

20 May 2019

Blacktop Lawyers
AUCKLAND

Attention: David Blacktop

11.04/43674

Dear David

Letter of issues - Mainland / Inkwise

1. We refer to the application from Mainland Print Limited (Mainland), a joint-venture company owned in equal shares by Blue Star Group (New Zealand) Limited (Blue Star) and Allied Press Limited (Allied Press), seeking clearance to acquire the heatset and coldset web offset printing assets of Inkwise Limited (Inkwise) (the Proposed Acquisition).
2. As advised, we have been unable to reach a decision on Mainland's application for clearance within the initial 40 working day statutory timeframe provided under the Commerce Act 1986 and need more time to reach a decision. This is because we need to investigate some issues further, as explained in this letter.
3. The issues which we need to investigate and analyse before reaching a decision on Mainland's application are whether the Proposed Acquisition would substantially lessen competition in the supply of coldset printing services in the South Island due to:
 - 3.1 unilateral effects by giving a combined Allied Press and Inkwise the ability to profitably raise prices and/or reduce quality to coldset printing customers in the South Island, as a result of the removal of a competitor;
 - 3.2 coordinated effects by making coordination more likely, complete or sustainable; and/or.
 - 3.3 vertical effects by giving Allied Press the ability and incentive to foreclose competing newspaper publishers or raise their costs to render them less competitive in downstream reader and/or advertiser markets for daily and community newspapers.
4. At this stage we are not satisfied that the Proposed Acquisition would not substantially lessen competition due to [3.1] to [3.3]. We discuss each of these issues, in turn, later in this letter.

5. At this time, we are not investigating further, and do not require any further information from Mainland, Inkwise or third-parties in respect of, unilateral effects, vertical effects or coordinated effects in the supply of heatset printing services in New Zealand.
6. In reaching the preliminary views set out in this letter, we have considered information provided by the parties to the Proposed Acquisition and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition issues may arise, as the investigation continues.
7. We will advise you if we identify any further issues during our analysis of the Proposed Acquisition that are not discussed in this letter.
8. We are available to meet with Mainland to discuss this letter.

Process and timeline

9. The Commission would like to receive submissions and supporting evidence from Mainland on the issues raised in this letter. We request that Mainland provides this information by close of business on **Tuesday 4 June 2019**, including a public version of any submission.
10. If Mainland considers it cannot adequately respond by this date, please contact us to discuss timing.
11. We will be requesting that other parties intending to make a submission on the issues in this letter provide their submission by **Tuesday 4 June 2019**, and that they provide a public version of their submission.
12. All submissions received will be published on our website with appropriate redactions. Mainland will have the opportunity to cross submit on the public versions of submissions from other parties. Other parties will also have the opportunity to cross submit on the public version of Mainland's submission. The Commission will not receive cross submissions after the close of business on **Tuesday 11 June 2019**.

The relevant markets

13. The Proposed Acquisition relates to the printing industry, specifically, the printing of newspapers, magazines and retail catalogues.
14. In its clearance application, Mainland submitted that the relevant markets for assessing the Proposed Acquisition are:
 - 14.1 the market for the supply of coldset web offset printing in the South Island; and
 - 14.2 the national market for heatset offset printing services, or in the alternative:
 - 14.2.1 the national market for the supply of printing for national retail catalogues;

- 14.2.2 the national market for the supply of heatset printing to magazine customers with print runs less than 20,000-25,000 copies; and
 - 14.2.3 the national market for the supply of heatset printing to magazine customers with print runs greater than 20,000-25,000 copies.
15. At this stage, we consider that the relevant markets for assessing the Proposed Acquisition are:
- 15.1 the market for the supply of coldset printing services in the South Island;
 - 15.2 the national market for the supply of heatset printing services; and
 - 15.3 downstream reader and/or advertiser markets for daily and community newspapers in areas of the South Island where Allied Press competes with other newspaper publishers (downstream markets).
16. These markets are largely consistent with the markets suggested by Mainland at [14.1] and [14.2], and are consistent with previous decisions of the Commission and the Australian Competition and Consumer Commission.¹ The downstream markets are relevant to our assessment of vertical effects.
17. At this time, we do not think it is necessary to define distinct customer markets for heatset printing (as suggested by Mainland). We can, as part of our competition analysis, consider any differences in competition between suppliers to print magazines versus catalogues, as well as the level of competition provided from sheet-fed printers for smaller print runs.

