

Office of Fair Trading letter to the Department for Business, Enterprise and Regulatory Reform regarding the National Newspapers Code of Practice

The OFT provided advice to the Secretary of State for Business, Enterprise and Regulatory Reform ('Secretary of State') regarding the undertakings underpinning the National Newspapers Code of Practice ('the Code') on 22 October 2008. At that point, the Secretary of State invited interested parties to make representations to him on the OFT's advice, before he made a final decision on the undertakings. Following the receipt of these written representations, the Department for Business, Enterprise and Regulatory Reform ('BERR') invited the OFT to comment on the representations which it had received. The OFT reviewed these representations and confirmed that its advice remained unchanged.

Following a request from an industry party, the OFT has decided, in the interests of constructive and transparent engagement with stakeholders, to publish a copy of the letter it sent to BERR which set out the OFT's comments on the representations which BERR had received. That letter is reproduced below.

Please note that the letter has been edited for publication in accordance with Part 9 of the Enterprise Act 2002 ('Part 9'). Amongst other things, Part 9 requires that the OFT has regard to the need to exclude from disclosure (so far as is practicable) commercial information whose disclosure it thinks might significantly harm the legitimate business interests of the undertaking to which it relates. Those areas in the letter where information has been excluded from disclosure pursuant to Part 9 are shown by the following symbol: [...].

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Dear Jonathan

Review of the National Newspapers Code of Practice

Thank you for your letter of 11 February 2009 in which you asked for the OFT's comments on the representations which the Department for Business, Enterprise and Regulatory Reform ('BERR') has received to its consultation regarding the OFT's advice on the undertakings which underpin the National Newspapers Code of Practice ('the Code'). The OFT has reviewed the representations that you have forwarded to us, focussing upon those specific issues where you asked for the OFT's comments in particular. The OFT's comments on each of those issues are provided below, alongside some high-level comments on potential future developments in self-regulatory arrangements in the national newspaper supply chain, given that most of the representations refer to that issue.

The OFT notes the wide support from industry parties across the national newspaper supply chain for the OFT's advice that signatory wholesaler parties be released from the undertakings underpinning the Code. It is pleasing that the OFT's advice appears to have been relatively well-received from most participants in the national newspaper supply chain and that its contents have been accessible to them.

Whether there is a case for the undertakings to be superseded with fresh undertakings rather than released

As you are aware, the OFT, when conducting a review of undertakings under section 88(4) of the Fair Trading Act 1973 ('FTA73'), is limited to assessing whether the undertakings remain appropriate, by reason of any changes of circumstances, to remedy or prevent the specific adverse effects which the Monopolies and Mergers Commission ('MMC') specified, on the basis of the facts found by the MMC. In this connection, the OFT can only advise the Secretary of State ('SoS') to supersede an undertaking if, having undertaken the above assessment, it considers that it is necessary to do so in order to

remedy or prevent those specific adverse effects on the basis of the facts found by the MMC i.e. the specific adverse effects identified by the MMC must continue to be of concern.

In the case of the Code, the OFT considers that, following its detailed analysis of the national newspaper supply chain, there have been three particular changes of circumstances since the MMC reported which mean that the primary adverse effect which the MMC specified, namely the wholesaler practice of refusal to supply new retail outlets where, in the wholesaler's view, the area was already adequately served, is unlikely to re-emerge in the future in the absence of the Code.¹ In addition, as regards the further adverse effect which the MMC specified, that is the imposition by wholesalers of a prohibition against sub-retailing by retailers, the OFT considers that the changes of circumstances which are relevant to remedying or preventing the wholesaler practice of refusal to supply mean that sub-retailing arrangements are no longer necessary to ensure the availability of national newspapers to consumers.² In these circumstances, it is not open to the OFT under the statutory test to advise that the Code be superseded to address the MMC's adverse effects as they do not continue to be of concern.³

In this context, it is also important to note that the National Federation of Retail Newsagents ('NFRN'), in its representations to BERR, in fact requests an outcome that goes significantly beyond the statutory remit on which the Code is based. The NFRN states that it would not support the release of the Code unless it is to be superseded by legislation that regulates the behaviour of publishers and wholesalers, or by a "*new, wider Code*" that is expanded under a new reference under the Enterprise Act 2002 to include magazines and all of the UK, rather than specifically indicating that the undertakings underpinning the existing Code should be superseded by new undertakings under the FTA73.⁴

In relation to the specific issue of whether there is a continued need for regulation to impose upon wholesalers an obligation to supply, the OFT considers that national newspaper publishers have a strong incentive to encourage availability of their titles to maximise profits from both copy sales and advertising, and to counteract generally declining national newspaper

¹ These changes of circumstances are the changes in the level of Carriage Service Charges ('CSCs'), changes in the role of publishers in the national newspaper supply chain and changes in the composition and relative prominence of different types of retail outlet.

