

27 February 2017

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Commerce Commission
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By email

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Dear Katie and Gavin,

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FAIRFAX/NZME: TAKING STOCK

1. As is usual in a lengthy Commerce Commission Investigation Process, a significant number of issues have been raised and dismissed by the Commission in the course of its investigation process. The Commission has issued a draft determination, held a conference, held a number of interviews which have been provided to us on a counsel only basis for comment, and has accepted further submissions from both the parties and third parties, to assist in crystallizing the issues before the Commission for determination.
2. The purpose of this letter is to reflect back to the Commission how we understand the Commission to be framing the last points that it needs to consider in order to reach a final determination, and the parties' position on those points.
3. We would be grateful if you could let us know if the articulation of the issues does not agree with your focus at this stage in the process, or if there is information that has been provided in this letter or otherwise, that the Commission has doubts about or does not agree with. This will provide us with an opportunity to ensure those issues are on the table for the meetings between Commission staff and each of the senior teams of Fairfax and NZME on 1 and 7 March 2017, respectively.
4. At its core, we see the differences in this process to be a contest between hard data on the one hand, and wishful thinking on the other - the parties have submitted extensive data, about revenue shares in the advertising market, market trends in revenue, synergies, and efficiencies, and accounting expert reports on the logical and necessary conclusions from that data.
5. In contrast, a large number of submitters in opposition have presented the Commission with their views as to why the businesses have not been successful (although they have not run those businesses in the recent – accelerating - market conditions). They have also expressed hope that different combinations of businesses in market might present a better alternative to the proposed merger.

6. But as the Commission is aware from the evidence at the conference, this proposed combination was not put to the Commission lightly, or early. The necessary corollary of that is that it cannot be put to the Commission later, because later will be too late.
7. In this respect, Fairfax and NZME were much encouraged by the Commission's statement in relation to the Vodafone/Sky decision where the Commission emphasised the necessarily forward looking, and not short term, focus of the Commission's factual and counterfactual assessment.
8. In relation to these markets, that assessment necessarily engages the ultimate fate of large scale print operations, in relation to which there is considerable evidence both in New Zealand and overseas, the consequence of which is, of itself, likely to be a detriment to public.
9. Most recently this phenomenon was highlighted in the January 2017 report prepared by the Canadian Public Policy Forum, "The Shattered Mirror: News, Democracy and Trust in the Digital Age", a copy of which is attached to this letter. Section 1, which highlights the trends for print, also reinforces the importance of a robust and financially sustainable news media. Page 99 also sets out competition policy recommendations. The clear conclusion to be drawn from this report is that allowing the current trends of financial decline to continue is itself a significant public detriment. Maintaining financially sustainable print media businesses is the true public benefit, for the reasons outlined by Fairfax and NZME in the Commission's conference.
10. In relation to the digital space, understanding the competitive trends also involves the Commission recognizing, as it did recently in Vodafone/Sky, that mobile and video is where the market for news and entertainment is growing rapidly. In that context, the Commission must also recognize the considerable advantages that the free to air operators have in producing news and entertainment for mobile and video distribution. Equally there is a considerable degree of self-supply as consumers and businesses create and distribute their own video and text news and distribute it via mobile through Facebook, YouTube and other channels. In relation to a number of news items, the media organizations are effectively the distributors of consumers' and businesses' own video content, which they release through the channels of their choosing.
11. To the extent that more detailed investigative work or opinion pieces may be the Commission's concern, the Commission must also reflect the costs of compiling that work, which are primarily journalist salaries. Contrary to the position if you are producing a print product, in a digital offering, those costs are perfectly scalable, they do not represent a barrier to expansion. The Commission must also recognise the role that magazines and specialist publications, as well as other newspapers, play in creating content of that nature, such as the Listener (owned by Bauer, that has also recently launched noted.co.nz, which has a number of long form articles on it of that nature), and also the NBR for business, and now Sun Media and other regional papers have created Newsie, for regional and local news from across the country, Jennings/Murphy's Newsroom, also The Spinoff for opinion pieces, and the list goes on.
12. Simply put, there is no exclusivity in the creation of news content, it is freely available. There are no barriers to entry or expansion in the creation of news content, journalists can be hired. There are no barriers to switching for consumers, especially in the digital space where consumers can switch between sources of information with a click or a Google search.

