited,³⁰ a large independent Australian publisher, which publishes approximately 50 books a year, publishes approximately [] New Zealand fiction books a year in New Zealand and overseas. However, the Commission considers that there is at least some segment of New Zealand publishing

²⁷ The two largest selling New Zealand books in 2012 were a cookbook by Annabel Langbein, a television personality and cook, and an autobiography of Ritchie McCaw, a rugby player.

²⁸ []

²⁹ []

³⁰ Text Publishing Company was the international publisher of *Mr Pip*. New Zealand fiction does not generally sell well, although *Mr Pip* was an exception selling about [] copies locally and approximately [] internationally and being short listed for the Booker prize.

rights (mainly those with a local focus) for which the market does not extend overseas.³¹

57. Therefore the Commission finds that the relevant market for the purposes of this decision is that for the acquisition of trade book publishing rights from New Zealand authors.

Third-party distribution services market

58. Distributors, including some of the international and independent publishers, provide a range of distribution services to both local and overseas independent publishers. These services include warehousing and physical distribution, sales and marketing. These services are provided in relation to sales to bricks and mortar retailers, rather than online retailers. Online retailers contract and order from independent publishers directly.
59. Generally, independent publishers do not have the capacity to maintain the staff and infrastructure required to distribute their books to bricks and mortar retailers. Bricks and mortar retailers also try to limit the number of sales agents with which they must negotiate. As a consequence, independent publishers most commonly use the distribution services of either international publishers or distributors to promote and deliver their books to booksellers.
60. There is a range of distinct distribution services which can be offered as a package or on a standalone basis. These services include warehousing, physical delivery, ordering/invoicing and sales. The 'menu' of services provided by the large New Zealand distributors and the merging parties is the same. The evidence suggests that these distributors are equally as well placed as the international publishers in the provision of these services.
61. Therefore the Commission considers that there is a market for the provision of distribution services to local publishers for print trade books. The Commission has assessed the impact of this merger on the New Zealand market.

Market for the supply of books

62. Distributors and publishers (both international and independent) sell print and e-books to bricks and mortar and online retailers. The relevant question is what the competitive alternatives for a book retailer would be if a hypothetical monopolist in book supply increased prices for either print or e-books (since both are supplied by the merging parties). The Commission finds that there is no good substitute for books.
63. As discussed earlier, within this market each publisher supplies a unique range of differentiated books, which may be more or less closely substitutable for the range supplied by another publisher. Retailers require access to a more or less

³¹ Although the main focus of New Zealand publishing is on locally focused non-fiction, this does not preclude a New Zealand fiction author, for example, from signing with Random House NZ or even Random House USA.

comprehensive range of books from a number of different publishers to offer their customers a retail assortment consistent with their particular retail model. They can also vary (to a greater or lesser extent) the retail shelf space and in store prominence given to different titles and publishers.

64. The Commission considered whether the retailers of e-books and print books have different competitive alternatives available to them geographically.
- 64.1 E-book retailers tend to source their books globally, often directly from a publisher's head office. These retailers deal directly with independent New Zealand publishers.
- 64.2 Print book retailers can be based online and/or in a bricks and mortar store. Online retailers tend to source books directly from international book consolidators, international publishers and independent publishers whereas bricks and mortar retailers tend to restrict their wholesaling negotiations to the international publishers and distributors. As there are no parallel import restrictions in New Zealand - online retailers list books from overseas and local suppliers directly on their websites.³² Bricks and mortar retailers also have access to parallel imports for books through overseas consolidators; however most of them choose not to use this option. Online retailers deal with a larger range of book suppliers than bricks and mortar retailers do.
65. For the purposes of considering this application the Commission does not find it necessary to form a definitive view on whether there are separate markets based on book format (printed or e-book) or by retailer type (online and bricks and mortar) as these distinctions would not alter the competitive assessment.
66. The Commission considers the impact of this merger on the market for the supply of trade books in New Zealand.

With and without the merger

67. With the merger in place, Bertelsmann and Pearson would form a new jointly-owned company to be called Penguin Random House or some other nominee, which would acquire Random House's and Penguin's trade book publishing businesses. The merged entity would continue to acquire publishing rights, distribute for third parties and supply to book sellers (both bricks and mortar and online).
68. The Commission considers that without the merger occurring, Penguin and Random House would continue to operate independently of one another as separate entities.