² The OFT's analysis regarding sub-retailing is included in OFT 1026, *National newspapers, A review of undertakings relating to the supply of national newspapers in England and Wales (the Code of Practice)* (October 2008) (hereafter OFT 1026) at paragraphs 4.58 to 4.61.

³ The OFT has also considered a number of potential variations to the Code during its review. Its conclusions on these variations can be found in OFT 1026, paragraphs 5.11 to 5.20.

⁴ *NFRN response to the Secretary of State's consultation on the National Newspapers Code of Practice in England and Wales*, page 1.

circulations.⁵ Given these incentives to encourage availability, national newspaper publishers have incentives to impose and monitor obligations on their wholesalers regarding supply to new retail outlets. [...].⁶

The impact of the removal of the Code on CSCs to smaller independent retailers

The OFT has considered the specific issue as to whether the removal of the Code could provide wholesalers with an opportunity to impose unreasonably high CSCs on smaller independent retailers. It is important to note that condition 4 of the Code, which relates to CSCs, only requires wholesalers to:

"[determine] carriage charges, which reflect the commercial and economic distribution costs of wholesalers in the handling of national newspapers ... by reference to the wholesaler's published tariff available at the time of application and as determined from time to time."

The limitation on CSC levels in the Code is therefore general in nature and does not appear to place a specific cap on CSCs or to significantly restrict the ability of wholesalers to charge higher CSCs. Indeed, it is important to note that the growth in CSC levels, which the OFT identifies in the review of the Code,⁷ has occurred since the Code was implemented, indicating that the Code does not prevent wholesalers from imposing higher CSC levels.⁸ In addition, according to evidence the OFT has obtained during the Code review, CSCs recovered around 74 per cent of wholesaler distribution costs in 2006 (the last year for which it has detailed information).⁹ Therefore, wholesalers would be able, whilst still complying with the provisions in the Code on CSCs, to impose a significant increase in CSC levels, such that they recover the full cost of distribution.¹⁰ These facts indicate that the Code itself does not

⁵ Further explanation of these national newspaper publisher incentives can be found in OFT 1026, paragraphs 4.27 to 4.30.

⁶ [...]

⁷ OFT 1026, paragraphs 3.29 to 3.34. The OFT notes that there is evidence that the average growth in CSC levels has moderated in recent years; evidence provided by [...] shows the compound average growth rate in CSCs to have been 3.3 per cent per annum between 2000 and 2005, the most recent years for which the OFT has detailed information.

⁸ Indeed, the NFRN has argued that the imposition of the Code was one of the factors that led to the growth in CSC levels during the 1990s. This is because the NFRN considers that the Code changed the principle that CSCs were a contribution to support the cost of distribution to remote rural retailers, which had previously restricted CSC growth (*NFRN Submission on the Code to the OFT*, 20 October 2006, page 31).

⁹ OFT 1026, paragraph 4.15.

¹⁰ The OFT notes the NFRN view that the figure of 74 per cent for the proportion of wholesaler distribution costs covered by CSCs was based on the OFT accepting a wholesaler assertion and based upon information from one source (Lucidea consulting). The OFT understands that the figures the multiple

significantly impede increases in the CSC levels charged by wholesalers. The OFT considers that, although removal of the Code would of course release wholesalers from its requirements in relation to CSCs, this would not, in itself, increase the prospect of wholesalers imposing unreasonably high CSC levels on smaller independent retailers for the reasons given below.

The OFT considers that there are two particular factors which mean that wholesalers are unlikely to be in a position to impose unreasonably high CSCs on smaller independent retail outlets, namely the emergence of a system of national CSC templates, and the role of publishers in imposing and monitoring obligations on their wholesalers.

