

COMMERCE COMMISSION

DETERMINATION

DECISION 580

Determination pursuant to the Commerce Act 1986 in the matter of an Application for authorisation of a restrictive trade practice. The Application is made by the:

NEW ZEALAND RUGBY FOOTBALL UNION INCORPORATED.

- The Commission:** P R Rebstock, Chair
D F Caygill
G Pickering
- Summary of Application:** The Applicant has applied for authorisation to enter into and give effect to arrangements to:
- (a) Institute a salary cap for the Provincial Unions competing in the Premier Division of the new inter-provincial rugby competition.
 - (b) Apply new rules governing player transfers.
- Determination** Pursuant to sections 58 and 61(1) (a) of the Commerce Act 1986, the Commerce Commission determines to authorise the Application, subject to specific conditions.
- Date:** 2 June 2006

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS.

TABLE OF CONTENTS

TABLE OF CONTENTS	2
EXECUTIVE SUMMARY	9
Introduction.....	9
Problem Definition.....	9
Proposed Resolution.....	9
The Proposed Arrangements	10
Previous Authorisation	11
Framework for Consideration	11
Commission Procedures	12
Draft Determination and Further Submissions	12
The Factual and Counterfactual.....	13
<i>The Factual.....</i>	<i>13</i>
<i>The Counterfactual.....</i>	<i>13</i>
<i>Recent developments re counterfactual.....</i>	<i>14</i>
<i>Conclusion on the Counterfactual.....</i>	<i>14</i>
Discretion to Grant Authorisation.....	15
<i>Section 44 exclusion</i>	<i>15</i>
<i>Commerce Act definitions of “market” and “services”</i>	<i>15</i>
<i>Market Definition</i>	<i>16</i>
Competition Analysis.....	16
Effects in the Premier Player Services Market	17
<i>Salary Cap - s 27 and s 27 via s 30.....</i>	<i>17</i>
<i>Transfer Fees and Transfer period - s 27.....</i>	<i>18</i>
<i>Transfer Fees - s 27 via s 30</i>	<i>18</i>
Effects in the Market for Sports Entertainment Services	19
<i>Section 27</i>	<i>19</i>
Section 29 analysis.....	19
Conclusion re Exercise of Discretion.....	20
Public Benefits and Detriments.....	20
<i>Potential Limitations of the NZRU’s Proposed Salary Cap.....</i>	<i>21</i>
Detriments.....	23
<i>Allocative Inefficiency</i>	<i>23</i>
<i>Productive Inefficiency.....</i>	<i>23</i>

<i>Loss of Player Talent</i>	23
<i>Reduction in Player Skill Levels</i>	24
<i>Innovative Efficiency Losses</i>	24
Overall Conclusion on Detriments	25
Public Benefits	25
Competitive Balance and the Uncertainty of Outcome Hypothesis	25
Enhanced Provincial Union Financial Performance	27
Enhanced International Performances	28
Evaluation of Above Claimed Public Benefits	29
<i>Spectator Enjoyment</i>	29
<i>Viewer Enjoyment</i>	30
<i>Increased Funding</i>	30
<i>Indirect Benefits</i>	31
Balancing Public Benefits Resulting from the Proposed Arrangements	31
CONCLUSION	32
DETERMINATION	34
Condition 1	34
Condition 2	34
Condition 3	34
Condition 4	35
Condition 5	35
Time Period	35
INTRODUCTION	36
The Arrangements	37
<i>Salary Cap</i>	37
<i>Player Transfer Rules</i>	39
<i>Withdrawal of Proposed Changes to rules for Modified Division One Unions</i>	40
FRAMEWORK FOR CONSIDERATION	40
COMMISSION PROCEDURES	41
Draft Determination and Further Submissions	42
Decision Not to Hold a Conference	42
Preparation of Determination	43
THE PARTIES	43

NZRU	43
Provincial Unions	44
Rugby Players Collective Incorporated (RPC)/New Zealand Rugby Players Association (NZRPA).....	44
Players	44
Sponsors	45
Broadcasters	45
Other Relevant Parties	45
RUGBY IN NEW ZEALAND.....	46
Grass-Roots Rugby	46
NPC Rugby	46
Super 14 Rugby	47
All Black Rugby.....	48
Revenue Streams	48
<i>Sponsorship</i>	<i>48</i>
<i>Broadcasting Rights</i>	<i>48</i>
<i>Gate-takings from spectators</i>	<i>49</i>
<i>Funding from NZRFU</i>	<i>50</i>
<i>Gaming revenue</i>	<i>50</i>
The New Competition Format	51
Development of Professionalism/Contracting Environment.....	52
Overview of Services Supplied and Acquired in the Provision of Rugby Matches for Viewing by the Public	54
The Purpose of the Proposed Arrangements.....	56
The Uncertainty of Outcome Hypothesis.....	56
The Economics of Salary Caps.....	60
Potential Limitations of the NZRU's Proposed Salary Cap.....	64
<i>Constraint Provided by the Cap.....</i>	<i>68</i>
<i>Revenue Disparity</i>	<i>70</i>
<i>Multiple Income Stream Incentives</i>	<i>71</i>
<i>Team-specific Talent</i>	<i>73</i>
<i>Empirical Evidence</i>	<i>74</i>
Summary of Potential Limitations of NZRU's Proposed Salary Cap.....	74
THE APPLICATION FOR AUTHORISATION	75
<i>The Player Movement Regulations.....</i>	<i>78</i>
<i>Summary of Conduct to be authorised</i>	<i>79</i>

THE FACTUAL AND THE COUNTERFACTUAL	81
The Factual	81
The Counterfactual	82
<i>Introduction</i>	<i>82</i>
<i>The Applicant’s Initial View of the Counterfactual.....</i>	<i>83</i>
<i>Variation to Application.....</i>	<i>84</i>
<i>The Commission’s View of the Counterfactual.....</i>	<i>87</i>
<i>Conclusion on the Counterfactual.....</i>	<i>87</i>
OVERVIEW OF THE COMMISSION’S ANALYSIS OF THE PROPOSED ARRANGEMENTS	88
The Commission’s Discretion to Authorise	88
Overview of Analysis Conducted by the Commission	90
ELEMENTS OF SECTIONS 27 AND 29.....	91
Section 27	91
Section 29	92
The Requirement for the Proposed Arrangements to Apply to “Services”	93
Is there a Relevant Service?	93
<i>a. Is the player providing the right or benefit “in trade”?</i>	<i>98</i>
<i>b. Do players engage in rugby playing activities pursuant to a contract?</i>	<i>99</i>
<i>c. Is the contract for or in relation to the “performance of work”?</i>	<i>99</i>
APPLICATION OF PART II OF THE COMMERCE ACT	101
Section 44 - Exclusion of Part II	101
Application to the Salary Cap Arrangement.....	102
<i>Section 44(1)(c)</i>	<i>102</i>
<i>Section 44(1)(f).....</i>	<i>102</i>
<i>Section 44(1)(h).....</i>	<i>102</i>
Application to the Player Movement Regulations.....	103
<i>Section 44(1)(c)</i>	<i>103</i>
<i>Section 44(1)(f).....</i>	<i>103</i>
<i>Section 44(1)(h).....</i>	<i>103</i>
Summary of Effect of s 44 Exemption Provisions	103
MARKET DEFINITION.....	104
Introduction	104
The Relevant Markets.....	105
<i>Premier Player Services</i>	<i>106</i>
<i>Rights to Player Services.....</i>	<i>110</i>
<i>Sports Entertainment Services.....</i>	<i>112</i>
<i>Supply of services of organising and running a rugby union competition.....</i>	<i>113</i>

