



Fairfax/NZME – review of the Commission’s proposed counterfactual

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1. Introduction and executive summary

1. We have been asked by Russell McVeagh to review a letter from the Commerce Commission, dated 6 March 2017, setting out the Commission's view of the relevant counterfactual in respect of the Fairfax/NZME merger.
2. The Commission's counterfactual []. However, in our view the evidence put forward by the Commission does not rebut the parties' counterfactual, []. In fact, the evidence put forward by the Commission is completely consistent with [], and is more consistent with the parties' counterfactual than the Commission's. Our analysis of these issues is set out in section 2 of this report.
3. Nevertheless, if the Commission's counterfactual were assumed to be the correct one, we go on in section 3 of this report to consider the implications of this counterfactual for the benefits and detriments of the proposed Fairfax/NZME merger. A key finding is that the counterfactual [].
4. We find that the present value of the quantified net benefits of the merger would be []. Therefore, for the combined quantified and unquantified effects of the merger to *not* result in a net public benefit, the present value of any unquantified detriments would need to exceed the present value of the quantified net benefits, being [].
5. We then review the plurality effects of the Commission's counterfactual against the factual:
 - a) Under the Commission's counterfactual, Fairfax and NZME would remain as two voices, but []:
 - i. [];
 - ii. []; and
 - iii. []
 - b) Under the factual, there would be one less major news organisation, but the merged Fairfax/NZME would be more sustainable and able to fund:
 - i. Quality journalism;
 - ii. Print; and
 - iii. More journalists, including in communities outside major metropolitan areas.
6. Without any way to measure the welfare impacts of these effects, we think it is difficult to state that plurality would be materially higher under the counterfactual than the factual. And even if that could be said, [].

2. The Commission's proposed counterfactual

7. Based on PwC's analysis, each of Fairfax and NZME have submitted that the likely counterfactual involves [].
8. [].
9. [].

- 10. [].
- 11. [].
- 12. [].
- 13. [].
- 14. [].¹ []:
 - a) [];
 - b) [];
 - c) []; and
 - d) [].
- 15. [].
- 16. [].
- 17. []:
 - a) []; and
 - b) [].

18. In Table 1 below we set out specific comments on each of the Commission's paragraphs proffered as evidence for its proposed counterfactual.

Table 1
Specific comments on the Commission's evidence in relation to its proposed counterfactual

Evidence proffered by Commission (including paragraph number)	NERA comment
[]	[].
[].	[]. ²
[].	[].
[].	[].
[].	[].
[].	[].

¹ [].

² [].

[] [].

[]. [].

19. We understand Fairfax and NZME will respond specifically on [10] of the Commission's letter.

20. Regarding [11] of the Commission's letter, we break this down by sentence in Table 2 below.

Table 2
Specific comments on the Commission's paragraph 11

Commission paragraph 11 sentence	NERA comment
[]	[]
[]	[]
[]	[]

21. We understand that each of Fairfax and NZME will comment on [12] to [14] of the Commission's letter, as appropriate. However, we do note [].

3. Implications for benefits and detriments

22. [], in this section we set out the implications of this counterfactual for the benefits and detriments of the proposed Fairfax/NZME merger.

23. Under the Commission's counterfactual, [].

24. [].

25. []³ [].⁴

26. []. However, the counterfactual would also lead to loss of consumer surplus, as print output reduces and journalistic quality decreases. Therefore, the factual would entail consumer surplus gains compared to the counterfactual.

27. Again, as it is unclear how the Commission views []. However, the parties have stated to the Commission [].⁵ As an indication, we consider two scenarios:

³ [].

⁴ [].

⁵ For example: see [], [], and [].

- a) [].⁶ [].⁷; and
- b) []:⁸
- i. []; and
- ii. [].⁹
28. [].¹⁰
29. As noted, cost reductions of this sort would reduce consumer surplus. It is conceptually possible that the value of the reduced consumer surplus would exceed the quantum of the cost reductions, and the opposite is also conceptually possible. Accordingly, our best measure of the value of the reduced consumer surplus is the quantum of the reduced costs. Therefore, the most appropriate approach is to continue to use the existing benefit quantification as the best indicator of the size of the benefits – the lower cost saving benefits would be offset by the higher consumer surplus under the factual.
30. Accordingly, setting aside the issue of plurality for the moment, the net benefits of the proposed merger would be:
- a) Significantly positive []; and
- b) More positive than the (quantified) net benefits under the draft determination.
31. In Table 3 below we set out our assessment of the quantified benefits and detriments of the proposed merger as against the [] counterfactual.

Table 3
Adjustments to Commission's benefit/detriment calculations, comparing the factual to the Commission's proposed [] counterfactual

Year	Counterfactual	Quantified detriments ¹¹	Quantified benefits less one-off costs ¹²	Quantified net benefits
1 (2018)	Status quo	[]	[]	[]
2 (2019)	[]	[]	[]	[]

⁶ [].

⁷ [].

⁸ [].

⁹ [].

¹⁰ [].

¹¹ As re-estimated by us in our 25 November 2016 report, and decreasing by 10% per annum as discussed above, assuming there are any detriments to competition.

¹² We use the Commission's assessment of quantified benefits and one-off costs, and assume that all one-off costs occur in year one of the analysis.

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3 (2020)	[]	[]	[]	[]
4 (2021)	[]	[]	[]	[]
5 (2022)	[]	[]	[]	[]

32. Therefore, for the combined quantified and unquantified effects of the merger to *not* result in a net public benefit, the present value of any unquantified detriments would need to exceed the present value of the quantified net benefits, being [].¹³
33. If the Commission determines that plurality effects can be considered a relevant detriment, then it would need to account for an ongoing weakening of plurality []. The Commission did not carry out this analysis in the draft determination, but instead simply analysed existing plurality.
34. The diminution of journalistic perspectives and voices may be particularly stark in the regions, where the economics of financing journalism are likely to be even more challenging than in the metropolitan areas. This is particularly impactful, as the Canadian Public Policy Forum's recent research report on news media in the digital age repeatedly highlights the importance of local news to communities. The report notes the important civic function that small-city daily and weekly newspapers provide: a mix of news, community information, and local advertisement that connects residents with where they live and can be crucial in election periods.¹⁴
35. The economics of financing regional journalism are likely to be more difficult under the counterfactual than the factual. The merged entity is likely to be better able to finance that journalism than either Fairfax or NZME under the counterfactual. Because of improved scale, synergies and sustainability, the merged entity would be better able to take advantage of economies of scope in respect of regional journalism, and to exercise options (e.g., to invest in new revenue generating initiatives). The annual synergies of [] (as calculated by PWC) would present the merged entity with cash to invest that the firms would not otherwise have, and the improved sustainability should also improve the merged entity's ability to raise further cash.
36. To summarise:
- a) Under the Commission's 6 March 2017 [] counterfactual, Fairfax and NZME would remain as two voices, but would []:
 - i. [];

¹³ Using a 10% discount rate.

¹⁴ The Shattered Mirror: News, democracy, and trust in the digital age. Public Policy Forum, 2017. pp. 50-52.

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- ii. []; and
 - iii. []
- b) Under the factual, there would be one less major news organisation, but the merged Fairfax/NZME would be more sustainable and able to fund:
- i. Quality journalism;
 - ii. Print; and
 - iii. More journalists, including in communities outside major metropolitan areas.
37. Without any way to measure the welfare impacts of these effects, we think it is difficult to state that plurality would be materially higher under the counterfactual than the factual. [].

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