13. To the extent there is reporting about the public sentiment of the merger, for example, the recent Horizon poll, that predominantly highlights the general levels of antipathy to the Transaction. The number of people who do not care or do not know whether they support or oppose the merger is the same as the number of people who when asked said they did not think it should proceed. When added to the number of people who support the merger, the poll, even with its dataset and methodological flaws, indicates the majority of New Zealanders, either do not care or concede they don't know enough to form a view, or support it.

The Commission and Parties agree

14. In its draft determination, after careful investigation the Commission made a number of findings the parties agree with the Commission on:
 - (a) The parties do not compete in any print newspaper market for metro dailies. Each of The New Zealand Herald, the Dominion Post, The Press, and so on are effectively the last remaining survivors in their respective geographic areas of the pressures that market dynamics have placed on print publication. Advertisers and consumers of those print publications do not relevantly overlap.
 - (b) Syndication of news content by NZME, and coordination on national advertising programs through the NAB, will continue unaffected post-transaction.
 - (c) Even on the overlaps modelled by the Commission in its draft determination, the maximum financial detriment arising from this transaction to New Zealanders, is substantially outweighed by the efficiencies arising through cost savings in synergies that the transaction will produce. So on a financial analysis the benefits of the transaction exceed the detriments.
 - (d) There will be no substantial lessening of competition in digital advertising. KPEX will continue to operate as an open access platform for the sale of New Zealand digital advertising inventory including digital inventory from the parties, TVNZ, Media Works, and other publishers who wish to participate in it, and NZME2's shareholding in KPEX will be only [] following the merger.

Outstanding points for resolution

15. The Commission found in its draft determination that horizontal overlaps between the parties would give rise to a substantial lessening of competition in respect of community newspapers, Sundays, and in relation to "premium digital advertising", which the Commission described as including advertising such as homepage takeovers.
16. As you know, the parties' position on the community newspaper overlap is that this conclusion is simply not right - nor is it of any significance in the broader scheme of the benefits of this transaction.
17. Twelve years ago the Commission found, when considering a 2 to 1 merger of community newspapers, that even then, community newspaper advertisers and readers had a number of options. At that time, they were primarily in the nature of flyers, and the low barriers to entry and expansion in community papers.

18. Plainly Facebook has made a significant difference to those options, and the data the parties have provided show that community newspaper advertising pricing has fallen in almost all areas of New Zealand and that there is no linkage between the rate of decline in those community newspaper advertising prices and whether or not NZME and Fairfax directly compete with one another in a particular circulation area. That is inevitably a direct result of the competitive alternatives from Facebook and other digital media. Facebook and other digital media have equally provided an alternative source of local information for readers of community papers. The suggestion that the transaction could give rise to any market power in community newspapers in any of the ten regions is extraordinary in today's dynamic market environment.
19. Equally, the community paper overlaps need to be put into context of the wider benefits of the transaction. The overlap papers account for less than [] of each party's total revenues. [].
20. In relation to the suggested "premium digital advertising" (homepage takeover) overlap, the parties have provided significant further evidence as to why that is not a relevant market, or consideration, from an antitrust perspective. Digital advertising is dynamic, and competitive.
21. The parties are proceeding on the assumption that, as set out in the Commission's draft, the pivotal issues which the Commission needs to resolve in order to reach a final decision in relation to this application, are:
 - (a) The overlap between the parties' digital news sites; and
 - (b) Broader plurality considerations.

Framework for assessment

22. The key issues that we understand that the Commission is focussed on, in order to resolve the outstanding issues set out above, are as follows.

The counterfactual
23. The draft determination outlined two counterfactual states, neither of which the Commission believed were likely. However, the Commission thought that they could be treated as two ends of a continuum with the actual (likely) counterfactual being somewhere between them.
24. The further evidence which the Commission has been provided with since the draft determination, including at the conference, and in the post-conference submissions should have assisted it in understanding that there is no point between those two unlikely scenarios that could be regarded as a likely counterfactual. This is unsurprising, if one draws a straight line between two unlikely scenarios, all points on that continuum remain unlikely.
25. The competitive environment is dynamic and changing fast. As the Commission has accumulated expertise in analysing media markets, since the draft determination was issued, including in its analysis of the Sky/Vodafone transaction, this fact must have become more apparent to it.
26. As this dynamic affects print markets, the trends described in May 2016 when the parties first filed their application for authorization, have continued unabated.

Their competitors in news have grown at exponential rates (MediaWorks/Newshub and RNZ's website have each grown their monthly unique audience by ~400,000 in the past 24 months). The ease of entry and expansion has been demonstrated by the entry of new websites with national news coverage. Facebook and Google have moved from taking about 80 cents of every new advertising dollar to 99 cents of every new advertising dollar in the space of a year in the US, and a similar trend (if not yet the same level of penetration) has occurred in New Zealand.