Conclusion on Relevant Markets.....	114
COMPETITION ANALYSIS - SECTIONS 27, 29 AND 30 ANALYSIS.....	115
Introduction	115
Contract, arrangement or understanding.....	116
<i>NZRU Regulations.....</i>	<i>118</i>
<i>Conclusion on Contract, Arrangement or Understanding.....</i>	<i>119</i>
Supplied or acquired by the parties to the contract, arrangement or understanding (CAU) in competition with each other?.....	120
<i>The CEA</i>	<i>120</i>
<i>The Regulations.....</i>	<i>121</i>
<i>Summary regarding whether parties are in competition with each other.....</i>	<i>121</i>
Effects in the Premier Player Services Market	122
<i>Will the salary cap provision result or likely result in a lessening of competition under section 27?.....</i>	<i>122</i>
<i>Will the Salary Cap Arrangement have the effect or likely effect of fixing, controlling or maintaining prices under section 30?</i>	<i>125</i>
<i>Will the transfer fee provision result, or likely result in a lessening of competition under section 27?.....</i>	<i>128</i>
<i>Will the proposed transfer fees have the effect or likely effect of fixing, controlling or maintaining prices under section 30?.....</i>	<i>133</i>
<i>Will the proposed transfer period result in or likely result in a lessening of competition under section 27?.....</i>	<i>134</i>
<i>Will the transfer period have the effect or likely effect of fixing, controlling or maintaining prices under section 30?.....</i>	<i>136</i>
<i>Comment on Minimum Squad Spend.....</i>	<i>136</i>
<i>Overall Assessment of Impact of the Provisions on Competition in the Market for Premier Player Services:.....</i>	<i>136</i>
Effects in the Non-Premier Player Services Market.....	137
<i>Player Movement Regulations.....</i>	<i>137</i>
<i>Will the transfer fee provision result or likely result in a lessening of competition in this market under section 27?.....</i>	<i>138</i>
<i>Will the proposed transfer fee provision result or likely result in a fixing, controlling or maintaining prices in this market under section 30?</i>	<i>138</i>
<i>Will the transfer period provision have the effect, or likely effect, of lessening competition under section 27?.....</i>	<i>139</i>
<i>Will the transfer period have the effect or likely effect of fixing, controlling or maintaining prices under section 30?.....</i>	<i>139</i>
<i>Overall Assessment of Impact of the Transfer Provisions on Competition in the Market for Non-Premier Player Services:.....</i>	<i>139</i>
SECTION 29 ANALYSIS	140
<i>Conclusion on Section 29.....</i>	<i>141</i>
Effects in the Market for Sports Entertainment Services	141

<i>Section 27 only</i>	141
<i>Will the Proposed Arrangements, taken as a whole, result or likely result in a lessening competition in this market?</i>	142
PUBLIC DETRIMENTS AND BENEFITS	144
The Role of Proposed Arrangements	147
DETRIMENTS	150
Allocative Inefficiency	150
Productive Inefficiency	152
Loss of Player Talent	157
Reduction in Player Skill Levels	163
Innovative Efficiency Losses	165
Conclusions on Detriments	166
BENEFITS	166
Competitive Balance and the Uncertainty of Outcome Hypothesis	166
<i>Evidence from New Zealand – Live Spectator Demand</i>	169
<i>Evidence from New Zealand – Television Audience Demand</i>	174
Enhanced Provincial Union Financial Performance	181
Conclusion on the Nexus for ‘Direct’ Public Benefits	182
Enhanced International Performances	183
Conclusion on Nexus for ‘Indirect’ Public Benefits	184
Evaluation of Claimed Public Benefits	184
<i>Direct Benefits</i>	184
<i>Indirect Benefits</i>	185
<i>Spectator Enjoyment</i>	185
<i>Viewer Enjoyment</i>	191
<i>Increased Funding</i>	196
<i>Assessment of Indirect Benefits</i>	204
Conclusion on Benefits	206
BALANCING	207
Balancing Public Benefits Resulting from the Proposed Arrangements	208
CONCLUSION	209
CONDITIONS	209
Introduction	209
Conditions	210

Limited Period of Authorisation	215
<i>Conclusion on Impact of Conditions and Time Period</i>	216
DETERMINATION	217
Condition 1	217
Condition 2	217
Condition 3	217
Condition 4	218
Condition 5	218
APPENDIX 1 – ELEMENTS OF PROPOSED SALARY CAP (PROVIDED BY NZRU)	219
APPENDIX 2 – DISCUSSION OF FORT-STROOMBERGEN CRITIQUES OF OWEN & WEATHERSTON UOH STUDIES	222
APPENDIX 3 – ECONOMETRIC ESTIMATION RESULTS – LIVE SPECTATOR DEMAND MODEL	226
APPENDIX 4 – DISCUSSION OF FORT-STROOMBERGEN CRITIQUES OF COMMISSION’S SPECTATOR DEMAND STUDY	227
APPENDIX 5 – ECONOMETRIC ESTIMATION RESULTS – TELEVISION VIEWER DEMAND MODEL	229
APPENDIX 6 – DISCUSSION OF FORT-STROOMBERGEN CRITIQUES OF COMMISSION’S TELEVISION VIEWER DEMAND STUDY	236
APPENDIX 7 – METHODOLOGY FOR ESTIMATING SPECTATOR BENEFITS	244
APPENDIX 8 – NZRU PLAYER MOVEMENT REGULATIONS	247

EXECUTIVE SUMMARY¹

Introduction

1. By letter dated 9 November 2005, the New Zealand Rugby Football Union Incorporated (NZRU) applied to the Commission under section 58 of the Commerce Act 1986 (the Act) for authorisation to enter into certain arrangements of the kind prohibited by s 27 (directly and via s 30) and s 29 of the Act.
2. In June 2005, the NZRU announced the formation of a new domestic competition structure. Commencing in the 2006 season, a new two-tiered domestic competition, comprising the Premier Division (PD) and Modified Division One (MD1), will replace the existing three-division National Provincial Championship (NPC).