Competition analysis – publishing rights market

69. The Commission is satisfied that the proposed acquisition would not be likely to have the effect of substantially lessening competition in the publishing rights market. Specifically, the Commission is satisfied that the merged entity would not have the

³² A consumer can then choose between the same book from Penguin New Zealand, Penguin US or a wholesaler depending on final delivered price and delivery times for example.

ability to profitably depress the prices (royalties and advances) paid to New Zealand authors given the number and strength of the existing competitors.

The applicants' submissions

70. Bertelsmann and Pearson submitted that the merged entity would not substantially lessen competition in the publishing rights market because:
- 70.1 the market is highly fragmented with low levels of concentration;
 - 70.2 authors have a wide range of competing publishers to choose from;
 - 70.3 smaller publishers can compete vigorously with larger publishers;
 - 70.4 it is easy for authors to switch between publishers;
 - 70.5 overseas publishers can publish New Zealand authors; and
 - 70.6 authors have countervailing power, and can, for example, self-publish.³³

Existing competition

71. The Commission calculated the shares of payments made to New Zealand authors by international publishers for 2012.^{34 35} These figures show that the merged entity would have an approximate share of payments to New Zealand authors of [].

Table 1: Acquisition of publishing rights

	2012 Royalty payments to New Zealand Authors \$	%
Penguin	[]	[]
Random House	[]	[]
Merged entity	[]	[]
Harper Collins	[]	[]
Hachette	[]	[]
Scholastic	[]	[]
Allen & Unwin	[]	[]

72. Hachette, Harper Collins, and Scholastic are large, international publishers that would continue to provide strong competition in the factual. Hachette and Harper

³³ Application para 18.3.

³⁴ Excluding David Bateman, Craig Potton and other smaller independent publishers.

³⁵ The international publishers have a target number of books that they aim to commission and publish each year. Royalty payments may fluctuate depending on the success of a book; however, we consider that these market shares are representative without independent publishers taken into account. We also note that the number of New Zealand books being published is declining independent of this merger.

Collins publish across all genres and Scholastic publishes books for children.³⁶ Together, these competitors accounted for around []% of payments to New Zealand publishers in 2012.

73. The market share figures in Table 1 do not include independent publishers, of which there are over 60 in New Zealand. A small independent publisher, such as Awa Press, publishes about [] New Zealand books per year whilst a larger independent publisher such as David Bateman publishes 30-40 books per year. These figures may be compared to the [] New Zealand books that the merging parties published in 2012. As such, the market share figures in Table 1 exaggerate the degree of market share aggregation as independent publishers remain an important part of the market.
74. New Zealand independent publishers are able to offer the full range of services to local authors and are able to successfully publish, sell and promote (through various distributors) a book locally as well as globally.³⁷ For example, the best-selling New Zealand published book of 2012 was Annabel Langbein's 'The Free Range Cook: Simple Pleasures', published by the independent publisher Annabel Langbein Media. In addition, contracts in the publishing industry tend to be on a per book basis making it easy for authors to switch between publishers.^{38 39}
75. No single independent publisher publishes books over the breadth of genres that the international publishers do. Many independent publishers focus on particular 'niche' topics. Individual independent publishers compete directly with the international publishers in their 'niche' genres. Considered together, independent publishers would provide viable alternative publishing avenues for New Zealand authors and thereby constrain the merged entity.⁴⁰ Although international publishers publish across a number of genres, they also have strengths in particular genres.
76. Industry players have not indicated that there are any genres where there are only international publishers available to authors but, even if this were the case, there are still five international publishers, apart from the merging parties, available to these authors. Given the large number of independent publishers in New Zealand, the Commission considers that the merged entity would face competition from a number of independent publishers in each separate genre and would therefore be constrained in its pricing to New Zealand authors.

³⁶ Hachette published 'Ritchie McCaw: The Open Side', and Harper Collins published 'Graham Henry: Final Word', the second and third bestselling New Zealand books in 2012.