The factual and counterfactual

18. To assess whether a substantial lessening of competition is likely requires us to compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the acquisition, often referred to as the factual) with the likely state of competition if it does not (the scenario without the acquisition, often referred to as the counterfactual) and to determine whether competition is likely to be substantially lessened comparing those scenarios.
19. In the factual, both the market for the supply of coldset printing services in the South Island and the national market for the supply of heatset printing services would become more concentrated. This is because the Proposed Acquisition:
- 19.1 would reduce the number of suppliers of coldset printing services in the South Island from three to two, due to Allied Press and Inkwise becoming associated entities. The only remaining supplier and competitor would be Stuff; and

¹ PMP Print Limited and APN Print NZ Limited (Commerce Commission Decision 708, 16 December 2010) and PMP Limited and IPMG Group (ACCC Public Competition Assessment, 28 March 2017).

- 19.2 would reduce the number of major suppliers of heatset printing services from three to two, due to Blue Star and Inkwise becoming associated entities. Ovato would be the major remaining supplier and competitor, and the only other supplier with web printing presses.
20. Our preliminary view is that the likely counterfactual is the status quo, where there would continue to be three suppliers in the market for the supply of coldset printing services in the South Island and in the national market for the supply of heatset printing services.

Competition assessment (unilateral effects) – coldset

21. The Proposed Acquisition would combine two of the three suppliers of coldset printing services in the South Island.
22. The first issue that we are still investigating is whether the Proposed Acquisition would substantially lessen competition due to unilateral effects by giving the combined Allied Press and Inkwise the ability to profitably raise prices and/or reduce quality to customers as a result of the removal of a competitor in the supply of coldset printing services in the South Island. We are considering:
- 22.1 whether the Proposed Acquisition would remove meaningful rivalry between Allied Press and Inkwise in the supply of coldset printing services; and
- 22.2 if so, whether Stuff would provide sufficient constraint to compensate for this loss of competition.
23. Evidence shows that the market for the supply of coldset printing services in the South Island is currently competitive and that prices have fallen as a result of Allied Press, Inkwise and Stuff competing to secure volume to utilise their presses. Even though the printing operations of Allied Press are distant from Inkwise (compared to the close proximity of Stuff's coldset printing plant in Christchurch), Allied Press and Inkwise still compete to supply coldset printing services. With the Proposed Acquisition, this rivalry between Allied Press and Inkwise would be lost.
24. The key question that we are continuing to investigate is whether Stuff would provide sufficient constraint to compensate for the loss of competitive tension if the Proposed Acquisition proceeds. In doing so, we are considering the points set out below.
- 24.1 How efficient (in terms of time and cost) Stuff's Christchurch printing plant is at printing newspapers of different sizes² relative to each of Allied Press and Inkwise. Also, how efficient it would be relative to a combined Allied Press/Inkwise with the acquisition. If Stuff is not as efficient in printing all newspapers, this could impact on the extent to which it would constrain unilateral price increases by a combined Allied Press and Inkwise.

² For example, large daily metropolitan papers versus weekly community papers.

- 24.2 How much spare capacity Stuff has to expand its coldset printing work for third-parties in Christchurch using its current inputs (ie, the presses it currently has and the shifts it currently operates).
- 24.3 What costs Stuff would incur expanding its coldset printing work for third-parties beyond the possible utilisation of its existing resources (eg, by increasing the number of shifts at its Christchurch plant). If Stuff faces high costs of expansion, it could be a weak constraint on the ability of the combined Allied Press and Inkwise to unilaterally raise prices or decrease service quality.
25. In terms of other considerations relevant to our assessment of unilateral effects, we note that:
- 25.1 given significant declines in printing volumes, our preliminary view is that there is unlikely to be new entry into the market for the supply of coldset printing services in the South Island. This means that the threat of entry would provide no constraint on a combined Allied Press and Inkwise; and
- 25.2 with the exception of Allied Press and Stuff (which as well as being suppliers of coldset printing services are the major newspaper publisher customers in the South Island), other customers are small and have no ability to self-supply. Given this, our preliminary view is that such customers may not be able to exercise any countervailing power. Countervailing power would therefore also provide a weak constraint on a combined Allied Press and Inkwise.