Problem Definition

3. The Applicant submitted that, after undertaking a comprehensive two-year review of the state of, and outlook for, rugby in New Zealand, unless changes were made to the NPC competition, there would be a continuation (and acceleration) of the trend towards uneven competition. It argues that this would result in lower spectator interest, decreasing revenues and potentially less competitive Super 14 Rugby and All Black sides. The NZRU stated that this was mainly as a result of the addition of five unions (previously in the old 2nd Division) to new PD competition structure. These new unions were likely to have fewer resources and less accumulated talent than the current 1st Division unions.
4. The NZRU's review also highlighted the current trend towards increasing costs and expenditure, which it considered was unsustainable in the absence of new revenue sources or cost reductions.

Proposed Resolution

5. To mitigate these trends, the NZRU is proposing to introduce certain mechanisms with the aim of creating more even national competition, thereby contributing to more attractive games, greater revenues, better performance of New Zealand Super 14 Rugby and All Black teams and better cost management within New Zealand rugby generally.
6. A further aim is to ensure that New Zealand rugby remains commercially viable and sustainable.

¹ This Executive Summary is provided for the assistance of readers. It does not purport to completely encompass all details of the Application, the Commission's investigation of the facts, the Commission's analysis of those facts and the Determination. Readers are referred to the body of text of this document for the full analysis behind the Commission's Determination.

7. One of the key mechanisms proposed is the introduction of a “salary cap”² for the NPC PD unions. The primary objective of this salary cap, along with proposed relaxation of player transfer rules, is to encourage a more even distribution of playing talent, thereby contributing to a more even competition. The NZRU argues that a more even competition would attract greater interest and would result in increased spectator enjoyment, larger crowds at matches, increased broadcasting and sponsorship revenues, and greater incomes for provincial unions.

The Proposed Arrangements

8. In brief, the NZRU has asked the Commission to authorise two arrangements³ (the “**Proposed Arrangements**”) with the provisions outlined briefly in Table 1:

Table 1: “Provisions” of the Proposed Arrangements

Proposed Arrangement	Provision
Salary Cap Arrangement	“ Salary Cap ”: Imposition of a \$2m salary cap per PD union on payment of players in accordance with clauses 50, 53-59 of the Collective Employment Agreement ⁴ , and summarised in NZRU’s table set out in Appendix 1.
Player Movement Regulations	“ Transfer Period ”: Restriction on transfers for the period from 1 October to after the end of the Super 14 final as described at para 2.7(a) of the Application.
	“ Maximum Transfer Fees ”: The imposition of a \$10,000–\$20,000 maximum fee for transfers from a MD1 union to a PD union, and imposition of a nil transfer fee for all transfers between PD unions.

9. The NZRU and the Rugby Players Collective Incorporated (RPC) have entered into a Collective Employment Agreement (CEA), which incorporates the salary cap. In addition, in relation to each of the Proposed Arrangements, the NZRU has prepared draft regulations. Regulations become binding upon players and unions when adopted by the NZRU Board.
10. The NZRU has stated that it does not seek to have the salary cap regulations authorised. Rather it seeks authorisation of the salary cap arrangement as contained in its Application and the CEA. Further, the Applicant states that these regulations,

² Although more correctly referred to as a “total player payroll cap”, the term “salary cap” was used by the Applicant and has been widely adopted. Therefore, the Commission will refer to it as a “salary cap” throughout this Determination.

³ In its Application, the NZRU also applied for authorisation of a third arrangement, the Proposed MD1 Arrangements. NZRU withdrew the Proposed MD1 Arrangements from its Application by letter dated 30 March 2006.

⁴ The Collective Employment Agreement between the New Zealand Rugby Union and the Rugby Players Collective, 2006-2008.

as drafted, will not be given effect to unless the Commission authorises the arrangements that are the subject of this Application.

11. However, the NZRU does seek to have its Player Movement Regulations authorised. These are attached as Appendix 1.

Previous Authorisation

12. The Commission granted the NZRU an authorisation in 1996, approving changes to the rules governing the transfer of players. The main features of the arrangements authorised were as follows:
 - a four week transfer “window”, or period in which all transfers must take place;⁵
 - a quota of no more than five players to transfer into any one union per year; and
 - a schedule of maximum transfer fees to be paid by the union gaining the player to the union losing the player.
13. The NZRU claims that, subsequent to the Commission’s 1996 authorisation, the rugby environment and markets for rugby players changed dramatically, both in New Zealand and internationally. Particular emphasis is placed on the increasing professionalism of all aspects of the game worldwide.
14. The NZRU and the RPC entered into a Collective Employment Agreement for the period 2006 to 2008. However, as this agreement contains the salary cap framework that is the subject of this Application, it will not be given effect to unless the Proposed Arrangements are authorised by the Commission.

Framework for Consideration

15. The Commission is responsible for deciding whether to authorise the Proposed Arrangements under the relevant provisions of the Commerce Act.
16. In brief, the Commission must determine whether a lessening of competition would result, would be likely to result, or is deemed to result in the relevant market, and, if so, whether the detriments flowing from this lessening of competition are outweighed by the public benefits that result or would be likely to result from the Proposed Arrangements. The Commission considers that a public benefit is any gain, and a detriment is any loss, to the public of New Zealand, with an emphasis on gains and losses being measured in terms of economic efficiency. If the Commission is satisfied that the public benefits outweigh the detriments, it must authorise the Proposed Arrangements.

⁵ NZRU subsequently narrowed this window from four weeks to two weeks. No authorisation was sought or provided for this change to the arrangements that were authorised in 1996.

Commission Procedures

17. The Application was registered on 9 November 2005. Written notice of the Application was provided to all parties who were considered to have an interest in it, and notice of the Application was advertised in national newspapers on 15 November 2005. Submissions were received from a number of interested parties, including Air New Zealand, SKY TV, Canwest/Media Works (TV3), and seven rugby unions.

Draft Determination and Further Submissions

18. Pursuant to section 62 of the Act, the Commission released its Draft Determination on 9 March 2006. The Commission sought further submissions from interested parties in respect of the preliminary conclusions reached in the Draft Determination, and asked parties to notify the Commission if they wished a conference to be held.
19. The Commission did not receive any such request for a conference under section 62(5) of the Act from either the Applicant or any of the interested parties.
20. By letter of 30 March 2006, the NZRU advised that it was withdrawing the request for authorisation of the proposed arrangements applying MD1 as set out in paragraphs 2.8 and 2.9 of its Application. These proposed arrangements (the MD1 Arrangements) were considered in the Commission's Draft Determination, and the Commission proposed to decline such arrangements. This was because it was not satisfied in all the circumstances that the MD1 Arrangements would or would likely result in a benefit to the public which would outweigh the lessening of competition arising from these arrangements.
21. The Commission received submissions on the Draft Determination from the Applicant and SKY TV, Counties Manukau Rugby Union, and the East Coast Rugby Union.