Market definition and market shares

27. These market dynamics put the Commission's analysis of market definition and market shares in digital news under pressure. In the draft determination the Commission effectively only took a small set of competitors and distribution channels to measure market shares and draw conclusions about market power, effectively because those sets of competitors were more capable of measurement, but they did not genuinely reflect the sources from which digital news is available.
28. This approach to market definition also played to the dynamic competitive effects assessment.
29. When considering competitive effects in news media markets, for businesses that are losing revenue and readers, the critical question is where the bulk of the revenue from those readers is going. The answer to that question identifies the competitive constraints.
30. In the case of Fairfax and NZME, the answer is not that the predominant place where readers and revenue is being lost to, is each other (both are losing revenue). The answer is that the revenue and the readers are moving to other news distributors and aggregators, such as Google and Facebook, and that people are multi-sourcing their news more often, including by reference to the digital sites of TVNZ, MediaWorks and RNZ, other local sites, and other international news sites, such as the Guardian, and so on.
31. The way that consumers access those sites is critical. They access articles from those publishers in Facebook newsfeeds, or as a result of Google searches of subjects of interest, or through features such as Google News or via Twitter. In addition, large organizations with their own brands, consumer profiles, and loyalty programmes, manage their media presence not only through advertising but also direct to consumer through social media and mailouts.
32. In this environment the publishers by no means control the wealth of news and information which consumers access, and which generate the critical revenues upon which their businesses are based, and their audience engagement is achieved. Whether or not these alternatives for consumers to source news/information are treated as being within or outside the relevant markets, there is no question that they are constraints in the sense that they represent the places where in an online digital world the parties' revenue and consumers are going to.

Plurality

33. The key point in respect of plurality is that this is not a merger of the two major newspapers in Beijing, where the Chinese language is paramount and Facebook is banned. Newspapers in New Zealand are just one, and not even the most

popular, mechanism for distribution of news and information. The old barriers of sunk print publishing investment and physical newspaper distribution networks, are now legacy cost basis.

34. In the online world, distribution of news/information is perfectly scalable. It has been disintermediated and effectively rendered costless through the internet.
35. This is the most critical feature of the digital news market that the Commission must grasp in order to properly evaluate the competitive effects of this transaction.
36. This critical framework has most recently been illustrated in an article in the Guardian (22 February 2017) which covers Mark Zuckerberg's manifesto for the future. The article states the obvious, that political and media elites have been pouring over every word of the nearly 6,000-word manifesto, that describes Facebook's journey to connect the world. In particular, the focus is on being the social media company or link as the primary conduit between citizens and politicians. There is no better illustration of the disintermediation of the news media in the distribution of news and information than that statement.
37. And while Facebook is arguably the most effective disintermediator of the media organizations and the public and their advertisers, it is certainly not the only one. Unless the Commission incorporates this dynamic into its competitive effects assessment, it will mischaracterize the future scenarios, both the factual and counterfactual and its consequential analysis of competitive effects in the New Zealand media markets will be fundamentally flawed.
38. In that context, the analysis of whether there might be an alternative "Plan B" for either or both of these companies, amongst the other media companies in New Zealand, is simply a red herring. Without the step change that the synergies deliver, every other pairing, just like the status quo, will lead to continued cost cutting, in a way that will affect the coverage and quality of the news products that these parties produce today. Going back to the question at the heart of the market definition and competitive effects analysis, "Who is eating my lunch?", none of the alternative, potential wished for Plan Bs that have been postulated for either business make any difference to their financial trajectory, nor to their ability to maintain the quality of journalism which they currently produce.

Summary

39. In summary, the parties each look forward to working through with Commission staff the final issues that the Commission must resolve in order to reach a final view in relation to this transaction.
40. In considering the information and evidence provided, the parties specifically ask the Commission to give full weight to the hard data, even though it leads to hard conclusions. The more wishful and nostalgic narratives, that have come from some commentators on the merger, needs to be put into context.
41. []. The parties are confident that the Commission will be sharply focussed on the quality of the hard data that is provided to it in its process, including the information on the more fundamental structural features of these markets that this merger creates the foundation to address.

42. The parties are grateful for the Commission's continued careful attention and focus on working through the outstanding issues in respect of this transaction and remain available, as required, to respond on further information requests.

Yours faithfully
RUSSELL McVEAGH

[Signed]

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