Competition assessment (coordinated effects) – coldset

26. The second issue that we are still investigating is whether the Proposed Acquisition would substantially lessen competition due to coordinated effects by making coordination more likely, complete or sustainable in the market for the supply of coldset printing services in the South Island. In doing so, we are considering:
- 26.1 whether conditions in the market make it vulnerable to coordination; and
- 26.2 whether the removal of one supplier from the market with the Proposed Acquisition would make coordination more likely, complete and/or sustainable.
27. We consider that suppliers could potentially coordinate by setting higher prices and/or by dividing up customers. We are continuing to investigate whether the market is vulnerable to coordination and the extent to which the ability and incentive for suppliers to coordinate their behavior might be augmented by the Proposed Acquisition.

Is the coldset market vulnerable to coordination?

28. There are a range of market features that make it more likely that firms would be able to successfully coordinate their behaviour to increase their profits. Not all need

be present for a market to be vulnerable to coordination. Nor does the existence of some or all of these features invariably mean that firms would engage in coordinated behaviour.

29. We consider that a number of features of the market for the supply of coldset printing services in the South Island may make it vulnerable to coordination. In particular:
- 29.1 suppliers' products are homogeneous;
 - 29.2 suppliers have information on each other's prices and volumes;
 - 29.3 the market is currently concentrated with few suppliers;
 - 29.4 there appears to be little innovation; and
 - 29.5 there is some symmetry in size and cost structures.
30. These factors may increase the scope for suppliers in the market for the supply of coldset printing services in the South Island to achieve and sustain some level of coordination. We discuss these factors below.
31. We note that the market also has excess capacity, which Mainland argues should make it less vulnerable to coordination. We are considering this argument and, in particular, suppliers' costs of using their spare capacity. If suppliers can readily expand using their existing capacity this can help to sustain coordination by increasing the threat of retaliation in response to individual deviation from coordination.

Homogeneous product

32. All three suppliers of coldset printing services in the South Island are able to print all formats of newspapers. We received feedback that there are no material differences between the quality of newspapers printed by Allied Press, Inkwise and Stuff. The newspapers printed by all three suppliers are similar, largely undifferentiated and homogeneous. This may mean that it is easier for suppliers to reach agreement on pricing levels and more difficult for them to deviate from coordinated outcomes through product differentiation.

Suppliers have information on each other's prices and volumes

33. The evidence currently before us suggests that all three suppliers of coldset printing services in the South Island are able to obtain information about each other's prices and volumes. This is because competitors' prices (or the relativity between prices) is communicated to them by customers as part of price negotiations and through feedback on unsuccessful price quotes. This transparency could make coordination by setting higher prices and/or by dividing up customers more achievable. However, we note that the full terms of customer contracts may not be transparent.

Relatively concentrated market

34. The fewer competitors there are in a market, the easier it is for them to coordinate. This is because it is easier to reach agreement between a small number of suppliers and easier to detect and punish cheating.
35. The market is currently relatively concentrated, with only three competitors in the market for the supply of coldset printing services in the South Island.

Little innovation

36. Evidence shows that there has been little innovation in the supply of coldset printing services. There appears to be static production technology in the printing industry. However, there is evidence from customers and suppliers of significant declines in coldset printing volumes and that suppliers do, and are incentivised to, compete strongly to win and retain customer contracts to utilise their printing presses. If suppliers have this incentive because the market is declining and they want to maximise capacity utilisation, then coordinated effects may be less likely.

Symmetry of size and cost structures

37. All three suppliers of coldset printing services in the South Island operate similar printing equipment (in terms of technology, not necessarily scale of operations). This means that there are likely to be some cost similarities between suppliers in terms of printing costs. In particular, all suppliers are likely exposed to the same changes in major costs of printing (ie, energy, ink and paper). This in turn could make it easier for suppliers to arrive at a tacit understanding making the responses of competitors more predictable and a coordination strategy more stable.
38. Notwithstanding these factors, we note that there are differences in the scale and size of the printing presses operated by Allied Press and Stuff compared with Inkwise and that post-acquisition there would be differences in scale between a combined Allied Press/Inkwise and Stuff. If the cost of printing varies materially with any differences in scale across the current suppliers of coldset printing services, then this may make coordinated effects less likely. We are continuing to investigate this point.