Decision Not to Hold a Conference

22. After reviewing submissions on the Draft Determination, the Commission decided not to hold a conference on its own motion. On 6 April 2006, the Commission notified interested parties of the decision not to hold a conference.
23. In preparing this Determination, the Commission has fully considered and given weight to information and analysis from a wide range of sources. It has:
 - reviewed the information and analysis in the Application, including the economic analysis submitted by the Applicant's economic experts;
 - sought further information and clarification from the Applicant on a range of points;
 - considered submissions from interested parties;

- interviewed the Applicant and other parties;
- sought advice from its own legal, economic, and industry experts; and
- conducted its own analysis and modelling.

The Factual and Counterfactual

24. In order to assess the competition effects, as well as the detriments and benefits, the Commission compares the factual to the counterfactual for each Proposed Arrangement. The factual is what would happen if a Proposed Arrangement were to proceed. A counterfactual will not necessarily be a continuation of the status quo, but rather encapsulates a pragmatic and commercial assessment of what is likely to happen in the absence of the factual.
25. The factual and counterfactual give rise to different states of competition in the relevant market. A comparison between them allows a judgment to be made as to whether competition in the factual is likely to be lessened relative to the counterfactual.
26. The Commission considers that arrangements to implement the proposed Salary Cap Arrangement are closely interrelated with arrangements to implement the proposed Player Movement Regulations and should properly be considered together (these are referred to jointly as the Proposed Arrangements).
27. The Player Movement Regulations will have some effects in respect of both PD and MD1 players and teams. However, it is considered that the effects on MD1 players and services will be minor.

The Factual

28. In this case, the factual scenario involves implementation of the new NPC competition structure, comprising the 14 team PD and the 12 team MD1 competition structure; a salary cap for PD; a transfer period of approximately 34 weeks; and transfer fees for transfers from MD1 to PD unions.

The Counterfactual

29. The Applicant proposed in its Application that the counterfactual is the implementation of the new inter-provincial competition format with no salary cap on PD unions, and a continuation of the Player Transfer Regulations, which contain a transfer period of two weeks and transfer fees for most transfers, including transfers between PD unions.
30. However, the NZRU has acknowledged in its Application that there are a number of risks inherent in this counterfactual. Specifically, the Applicant submitted that there is a risk that it would result in a more uneven domestic competition, which, in turn, is likely to contribute to lower spectator interest, decreasing revenues and ultimately less competitive Super 14 Rugby and All Black performances. This is

mainly because the addition of the four new teams to the PD, a feature of both the factual and the counterfactual, would result in greater unevenness in the competition.

Recent developments re counterfactual

31. On 9 May 2006, the NZRU advised that, as a result of further negotiations with the RPC, the Player Transfer Regulations had been suspended for one year until the conclusion of the 2007 Super 14 season. Instead, in the event that the Proposed Arrangements are not authorised, Clause 50 of the CEA (relating to player transfers) would apply for the intervening year, at which point new regulations replacing Clause 50 would be negotiated between NZRU and RPC.
32. The Commission considers that overall the proposed variation will have the effect of reducing the difference between the factual and the counterfactual in relation to the player movement rules, especially during the first year when Clause 50.5 would apply. The effect of the variation on the likely counterfactual in subsequent years is unknown, but it seems likely that any future negotiated rules governing player transfers will be less restrictive than the Player Transfer Regulations.
33. The Commission notes that the Applicant's counterfactual, with the fact that player transfer rules beyond 2007 are unspecified at this point, presents difficulties for the analysis. However for the purposes of the analysis, the Commission proposes to adopt the counterfactual with the characteristics set out below.

Conclusion on the Counterfactual

34. On the basis of the information it has received to date, the Commission considers that the likely counterfactual will have the following characteristics:
 - the new competition format;
 - a transfer window from 29 May 06 to the Friday after the Super 14 Competition in 2007, and beyond that, a negotiated transfer window, likely to be significantly wider than the two weeks in the Player Transfer Regulations, but to some degree narrower than is proposed in the Player Movement Regulations, or would otherwise be the case if a salary cap were implemented; and
 - player transfer fees to be paid by PD unions when a player transfers from an MD1 union to a PD union, from 29 May 06 to the Friday after the Super 14 Competition in 2007, and beyond that, negotiated player transfer fees at levels and in circumstances to be negotiated. Again, the Commission expects that in this scenario, the circumstances in which fees would be paid maybe to some degree wider than proposed in the Player Movement Regulations, or would otherwise be the case if a salary cap were implemented.

Discretion to Grant Authorisation

35. The Commission has broad discretion to decide whether to grant an authorisation where proposed conduct might breach Part II of the Commerce Act.
36. Considering whether there might be a breach of s 27 (either directly or via s 30) or s 29 involves consideration of the following issues:
 - Does s 44 prevent Part II of the Act from applying to all or any of the Proposed Arrangements?
 - If not, do the Proposed Arrangements affect “services” or a “market”, as these terms are defined in the Commerce Act?
 - If there is an affected market, what is it? and
 - If so, do the Proposed Arrangements satisfy the elements of ss 27, s 30 or s 29?

Section 44 exclusion

37. The Commission’s view is that although section 44 means that Part II of the Act is unlikely to apply to the agreements in so far as they affect the salary and conditions of NPC rugby players who are employees of the NZRU or provincial unions, Part II of the Act is still likely to apply to non-employee players.

Commerce Act definitions of “market” and “services”

38. A “market”, as this term is used in the Act, can only be for “goods” or “services”, as these terms as used in the Act. Applying the Commerce Act definition of “services”:
 - rugby played by employees is not a “service”;
 - rugby played by independent contractors is a “service”; and
 - rugby played by “volunteers” who receive no payment or remuneration other than for expenses might be a “service” in particular circumstances.
39. For rugby playing to be a “service” within the meaning of the Act (and therefore to be analysed under Part II), then there must be some rugby players who are independent contractors or volunteers. The Commission considers that:
 - there are clearly some NPC rugby players who will play in the MD1 (in the counterfactual) and who will be volunteers;
 - there is a real possibility that there are NPC rugby players who will be playing in the MD1 and who would be independent contractors (but for the Proposed Arrangements); and

- there is also a real possibility that players might be engaged by the PD unions as independent contractors using the independent contracting procedure in clause 4.2 of the CEA.
- 40. The Commission cannot rule out the possibility that some players might now, or at some point in the future, be employed as independent contractors, who are providing “services” in terms of the Act.
- 41. The Commission is therefore satisfied that there will likely be “services” (in the sense intended by the Act) provided by some NPC players (whether playing for PD or MD1 teams). These services will be provided within one or more markets for the purposes of the Act.