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³⁹ Popular local children's author Joy Cowley, for example, has published books with Scholastic NZ, Penguin NZ and Random House NZ.

⁴⁰ As noted, independent publishers either individually or collectively consider the same range of publishing rights as that considered by the international publishers, and represent a real alternative to authors. Even if the independent publishers do not have the marketing or distribution reach of the international publishers themselves, they are able to rely on the services of distributors to replicate the full service offered to authors including domestic and international distribution by the international publishers.

- 77. A number of independent publishers advised the Commission that the proposed acquisition may provide opportunities for them to secure authors who may not want to be represented by such a large entity.⁴¹
- 78. The Commission also considered whether authors could self-publish as an alternative to using an established publisher. The Commission considers that self-publishing is unlikely to be an effective alternative for authors because:
 - 78.1 self-published New Zealand authors that have been successful are often well known personalities in their own right. For example Annabel Langbein [⁴²]
 - 78.2 it is very difficult for authors to self-publish successfully due to their lack of experience with design, editing, marketing and promotion;⁴³
 - 78.3 costs, including printing and distribution are significantly higher for smaller batches of books;
 - 78.4 publishers spoken to by the Commission do not currently consider self-publishing as a constraint;⁴⁴ and
 - 78.5 even in cases where a self-published author gains popularity, such as with the ‘Fifty Shades of Grey’ trilogy, a publisher would then acquire the book rights to offer the promotion and sales functions which could make the book a best-seller.
- 79. The Commission is therefore satisfied that the merger would not lead to significant aggregation in this market and that the merged entity would be constrained by existing competition post-acquisition.

Competition analysis – third-party distribution services market

- 80. The Commission is satisfied that the proposed acquisition would not likely have the effect of substantially lessening competition in the market for the third party distribution of trade books in New Zealand. Penguin currently distributes for only one small independent publisher and therefore the aggregation in this market would be small. The Commission does not consider that the merged entity would have the ability to profitably raise prices for distribution services in New Zealand or to refuse to offer these services in New Zealand due to the strength of existing competition, and the ability of distributors that service international publishers to easily expand to servicing New Zealand independent publishers.

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The applicants' submissions

81. Bertelsmann and Pearson submitted that there are a number of other publishers that self-supply their own distribution services, and offer distribution services to third parties and that these parties would constrain the merged entity.

Existing competition

82. The merging parties and Harper Collins are the only international publishers that currently offer distribution services to New Zealand independent publishers. The Commission has been unable to collect representative market share data for this market. Random House NZ currently represents seven New Zealand independent publishers.⁴⁵ Penguin NZ only represents Awa Press Limited. There are also local distributors that also distribute books for New Zealand independent publishers.
83. The current companies that distribute for New Zealand independent publishers apart from the merging parties are:
- 83.1 Harper Collins;⁴⁶
- 83.2 David Bateman;⁴⁷
- 83.3 Nationwide Books;⁴⁸
- 83.4 Bookreps;⁴⁹
- 83.5 Books R Us;⁵⁰ and
- 83.6 Archetype.⁵¹
84. [
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85. Craig Potton Publishing Limited self-distributes its published books.
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⁴⁵ These publishers are Huia (NZ) Limited, Victoria University Press, Te Papa Press, New Holland Publishers (NZ) Limited, Auckland Art Gallery, Hyndman Publishing Limited.

⁴⁶ Harper Collins represents Bridget Williams Books, Exisle Publishing and Auckland University Press.

⁴⁷ David Bateman distributes for nine New Zealand publishers, these are Spot X, Trio, Lime Grove, Annabel Langbein [] Calico, David Ling, White Knights, Moss, Beatnik.

⁴⁸ Nationwide Books is a []

⁴⁹ Bookreps represents one small New Zealand Publisher Kaka Media.

⁵⁰ Books R Us represents Bush Press, Grantham House and Renaissance.