Would the Proposed Acquisition facilitate coordination in the coldset market?

39. We note that where an acquisition materially enhances the prospects of any form of coordination between businesses, the result is likely to be a substantial lessening of competition. This could happen if the Proposed Acquisition is likely to change conditions in the market for the supply of coldset printing services in the South Island so that coordination is more likely, more complete, or more sustainable.
40. While we are continuing to investigate, we consider that the Proposed Acquisition may make coordination more likely, complete or sustainable in the market for the supply of coldset printing services in the South Island. This is because the Proposed Acquisition:
 - 40.1 would result in a market with only two competitors in which coordination would be easier; and

- 40.2 may remove the last remaining competitor with the ability and incentive to disrupt or destabilise coordination.
41. The Proposed Acquisition would eliminate the only competitor to Allied Press and Stuff in the supply of coldset printing services in the South Island. Inkwise provides coldset printing services to a large number of the independent newspaper publishers in the South Island (in particular, weekly community newspapers). While Inkwise has materially less printing capacity than Allied Press and Stuff, Inkwise has significant excess capacity that it could utilise to do more coldset printing work. However, we note that the scale of Inkwise's coldset press means that it may not have the same capability (as Allied Press and Stuff) to print large runs of major metropolitan daily newspapers.
42. We consider that an important issue that is likely to influence our ultimate conclusion on whether or not the Proposed Acquisition is likely to substantially lessen competition due to coordinated effects (ie, whether the loss of one competitor matters in this market), is the role that each supplier currently plays in constraining prices in the market and/or would play in constraining or destabilising any coordination in the counterfactual. Given this, we are continuing to investigate the following points in particular:
- 42.1 the impact that each of Allied Press, Inkwise and Stuff currently have on pricing in the market, including whether they lead price changes, are a price follower and the impact that they have had on each other's prices;
- 42.2 whether the cost of coldset printing materially varies with any differences in scale between Allied Press, Inkwise and Stuff currently, and would vary post-acquisition between a combined Allied Press/Inkwise and Stuff; and
- 42.3 the costs that each of Allied Press, Inkwise and Stuff would incur to expand and the incentives that they have to fully utilise their printing capacity, both currently and in the counterfactual.

Competition assessment (vertical effects) – coldset

43. The third issue that we are still investigating is whether the Proposed Acquisition would give Allied Press the ability and incentive to foreclose competing newspaper publishers or raise their costs to render them less competitive in the downstream markets. In doing so, we are considering:
- 43.1 the extent to which Allied Press (through its shareholding in Mainland) would control the supply of coldset printing services in the South Island with the Proposed Acquisition; and
- 43.2 whether Allied Press would have an incentive to foreclose competing newspaper publishers by raising their costs to render them less competitive with its own newspapers.

44. The extent to which Allied Press would control the supply of coldset printing services post-acquisition depends largely on the views we reach on unilateral effects and the constraint provided by Stuff (discussed above). Whether Allied Press would have an incentive to foreclose competing newspaper publishers depends on:
- 44.1 the extent to which publications of Allied Press compete with those of other newspaper publishers; and
 - 44.2 the costs and benefits to Allied Press of engaging in such a strategy. In other words, whether it is likely to earn sufficient additional profit from a foreclosure strategy to outweigh the costs of any lost sales in terms of the provision of coldset printing services (that might be achieved by Allied Press or Mainland).
45. At this stage, we are not seeking any further information to assist our assessment of vertical effects, beyond the information we are seeking (and questions we are considering) in respect of our assessment of unilateral and coordinated effects.

Next steps

46. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Acquisition. However, we welcome any further evidence and other relevant information and documents that Mainland is able to provide regarding the issues identified in this letter.
47. Please contact me if you have any questions about this letter.

Yours sincerely



Susan Brown
Senior Investigator