Market Definition

- 42. The Commission is of the view that the markets relevant to its consideration of the Application are:
 - the market for the provision and acquisition of premier rugby player services;
 - the market for the provision and acquisition of non-premier rugby player services; and
 - the market for the provision and acquisition of sports entertainment services.

Competition Analysis

- 43. Having decided that the Proposed Arrangements might affect a market(s) for services, and that they are not likely to be exempt under Part II, the Commission then considered whether there was any real possibility of the elements of s 27 (whether directly or via s 30) and s 29 being made out.
- 44. As stated in the jurisdiction section, the rugby played by employee players would not comprise “services” and would therefore not form part of any relevant “market”. Attention in this section was therefore restricted to the effect on a market for (and services provided by) non-employee players.
- 45. Under s 61(6) the Commission must first satisfy itself that the arrangements would, or would be likely to, result in a lessening of competition under s 27, before it proceeds to consider whether the claimed benefits would, or would be likely to, outweigh the lessening of competition. Any such lessening of competition, for the purposes of jurisdiction, does not need to be substantial.
- 46. The Commission also considered whether the Proposed Arrangements might constitute a fixing, controlling or maintaining of prices, and therefore amount to a deemed lessening of competition under s 30 of the Act.

47. In determining whether a lessening of competition is likely to occur, the Commission has assessed the competitive effect or likely effects of each arrangement by comparing competition in the relevant markets in the factual with competition in the counterfactual.
48. It is also important to emphasise that the purpose of this analysis is to determine the effects, or likely effects, of the Proposed Arrangements in terms of their impact on the *competitive process* in the *markets* for player services and sports entertainment, as opposed to their effects on the NPC competition itself.
49. Therefore, for each of the three markets under consideration, the Commission analysed the Proposed Arrangements under s 27 and s 30. Section 29 was considered later.

Contract, Arrangement or Understanding

50. The Commission first considered whether the CEA and the Player Movement Regulations amount to a contract, arrangement or understanding for the purposes of the Act.
51. The Commission considered it highly likely that the CEA and the Player Movement Regulations are each a contract, arrangement or understanding for the purposes of ss 27, 29 and 30.
52. The Commission also considered whether any of the parties to the contract, arrangement or understanding are in competition with each other (or would be in competition but for the provision) for the supply or acquisition of the goods or services at issue. This was necessary for the purposes of s 30 of the Act.
53. The Commission's view is that there is an arrangement or understanding between competitors via the CEA and the Regulations, both in terms of the players providing services and the provincial unions acquiring those services.

Effects in the Premier Player Services Market

Salary Cap - s 27 and s 27 via s 30

54. The Commission considers the Salary Cap Arrangement will lessen competition by imposing constraints on the mix of both the quality and quantity of player services that certain larger-resourced unions might otherwise acquire in a market constrained only by the player transfer regulations but no salary cap.
55. Hence, in the Draft, the Commission considered that the salary cap would, or would be likely to lessen competition under section 27.
56. Also in the Draft, the Commission considered that the Salary Cap Arrangement was an agreement by all PD provincial unions to ensure that none of them would pay more than \$2m in aggregate to their players at any one time. This would result in

situations where certain players would be paid less than they otherwise would, and thus constitutes a controlling or maintaining of prices in the premier player services market, including non-employee players, and hence constitutes a deemed lessening, under s27 via 30 of the Act.

57. In submissions on the Draft, the NZRU disputed the Commission's conclusions that the salary cap would or would be likely to result in either a lessening or a deemed lessening of competition in the market for non-employee players. The NZRU pointed to the very small numbers of independent contractors in this market now, and to its belief that there would possibly be none in the future, therefore reserving its position that a lessening or deemed lessening could arise under ss 27, 29 or 27 via 30. However the Commission was not persuaded by this argument, and considers that the fact that little or no trade presently occurs in this market does not obviate the need to analyse the impact of the proposed arrangements on competition in that market.
58. Therefore, the Commission remains of the view that a lessening or deemed lessening of competition might arise as a result of the salary cap, under ss 27, or s 27 via 30.

Transfer Fees and Transfer period - s 27

59. In relation to the proposed transfer fee and the transfer period, in the draft, the Commission did not consider that competition would be lessened in this market. The Commission reviewed this preliminary conclusion in the light of the change to the counterfactual as a result of the variation to the CEA. The proposed transfer fees and transfer period in the new counterfactual are now much more akin to those proposed in the factual, in the first year at least.
60. Although it seems likely that in the absence of a salary cap, any new player movement rules negotiated beyond the first year would be likely to be more restrictive than the (new) Player Movement Regulations, it seems unlikely that they will be as restrictive as the (previous) Player Transfer Regulations.
61. However in view of the uncertainty around the outcome of those future negotiations, the Commission does not consider that it has received sufficient information to change its earlier conclusion, and remains of the view that competition will not be likely to be lessened in this market as a result of the proposed transfer fee and transfer period.

Transfer Fees - s 27 via s 30

62. The Commission remains of the view that Player Movement Regulations relating to the transfer fees would have, or would be likely to have, the effect of controlling or maintaining prices in the premier player services market, and hence would constitute a deemed lessening.

Effects in the Market for Sports Entertainment Services

Section 27

63. The Commission has considered whether any of the Proposed Arrangements would have the effect, or likely effect, of lessening competition in the market for sports entertainment services under s 27 of the Act. There are no s 27 via s 30 or s 29 issues that arise in respect of this market.
64. With respect to the impact of the salary cap on those PD unions that are constrained, the Commission considers the likely improved performance by unconstrained teams is expected to counterbalance any diminished performance by the constrained unions. Subsequently, the entertainment provided by watching NPC, and therefore rugby union *as a whole*, would not be negatively impacted in the sports entertainment market.
65. Therefore, the Commission's view is that the Proposed Arrangements would not lessen, nor would be likely to lessen, competition in this market.

Section 29 analysis

66. The Commission does not accept the NZRU's argument that a breach of s 29 could only occur in the rights to player services or union-to-union market. Rather, the Commission considers that the exclusionary conduct could also occur in the acquisition and supply of player services, in which provincial unions compete to acquire player services.
67. In the Draft, the Commission expressed the view that there will or would likely be a lessening of competition under s 29, but that any further likely effects of lessening competition from a boycotting arrangement amongst competing provincial unions would be slight, as most of the competition effects of the salary cap in the acquisition of player services had already been captured by the analysis of the Proposed Arrangements under s 27 and s 27 via s 30.
68. In submissions on the Draft, the NZRU disputed this finding, stating that s 29 cannot apply to the market for player services as the provincial unions do not supply services to each other. However, the Commission considers that there is a relationship between the transfer fee provision and the acquisition of player services, albeit an indirect one. Hence the Commission remains of the view that the salary cap would, or would be likely to result in a lessening of competition under s 29, by the giving effect to a boycotting arrangement amongst provincial unions competing for player services, including non-employee players, even though this effect may be small.