⁵¹ This is a team of freelance commission sales representatives. []

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86. South Pacific []

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Potential entry

- 87. The Commission considered whether the provision of such services can be imported through the use of distributors located outside of New Zealand. The current distribution service providers from overseas (Australia) tend to provide warehousing and physical distribution services and not the sales and promotion functions to independent publishers overseas.
- 88. Alliance Distribution Services Pty Limited (Alliance) is owned by Hachette Australia. Alliance provides warehousing and physical distribution only and has in the past distributed for Allen & Unwin in New Zealand. The Commission considers that Alliance and other overseas distributors could be alternatives to the merging parties' physical distribution services for New Zealand independent publishers. These services could be used by themselves or in conjunction with sales agents such as Archetype if the full range of services is required.

Conclusion

- 89. The Commission is satisfied that the merged entity would be constrained by a combination of existing competition and the ability other publishers and agents to expand their distribution services to independent publishers.⁵⁵

Competition analysis – market for the supply of books

- 90. The Commission is satisfied that the proposed acquisition will not be likely to have the effect of substantially lessening competition in the market for the supply of books. This is because the Commission does not consider that the merged entity would have the ability and incentive post-merger to raise prices to online and bricks and mortar retailers given the strength of existing competition and the negotiating power of some customers.

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⁵⁴ The proportion of New Zealand books it distributes []

⁵⁵ The Commission notes that a number of the parties spoken to expressed concern that the merged entity may consolidate its distribution services and move the Random House warehouse to Australia which would increase lead times. However, this appears to be a current trend in New Zealand independent of the merger. []

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The applicants' submissions

91. Bertelsmann and Pearson submitted that “the presence of a large number of competitors will constrain [the merged entity’s] ability to increase prices or reduce service levels below competitive levels because doing so would divert wholesale book sales to one of its number of competitors”.⁵⁶
92. Bertelsmann and Pearson also submitted that the merged entity would continue to be constrained by retailers that have a high degree of countervailing power for the following reasons:
- 92.1 bricks and mortar stores are an important gateway to consumers and publishers rely on positioning of their titles in-store and online to drive sales;
- 92.2 the three largest bricks and mortar customers account for a large proportion of their sales; and
- 92.3 retailers can threaten to parallel import.⁵⁷

Existing competition

93. As previously discussed, each publisher supplies a unique range of differentiated products to consumers via retailers, which may be more or less closely substitutable, and retailers require a more or less comprehensive range of titles to offer their customers but also play an important role in promoting books through the allocation of shelf space and in store promotion.
94. Online retailers pursue a larger supply network than bricks and mortar retailers do by sourcing books directly from independent publishers and international book wholesalers (such as consolidators). It is useful to consider these different supply alternatives when assessing the competitive effects of this merger.
- 94.1 As noted, bricks and mortar retailers also try to limit the number of sales agents with which they must negotiate and therefore do not tend to deal directly with independent publishers. Bricks and mortar retailers tend to display their entire stock of books on their store selling floors and pay for books on delivery – this makes the volume purchase decision crucial to such retailers even though most of their books are purchased on a sale-or-return basis. As there are no parallel import restrictions in New Zealand bricks and mortar retailers could also source books from overseas, however, they generally choose not to use this supply option.
- 94.2 Online retailers do not hold stock, rather they order books from the publisher or wholesaler after these are ordered through their internet site. This means they are not limited by physical space and can offer the entire range of publishers’ lists on their sites. New book titles are uploaded automatically

⁵⁶ Application para 18.2 (a).

⁵⁷ Application para 24.1

onto the online retailer’s website either directly from publishers or through updates from Nielson Book Data.^{58 59}

95. The Commission calculated the 2012 market shares for the international publishers and distributors based on sales revenues. These figures include all the books that are sold to retailers by suppliers based in New Zealand including the distribution of both international and local independent publisher’s ‘agency’ books.⁶⁰ These figures show that the merged entity would have a []% market share post-merger. These figures exclude David Bateman and Craig Potton figures which were unavailable, therefore, these market shares are overestimates.⁶¹

Table 2: Market shares for supply of trade books to New Zealand bricks and mortar retailers in 2012⁶²

	2012 Wholesale revenues with agencies \$	%
Penguin	[]	[]
Random House	[]	[]
Merged entity	[]	[]
Harper Collins	[]	[]
Hachette	[]	[]
Macmillan	[]	[]
Scholastic	[]	[]
Allen & Unwin	[]	[]
Annabel Langbein	[]	[]
Bookreps	[]	[]
South Pacific	[]	[]
Nationwide Books	[]	[]

96. Table 2 shows the aggregation in the supply of trade books as it would affect bricks and mortar retailers. As noted above, online retailers have a larger range of supply alternatives not included in these figures such as international consolidators and direct sourcing from independent publishers.