Firstly, the OFT notes that since 2002 each of the three multiple wholesalers has adopted transparent, national CSC templates which are applied to all types of retailers they serve.¹¹ This means that it is less likely that wholesalers would vary CSCs so that they charge higher CSCs to smaller independent retail outlets than they would for other types of retailers. Secondly, the OFT notes that there is also evidence that national newspaper publishers monitor CSC levels, with one major national newspaper publisher requiring the wholesaler to provide it with a copy of its current CSC template, and the formula applied to calculate annual increases; the wholesaler is obliged to inform the publisher if it intends to vary from this formula.¹² Given the strong publisher incentives to ensure the wide availability of their titles, which we have referred to above, publishers have strong incentives to take action to restrict wholesalers from imposing excessive CSCs which could lead to retailer exit and consequently reduce the availability of their titles.

The OFT has specifically considered the views of some industry participants, expressed during the Code review, that there is a requirement for more detailed regulation of CSCs. It is important to note that detailed regulation of CSCs falls outside of the scope of a solution to remedy or prevent the adverse effects specified in the MMC's report on the facts found by the MMC. The MMC, at various points in its report, refers to CSCs, but at no point in its report does it link CSCs, directly or indirectly, to the adverse effects specified in its report. Any variation to/superseding of the Code to address CSCs, therefore, falls outside the applicable statutory remit for the review of the Code.¹³

The economic case for wholesalers to supply remote retail outlets in the absence of the Code

wholesalers provided to Lucidea consulting were subject to independent audit to ensure accuracy of definitions and correct apportionment of costs.

¹¹ Except in very limited circumstances, such as the template which one wholesaler applies for supply to rural retail outlets, which we refer to on page 6 of this letter.

¹² OFT 1026, paragraph 3.16.

¹³ OFT 1026, paragraph 5.14.

It is important to note that, consistent with the adverse effects which the MMC specified on the facts found by the MMC, the Code only applies on a statutory basis to the supply of national newspapers to *new* retail outlets. Therefore, any supply to *existing* retail outlets in remote areas would be on a voluntary basis and not pursuant to the statutory basis under the Code.

The OFT appreciates the possible political sensitivities regarding the maintenance of supply to retailers in remote areas, and has carefully considered during its review whether there would likely be continued supply to retail outlets with smaller news bills; it is relevant to note that these would include retail outlets in remote areas given lower population densities in these areas.¹⁴ The OFT considers that two of the changes of circumstances which it identified in its review of the Code would be relevant to ensure continued supply to these types of retailers, that is the changes in the level of CSCs and the changes in the role of publishers in the national newspaper supply chain. The reasoning for this is explained below. It is important to note that, although the focus of the OFT's review has been on supply to new retail outlets, the OFT also considers that these changes of circumstances would mean that the possible practice of refusal to supply is not likely to be significant regarding existing retail outlets.¹⁵

Firstly, as regards changes in CSCs, the changes which the OFT has identified to the level of the CSCs, particularly the significant growth in the minimum CSC levels, provides wholesalers with a significantly increased minimum amount of revenue from supplying new retail outlets now than was the case in 1993, regardless of whether there are increased overall newspaper sales arising from that supply. This means that wholesalers would be more likely to have a commercial incentive to supply retail outlets with smaller news bills (including those in remote areas) as the increased CSC revenue obtained, when combined with the wholesaler margin, would be more likely to meet the incremental costs of supply to a new retail outlet.¹⁶ In this context, we note one wholesaler indicated to the OFT that it considered that the incremental costs of supply were met for all, but a limited number of the retail outlets that it serves.¹⁷

¹⁴ To the extent that such remote retail outlets have large news bills, those newsbills themselves would be likely to justify continued supply given the revenue they would provide to the wholesaler. In addition, where such retailers are part of a multiple group, the change of circumstances which the OFT identified regarding the changes in composition and relative prominence of different types of outlets (OFT 1026, paragraphs 4.38 to 4.57) would be relevant.

¹⁵ OFT 1026, paragraph 5.9.

¹⁶ See OFT 1026, paragraphs 4.10 to 4.12 for more information on this issue. Footnote 137 of OFT 1026 considers the difficulties associated with calculating incremental cost in this sector.

¹⁷ [...].