Conclusion re Exercise of Discretion

69. The Commission's view is, therefore, that the Proposed Arrangements are likely to result in a lessening of competition, or are deemed to lessen competition, in the relevant markets.
70. Having reached this view, the Commission then considers the benefits and detriments that are likely to result from parties entering into the Proposed Arrangements, or giving effect to the provisions.

Public Benefits and Detriments

Background

71. The Commission's view is that a lessening of competition would occur in the premier players' services market as a result of the Proposed Arrangements. A lessening of competition would be expected to result in economic detriments to the public of New Zealand, in terms of a loss of economic efficiency.
72. The Commission must therefore identify and weigh the likely benefits and detriments flowing from the Proposed Arrangements. Should it be satisfied that the benefits clearly outweigh the detriments, then the Proposed Arrangements must be authorised. To the extent possible, the Commission must attempt to quantify the benefits and detriments.
73. The NZRU believes that the unbalanced nature of the domestic provincial competition would worsen if the Proposed Arrangements were not authorised because of the recent restructuring of the domestic competition, which saw the promotion of four weaker teams to the Premier Division level. It argued that a failure to intervene to arrest this decline in competitiveness would result in a significant risk that spectator and viewer interest would fall, which would in turn put at risk the considerable sponsorship and broadcasting revenues it relies upon. The NZRU has settled on a salary cap as its preferred option, with new, liberalised Player Movement Regulations to replace the Player Transfer Regulations.
74. It claims support for this view from a hypothesis in the economics of professional team sports—the "uncertainty of outcome hypothesis"—posits that an unbalanced league causes audiences to lose interest and revenues to fall. Imbalance may occur through teams based in regions with large, wealthy populations having an in-built advantage in acquiring the services of the best players. In doing so, they may disadvantage the poorer teams, and hence imbalance the league as a whole.

Salary Cap Model

75. The Commission used a simple, stylised model to explain in principle the likely impact of a salary cap. This found that an effective salary cap was likely to:
 - reduce the league's total player remuneration;

- result in good players being more evenly shared between the teams;
- increase union surpluses (all else being the same);
- result in a ‘misallocation’ of players between teams (allocative inefficiency);
- create incentives for unions to evade or avoid the cap, which must be countered by monitoring and enforcement activity (productive inefficiency);
- encourage more players to go overseas because of the impact of the salary restrictions, particularly on lower-level players; and
- create ill-feeling in those players unable to move between teams and from a more unequal distribution of salaries within capped teams.

76. However, in practice, the impact of a salary cap will depend critically upon how it is structured and implemented.

Potential Limitations of the NZRU’s Proposed Salary Cap

77. There appears to be a number of aspects of the NZRU’s proposed salary cap that may limit its effectiveness. These in turn will influence the Commission’s assessment as to the likely impact of the proposed cap, and the nature and magnitude of the benefits and detriments likely to flow from its operation. These factors are as follows.

Hardness of the Cap

78. The proposed cap may not be as ‘hard’ as supposed or intended. There may be scope for wealthy unions to increase legitimate payments to players outside the cap, or to use non-pecuniary benefits (e.g., better coaches, medical specialists and facilities) to undermine the cap. Team roster instability (season to season variability in playing squads) in overseas leagues has led to softening of salary caps. It has also been suggested that the monetary fines might need to be increased, or other types of penalties (e.g., forfeiture of competition points) added, to ensure compliance.

79. Even well-established salary caps seem difficult to manage and monitor. In addition, it seems to be difficult in practice to frame rules of sufficient comprehensiveness to cover all possible eventualities. To date the Commission has only been provided with draft regulations, and so there remains uncertainty regarding how hard the salary cap may be in practice.

Constraint Provided by the Cap

80. The Commission is sceptical about the extent to which the proposed salary cap would constrain, even if it were a ‘hard’ cap. Initially at least, the cap would constrain only a few provincial unions. Originally, the intention was to set a more

restrictive cap. The fact that only a few of the largest-revenue unions would be constrained may create incentives to ‘cheat’ the cap. Furthermore, the CEA is only for three years, so the cap could be renegotiated and raised over time.

Revenue Disparity

81. It is evident that the provincial unions have very unequal income levels. Whilst the salary cap may place pressure on some of the wealthy unions to release players, there is no mechanism in the proposed arrangements to raise the spending capacity of the less wealthy unions, so that they could afford to hire those players. Salary caps in overseas professional sports leagues often include revenue-sharing, which helps to reduce the underlying income inequalities between teams in the league, but this important element is missing from the NZRU’s proposal.

Multiple Income Stream Incentives

82. Anecdotal evidence suggests that players of equally high ability tend to benefit from playing alongside one another, and there are strong incentives for them to do so to improve chances of selection for Super 14 and All Black teams. Super 14 and All Black salaries are substantially higher than domestic provincial competition salaries. Hence, talented players may be willing to accept a reduction in their provincial competition salaries in order to remain with a union that maximises their exposure to selectors and the development of their skills, to increase their chances of progression to higher competitions. This may allow wealthy unions to retain their best talent, even in the face of salary cap restrictions.

Team-specific Talent

83. It has been argued that teams are coalitions of individual players for which the collective results are greater than the sum of the individual results. Some team members are more productive in the coalition than they would be elsewhere. If the value of the player is partially attributable to his team, then the player’s talent is team-specific. In this case, the pursuit of absolute competitive balance would result in a league-inferior redistribution of talent, since any relocated talent would be less productive. Balance may be enhanced by the cap, but the expense could be an inferior allocation of talent across the league.

Summary

84. To sum up, there is significant uncertainty about how effective the proposed salary cap would be, particularly in respect of how hard it would be, and how effectively it would be monitored and enforced. In addition, the initial level of the cap appears to have been set at a level not to constrain to any significant degree. In addition, there is no provision for revenue-sharing and senior players may be resistant to moving to other unions. These considerations have coloured the Commission’s views as to the likely benefits and detriments of the Proposed Arrangements.

Detriments

85. The detriments have been considered under a number of headings: allocative efficiency, productive efficiency, loss of player talent, reduction in player skill levels and loss of innovative efficiency. Each of the detriments has been estimated annually for the next five years, and then a real inflation-adjusted discount of 6.8% has been applied to give their present values.