⁵⁸ Neilson Book Data provides book-related data services to more than 100 countries worldwide.

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⁶⁰ These are the books that are distributed on behalf of independent publishers.

⁶¹ While these are representative, one best seller in New Zealand can substantially skew market share data in the year it was released.

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97. Hachette, Harper Collins, Macmillan, Scholastic and Allen & Unwin are all large, international publishers that would continue to provide strong competition for the merged entity. As well as their own books, Harper Collins and Allen & Unwin also distribute for a number of overseas publishers in New Zealand.⁶³ These international publishers have a similar general range to the merging parties.
98. A number of industry players informed the Commission that the purchase of books by end consumers through online retailers, can serve as a price ceiling on the price of books to bricks and mortar retailers. This is because any price increases that the merging parties attempt to impose on its retail customers could result in lower volumes of sales by these retailers, which could in turn result in lower profits for the merged entity. This would thereby discipline a price increase. Alternatively, the merging parties could be in a position to impose a price increase without risk of much impact on their sales if their retail customers are likely to absorb these price increases without exiting or shrinking their business.
99. Furthermore, the price of imports may also be directly affected by the global nature of this merger. Since the merging parties tend to hold rights to the same books globally, the pricing of imported books post-merger (as a price ceiling for books sold by the merging parties locally) therefore depends on the level of aggregation from this merger in other countries and any consequent lessening of competition.
100. The Commission did not consider this issue further due to the strength of other more direct competitive constraints.
101. The Commission considers that the remaining international publishers, Hachette, Harper Collins, Macmillan, Scholastic and Allen & Unwin would continue to provide a strong constraint on the merged entity for the supply of trade books to both online and bricks and mortar retailers. Online retailers would additionally be able to source books from overseas consolidators and independent publishers. Although bricks and mortar retailers do not currently use these sources of books, there are no significant barriers to imports or to sourcing books directly from independent publishers.

Countervailing power of retailers

102. The Commission understands that retailers currently enjoy reasonable levels of bargaining power in their negotiations with wholesalers. As noted earlier, while retailers need access to a range of publishers in order to provide an attractive assortment of books to their customers, they also play an important role in bringing those books to the attention of customers and promoting sales. Retailers negotiate flat discount rates with wholesalers as part of their terms of trade. Currently retailers are able to negotiate additional discounts on lead titles and are free to choose the

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individual titles and the quantities of each title that they order from publishers' lists. Further there is evidence of pushback from retailers on negotiated terms.⁶⁴

- 103. In addition, the Commission considers that some retailers have a degree of countervailing power that would constrain the merged entity post acquisition. This countervailing power is derived from the retailer's ability to switch purchases away from books and towards other products. The Warehouse, Paper Plus and Whitcoulls all sell products other than books. The Warehouse sells a wide range of goods including electronics, clothing, homeware and hardware. Whitcoulls and Paper Plus both sell other product portfolios like gifts, and stationery [⁶⁵]. Faced with an increase in wholesale prices for the merged entity's books these retailers could switch, or threaten to switch, volumes away from books to other products. Publishers value placement on lead tables at the retail store entrance or on the front page of a retailer's website as a marketing tool. The preferential placement of alternative products would likely harm book sales and thereby discipline an attempt to increase the price of books to retailers.
- 104. In the Commission's view retailers are well placed to negotiate with publishers and this is unlikely to change substantially post-merger.

Conclusion

- 105. The Commission is therefore satisfied that the strength of existing competitors and the negotiating power of customers would constrain the merged entity.

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Determination on notice of clearance

106. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the relevant markets.
107. Pursuant to section 66(3)(a), the Commission gives clearance for Bertelsmann SE & Co. KGaA and Pearson plc to form a yet to be incorporated entity (Penguin Random House or other nominee), to acquire the consumer book publishing businesses of Bertelsmann and Pearson.

Dated this 19 day of March 2013



Dr Mark Berry

Chair