

22 May 2006

Nicky Beechey
Chairperson
Commerce Commission
P O Box 2351
WELLINGTON

via email

Dear Nicky

Quantitative Analysis – Television Viewers

Further to our letter dated 18 May 2006, we have attached to this letter three statements from the expert economists/econometricians we have retained to assist us with responding to the Commission's paper entitled "What Drives Television Demand for NPC Rugby". We have also attached a further copy of our 18 May letter so that all of the relevant material on behalf of the NZRU can be considered together.

In summary, the attached statements make the following main points:

- a) Professor Rod Fort – a world renowned expert in the field of sports economics and a very experienced econometrician considers that there are a number of problems with the Commission's model which mean that the results would not provide a reliable basis for reaching the conclusion that uncertainty of outcome does not matter to the TV viewer. He points to:
 - (i) A lack of variation in the data which for reasons he expands on are likely to mean that the standard tests of statistical significance will be reduced in power and the regression results misleading.
 - (ii) The methodology uses too narrow a definition of Uncertainty of Outcome and misinterprets a number of the variables. He notes that a number of the variables used to measure match quality and other matters actually measure match uncertainty, season uncertainty and consecutive season uncertainty.
 - (iii) The use of income to measure price is flawed.
 - (iv) Multicollinearity in the analysis of a plethora of variables.
 - (v) Modelling the old Air New Zealand NPC competition can only give an indirect insight into the new competition.



He finds that the conclusion in the Commerce Commission's report that uncertainty of outcome is not a significant determinant of TV demand for NPC matches is not actually supported by the analysis. Econometric issues, rather than true insignificance explain why 19 of 26 variables are found to have no statistical significance. Further, two of the five variables that are found to be statistically significant actually measure aspects of uncertainty which supports the idea that uncertainty matters to viewers.

He also notes that much of his original statement in support of the NZRU's proposed Salary Cap was based on benefits flowing from an increase in the quality of performance in the new competition. He notes that the Commission study shows that quality matters to viewers and sees even further benefits flowing to viewers as a result of this conclusion.

- b) Dr Adolf Stroombergen, the Chief Economist of Infometrics, with more than 20 years experience in economic modelling, has also concluded that the work undertaken by the Commission is not a reliable basis for concluding that there is no relationship between uncertainty of outcome and television audience size. This is due to a number of econometric factors relating to model estimations, multicollinearity and measurement error. He also points to some non-econometric factors which tend to undermine the reliability of the conclusions in his opinion, noting:
- (i) An increase in the number of TV viewers is only one aspect of the benefit of a more even competition, the other is the increased enjoyment by existing viewers;
 - (ii) The entry of weaker teams into the Air NZ Cup means that the variation in the number of TV viewers under the NPC may be much lower than the variation in viewer numbers under the Air New Zealand Cup in the absence of a method of generating a more even competition.
- c) Brown Copeland & Co Limited. This report focuses on a number of qualitative matters which the NZRU submits are material to the Commission's consideration of the quantitative analysis and support the NZRU's submissions in its letter of 18 May 2006 that the quantitative analysis needs to be considered in a wider context. These include:
- (i) The difference between the NPC Division 1 and Air New Zealand Cup competitions.
 - (ii) The Salary Cap's principal purpose is to improve team quality by:
 - forcing Rebel Sport Super 14 players to be more evenly spread; and
 - forcing "fringe" Air New Zealand Cup players (i.e. those players who may not make the starting 22 in the major unions but who are

- clearly talented enough to play for other unions whose playing roster does not include as many Super 14 players) in the major Unions to transfer or be loaned; and
- a more even competition leads to improved player performance/quality.
- (iii) There are very few options for the NZRU to influence the variables the Commerce Commission has found to be statistically significant apart from improving team performance via the Salary Cap.
- (iv) Even if it was accepted that there was no increase in the number of viewers there is still additional benefit to the TV viewer from watching a “better” game of rugby that he or she would have watched anyway.
- (v) The extra benefit to existing viewers can still be confidently (and conservatively) calculated as being in the range of 0.60c - \$1.20 per person viewing.
- (vi) The Commerce Commission’s data does not include non-subscribers who may be more sensitive to even matches.
- (vii) The quantitative analysis in the Commission paper has to be seen in the context of the qualitative information available including the views of those who make commercial decisions about whether these benefits exist (such as NZRU and Sky TV) and the evidence of overseas leagues where a Salary Cap would appear to have led to greater benefits to TV viewers and broadcasters have shown a willingness to pay higher prices for TV rights.

In light of these reports, the NZRU submits that whilst the Commerce Commission’s report is interesting and innovative, it presently suffers from too many econometric flaws that are too difficult to rectify easily or quickly and hence it should not be given much, if any, weight by the Commerce Commission in formulating its final determination. The better view at this point is that there will be greater audience attractiveness to the concept of a more even and better quality Air New Zealand Cup competition as a result of the Salary Cap compared to the same competition without such a cap.

In the event that the Commerce Commission is minded to rely on the findings in its econometrics report, the NZRU again refers to the material that it has already provided in relation to how the Salary Cap will improve the quality of the Air New Zealand Cup competition which can be found at:

- a) Rod Fort-his first statement at paragraphs 84,89 and 90(attached as Schedule H to the NZRU’s original application). Professor Fort notes that the cap provides players with an incentive to train harder and concludes at para 90 that he expects that play “will be strengthened top to bottom” relative to there being no Salary Cap.

- b) Wayne Smith – As set out in his statement of 31 March 2006, Wayne Smith coached under a salary cap regime in England and he specifically states his observation that the evenness of competition “was a very important factor in the increase in player skills in that competition” with there being no better environment to develop as a player than such a hugely competitive competition (para 9). And now as an All Blacks Selector and Assistant Coach, he records that the All Blacks Selectors envisage higher skill levels arising from the proposed NZRU Salary Cap (para 13) competition;
- c) Ian Schubert – he notes in his statement of 30 March 2006 regarding the impact of the more even competition that has resulted from the Salary Cap in the NRL that in the performance of players has been enhanced due to the competitive nature of the clubs to ensure that they produce the best results from the players that they have on the roster and are developing, and increased game time for the best players (see his comment on para 576 of the Draft Determination);
- d) the NZRU’s own experience referred to at paragraphs 31.4.1 and 34.4.2 of its original application; and
- e) the Brown Copeland original statement at paragraphs 66-68(Schedule J to the original application).
- f) support for the view that there will be benefits to TV viewers from a higher quality competition can be taken from the letter that the NZRU understands Sky Television is sending to the Commission regarding this analysis.

Finally, the NZRU submits that the Commission could confidently apply the same quantification formula to the additional benefits to TV viewers from a more attractive game as adopted previously (in Decision 281) and as referred to in the Brown Copeland reports in the absence of any better or even any alternative approach suggested by any interested party.

Please contact me if there is anything arising from the above or the attached material that you would like to discuss.

Yours faithfully



Keith Binnie
General Counsel