Allocative Inefficiency

86. In the premier player services market, the salary cap is likely to result in wealthier teams valuing marginal players more highly, and therefore being willing to pay them more, than would less wealthy teams. Some player 'trades' would be blocked by the cap. The resulting player 'misallocations' provide a measure of the allocative inefficiency in the market.
87. The salary cap model provides a means of estimating the size of this detriment. It was assumed that 42 players (10% of the assumed sum of Union squads) would be 'misallocated' by Year 5, with lower numbers in earlier years. Combined with other assumptions, this led to an estimated loss of about \$133,000 over the five years in present value terms.

Productive Inefficiency

88. A salary cap needs to be enforced, and this requires monitoring to ensure compliance. Salary cap rules can be complex, and hence potentially expensive to enforce. Compliance costs would be imposed on all unions, and enquiry costs would be imposed upon unions who are alleged to have breached the salary cap. There may also be productive inefficiencies arising from the incentives upon unions to use resources to find loopholes in the Regulations, and to lobby for relief from the Regulations (rent-seeking costs). In addition, there would also be initial set-up costs from establishing the regime, and also a first year cost 'premium' to reflect the intensified effort needed in the first year of operation. A possible mitigating factor is that only a few teams would be constrained at first, and so the monitoring effort could initially be focused on them, rather than on all teams.
89. The Commission's preliminary estimate is that the proposed salary cap could cost between \$678,000 and \$788,000 in the first year of operation, and between \$460,000 and \$540,000 per year thereafter at current prices. In present value terms, the productive inefficiency cost over the five year period would be between about \$2,100,000 and \$2,458,000 million.

Loss of Player Talent

90. The modelling analysis indicated that the salary cap, by constraining at least some provincial unions, would cause average player remuneration to fall. Greater player migration overseas is likely to be encouraged, to join the large number of New Zealanders playing rugby for pay overseas. Although it is recognised that the

expansion of the number of teams in the Premier Division would provide more openings for players, this feature would be present regardless of the Proposed Arrangements.

91. The Commission's assessment is that the salary cap is likely to increase outward migration of rugby players in the younger and mid-range levels to some degree. The welfare cost of this would be their lost 'productivity', which could be measured by their domestic salary. A salary at the marginal NPC level (adjusted for overseas savings returned to this country) is assumed, along with the following high (and low) predictions for player losses: six (three) players in Year 1; 12 (six) in Year 2; 18 (nine) in Year 3; 24 (12) in Year 4; and 30 (15) in Year 5. In each case, once lost, a player is assumed lost for five years, meaning that losses extend out beyond the five year horizon in this case.
92. The present value of these higher and lower bound losses, discounted to their present values, total \$1,895,000 and \$948,000 respectively.

Reduction in Player Skill Levels

93. Player skill levels might be eroded when players' desire to transfer are frustrated, or when players are retained as 'back-ups' and get limited game time. Greater inequality in NPC salaries could also arise. Both could lead to players becoming disgruntled, with this in turn sapping team morale. On the other hand, if the cap were to lead to a more balanced competition, this could serve to hone players' skills to a higher level.
94. The proposed replacement of the Player Transfer Regulations with the new Player Movement Regulations would entail the elimination of most of the existing transfer fees payable by acquiring unions to ceding unions. As unions losing players would not be compensated for the costs they had incurred in developing transferring players, this could reduce the incentives for unions to incur the costs of developing players in the first place. On the other hand, it is acknowledged that the change in the competition format, which increases the number of player positions, and the efforts by the NZRU and the Unions to enhance player development, although a part of the counterfactual too, could help to nullify the possible erosion of skill levels by the Proposed Arrangements.
95. Overall, the Commission's view is that this detriment, if it exists, is likely to be small.

Innovative Efficiency Losses

96. The Commission's view is that there is not likely to be any significant innovative efficiency losses.

Overall Conclusion on Detriments

97. A summary of the detriments of the Proposed Arrangements is given in Table 2. These are estimated in present value terms over the five year time frame. The Commission’s assessment of the quantified detriments is that they might be of the order of \$3.2 million and \$4.5 million. In addition, the Commission has not been able to quantify the detriments from the reduction in player skill levels and from the loss of innovative efficiency, which it considers are likely to be small.

Table 2: Summary of Detriment Estimates

Type of Detriment	Estimated Size
Quantified (allocative and productive inefficiency, loss of player talent)	\$3,181,000 to \$4,486,000
Reduction in player skill levels	Small
Loss of innovative efficiency	Small
Total (rounded)	>\$3,181,000 to >\$4,486,000

Public Benefits

98. The Applicant argued that there is a clear nexus between implementation of the Proposed Arrangements and a range of ‘direct’ public benefits. This nexus, according to the NZRU, may be explained in two steps:
- firstly, the Proposed Arrangements would lead to a more even distribution of talent amongst provincial unions, thus producing a more balanced PD competition; and
 - secondly, a more balanced competition would generate greater public enjoyment of the game, from which would flow ‘direct’ public benefits.
99. The Applicant also argued that a more even competition would lead to enhanced performances by international New Zealand sides. It is claimed that this would produce a range of ‘indirect’ public benefits.
100. As noted earlier, the Commission identified a number of factors that could potentially impede the effectiveness of the proposed cap in promoting balance. The Commission has taken account of these factors in estimating the expected public benefits that are likely to arise from implementing the Proposed Arrangements in the PD.

Competitive Balance and the Uncertainty of Outcome Hypothesis

101. An important claimed link in the chain of cause and effect, which goes to the heart of the claimed public benefits, is that a more balanced competition is a

more attractive one. It has long been argued overseas that a key ingredient of demand for viewing professional team sports is the excitement generated by the uncertainty of the outcome of individual games. It is contended that an unbalanced competition causes audiences to lose interest and attendances decline. This proposition is known in the sports economics literature as the *uncertainty of outcome hypothesis* (UOH).

102. In many professional sports overseas, league administrators have introduced a myriad of rules and labour market restrictions, including transfer regulations and salary caps. Many of these restrictions have led to antitrust cases being taken against administrators. A key antitrust defence for such restrictions advanced by league operators' appeals to the UOH. The argument typically rests on three core claims:
 - inequality of resources leads to unequal competition;
 - fan interest declines when outcomes become less uncertain; and
 - specific redistribution mechanisms produce more uncertainty of outcome.
103. Empirical work in recent years testing the hypothesis in relation to at-match spectators has provided mixed support; some studies have offered clear support for the hypothesis, some have offered weak support, and others have contradicted it altogether. In New Zealand, two recent econometric studies (one of which focussed on demand for NPC matches) found very little evidence that uncertainty of outcome has any effect on attendance. These findings potentially undermine a key argument underpinning the NZRU's rationale for seeking to introduce the Proposed Arrangements (i.e., that a more balanced competition is a more appealing one to spectators). Even if the Proposed Arrangements were successful in distributing talent more evenly, it is not obvious that the claimed benefits would flow.
104. The Applicant also provided testimonial evidence on the Australian experience with salary caps in the AFL and NRL as examples where payroll restrictions have seemingly improved competitive balance, and therefore, the attractiveness of those sports leagues to spectators. However, it is unclear from this evidence to what extent the apparent increase in demand for live matches is attributable to the introduction of the salary cap as other possible drivers of demand (e.g., changes in consumers' preferences and/or demographics) are not taken into account. In the case of the AFL, a suite of league restrictions were introduced, so once again, it is unclear to what extent the success of this league is attributable to the salary cap alone. Finally, even if it were clear that the Australian salary caps have been as successful as claimed by the Applicant, it is not at all clear that comparable schemes applied to rugby union in New Zealand would produce similar results.
105. Taking into account all the quantitative and qualitative evidence available, the Commission treated conservatively any substantial public benefits to spectators

that are expected to flow from any enhancement in competitive balance in the domestic provincial competition.