Secondly, regarding the increased role of national newspaper publishers in the national newspaper supply chain, as referred to above, publishers have a strong incentive to encourage the availability of their titles and can do so by imposing contractual obligations on their wholesalers to supply retail outlets in their allocated territory (including individual retail outlets in remote areas). This incentive applies to continued supply in remote areas, as well as other areas. In addition, and specific to retail outlets with smaller news bills, the OFT notes that national newspaper publishers have specific incentives to ensure the continued availability of Home News Delivery ('HND') services to consumers, given their specific importance in counteracting declining newspaper circulation.¹⁸ As HND is most often provided by smaller retail outlets, the beneficiaries of this aspect of national newspaper publishers' incentives would be those retail outlets. Finally, the OFT has raised the specific issue of supply to rural retail outlets with a major national newspaper publisher; that publisher has emphasised specifically that the wide availability of its newspapers, including to rural areas, is of particular importance to its position as a "national" newspaper publisher.¹⁹ This would be likely to give it an incentive to take action to ensure that its newspapers are widely available on a national basis.

The OFT considers that the commercial incentives on wholesalers to supply to retail outlets, created by the changes in the level of CSCs and the publisher incentives to encourage availability, provide a strong economic case for the continued supply of newspapers to retail outlets, including those in remote areas. However, the OFT cannot rule out the possibility that there may be individual instances of wholesalers refusing to supply retail outlets in limited circumstances, although, the OFT considers that the changes of circumstances above mean that any general practice of wholesaler refusal to supply on the basis that an area is already adequately served, that is the adverse effect which was identified by the MMC on the facts found by the MMC, is unlikely to re-emerge in the future.

In addition to the above, which deals with the economic case for continued supply and which is discussed in the OFT's advice, it is also relevant to note that, in practice, each of the wholesalers has adopted specific arrangements to ensure the supply of newspapers to remote retail outlets which are independent of the supply application process in the Code. In particular, the OFT is aware that each of the wholesalers waive the Minimum Entry Level to certain retailers in rural areas or where they identify a social need to do so.²⁰ The OFT is also aware that one multiple wholesaler has also put in place a specific CSC tariff for supply to certain retail outlets in more remote areas to facilitate supply to them.²¹ Given that these arrangements to facilitate the

¹⁸ OFT 1026, paragraph 4.29.

¹⁹ [...]. [...] also emphasised at that meeting that availability of its titles in rural areas was an important concern for advertisers which use its publication for classified and display advertising.

²⁰ Each of the wholesalers' have confirmed this to the OFT. [...].

²¹ [...].

supply of national newspapers to rural retail outlets are independent of the Code, the OFT sees no reason why they should not continue into the future in the absence of the Code such that, as a practical matter, retail outlets in remote areas would thereby continue to be able to access national newspaper supplies into the future.

Self-regulatory developments

The OFT has noted the proposals from several industry parties to agree some form of new code of conduct in relation to the supply of newspapers (and magazines). As set out above, the OFT does not consider that the Code remains appropriate to remedy or prevent the specific adverse effects identified by the MMC, due to the changes of circumstances which have been identified in the OFT's advice to the SoS. The OFT, however, welcomes the industry seeking to take appropriate steps towards self-regulation that would improve the distribution of newspapers and address any issues in the newspaper (and magazine) supply chain(s) that are of concern and/or may raise competition concerns (including issues which were not within the scope of the adverse effects of the MMC's findings), provided that any such steps comply with competition law. The OFT considers that it is appropriate for industry parties themselves to develop such self-regulatory initiatives, based on their experience and expertise. Nonetheless, the OFT has recently responded to an approach from the Joint Industry Group ('JIG'), which represents industry parties across the national newspaper supply chain, and has referred it to the OFT's published guidance regarding the application of aspects of competition law to the activities of self-regulating bodies. The OFT has also invited the JIG to a conference that the OFT will shortly be hosting to discuss issues regarding effective self-regulation.²² When any self-regulatory initiatives are at a more advanced stage, the OFT would be willing to discuss with industry parties specific issues regarding developments in self-regulation which they might raise.

Conclusion

The OFT has carefully considered the points raised in each of the representations which BERR has forwarded to us. It notes the wide support from industry parties across the supply chain for the OFT's advice that signatory wholesaler parties be released from the undertakings underpinning the Code. Having considered the detail of these representations we can confirm that, in the light of the issues raised, we do not consider it necessary to amend or supplement the advice which we originally provided to the SoS on 22 October 2008.

Should you have any questions regarding this letter, or any aspect of the OFT's advice to the SoS, please feel free to contact me.

²² A copy of this letter was provided to you on 5 February 2009.

Yours sincerely

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Markets and Projects, Goods**

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