106. Little empirical work has been performed to evaluate the impact of competitive balance on television viewership overseas, let alone for rugby union in New Zealand. Hence, there is even less empirical support for the UOH in relation to television viewers than for live spectators.
107. The Commission undertook its own econometric study on this issue (by examining the key drivers of viewer ratings for televised matches) and found little support for the UOH in the New Zealand data. Instead it was found that match quality (in particular, the number of Super players involved in a contest) was a significant driver of audienceship.
108. The Commission received submissions from broadcasters in support of the Proposed Arrangements on the grounds that a more even competition would be more attractive to viewers. However, it was unclear from the testimonies received on what basis broadcasters had come to this conclusion. No details of any rigorous analysis (quantitative or qualitative) to support these views were offered. Furthermore, little could be inferred on broadcasters' true willingness to pay for greater uncertainty of contest outcome, which arguably reveals the most useful information on the value placed on uncertainty of match outcome by viewers.
109. Once again, the Commission took all the relevant quantitative and qualitative evidence into account when forming a view on the UOH in relation to television viewers. On the basis of this evidence, it concluded that little or no public benefits are likely to flow from increased uncertainty of outcome of PD matches under the factual. However, the Commission concluded that any public benefits likely to flow to television viewers under the factual are likely to derive from improved contest quality.

Enhanced Provincial Union Financial Performance

110. The Applicant argued that a more attractive domestic competition would lead to stronger financial performance of the provincial unions, and counted this as a public benefit. Enhanced financial performance is expected through growth in spectator numbers, broadcasting revenues and sponsorship.
111. Public benefits may flow as a consequence because: (a) greater financial strength may mean more resources available for player development; (b) unions may have greater means to provide better facilities for spectators; and (c) unions may be more successful in attracting talent from overseas and/or keeping local talent from migrating abroad.
112. However, the Commission does not consider that these results in themselves would necessarily represent net public gains. Since the Commission does not consider transfers between individuals as 'benefits' when weighing up overall

gain to society, all expected gains to rugby union must be offset against any accompanying costs, including opportunity costs and losses, to other parts of society.

113. For example, increased spectator revenues would represent a gain to rugby union, but would also represent a loss to other forms of sports entertainment, given individuals' finite leisure time. Likewise, increased sponsorship of rugby union must necessarily be to the detriment of other potential recipients of sponsorship. Hence, it would be incorrect to count the full quantum of all additional revenues as a net public benefit; any relevant offsetting losses must also be incorporated.
114. Nevertheless, the Commission considers it likely that there is some nexus between the enhanced financial performance of provincial unions (and the NZRU), resulting from a more attractive domestic competition, and benefits to the public of New Zealand. Unions could utilise any additional resources to enhance the attractiveness of the domestic competition, which will likely generate public benefits.

Enhanced International Performances

115. The NZRU strongly submitted that a more even PD competition would lead to improvements in the skill factors of the most able rugby players and consequently improved performances for New Zealand representative squads (e.g., Super 14 teams, the All Blacks, etc.). It is argued that this would in turn generate public benefits from overseas (the 'indirect' benefits).
116. According to the NZRU, this may occur for a number of reasons. First, a more even domestic competition is expected to incentivise players to train harder to remain competitive, and this would have flow-on benefits to higher levels of competition.
117. Second, avoided 'stockpiling' of players would mean more match-time, which aids skill development. Offsetting this is the natural preference for good players to associate with strong rather than weak unions. Players face strong incentives to join unions that would maximise their chances of progressing to higher competitions. For a few players, the preferred strategy may be to remain with a strong union (to benefit from superior training resources) rather than play for a poorly equipped union. Players may also prefer to remain with a strong union if they consider that their ability to impress selectors may be hindered by poorly performing team-mates.
118. Third, the NZRU anticipates that reduced spending on player salaries as a result of the salary cap would free up funds for increased spending on player development.
119. Fourth, the NZRU argues that the cap would force some unions to seek talent from overseas in order to remain competitive, which would help lift the

standards of New Zealand rugby. It is claimed that in the long-run all unions would be more financially prosperous under the factual, eventually leading to the inward flow of overseas players. Counterbalancing this is the possibility that overseas talent may displace local talent, yet may not be eligible for selection for the All Blacks and other international representative sides. In any case, it is likely that any benefits from overseas talent migrating to New Zealand would only be felt in the long-run, so the Commission proposes to not give significant weight to this claimed benefit.

120. The Commission accepts that the impact of the Proposed Arrangements could flow through to the performance of representative teams, and to enhanced financial performance of the provincial unions (and the NZRU). Given the offsetting factors mentioned, and the fact that these flows are only likely to give rise to ‘indirect’ public benefits, the Commission considers that these effects are likely to be weak.

Evaluation of Above Claimed Public Benefits

Spectator Enjoyment

121. Increasing the attractiveness of the game for spectators and television viewers, compared to the lesser attractiveness of a competition with declining balance in the counterfactual, would count as a benefit to the New Zealand public.
122. In quantifying the claimed benefits, the Applicant utilised a simple spectator demand model, and estimated net public benefits from increased spectator enjoyment to be between \$105,000 and \$420,000 per year, commensurate with a 10 to 20% increase in spectatorship.
123. The Commission’s view is that such increases are likely to be too optimistic, given the suggested weak link between the Proposed Arrangements and the claimed benefits. It seems unlikely that benefits would flow uniformly over time as the Applicant assumes, since the cap is only likely to be binding as time passes. Therefore, the Commission assumed that benefits would flow only gradually over time. It therefore considered that an eventual zero to 20% increase in spectator demand, i.e., in the long-run, when the cap fully becomes effective, to be more plausible. Finally, the Applicant did not assess benefits over a fixed time horizon, whereas, as mentioned earlier, the Commission adopted a period of analysis of five years.
124. On the basis of these assumptions, the Commission estimated that the likely public benefits from increased spectator enjoyment under the factual to be between \$0 and approximately \$1,100,000 over five years, in present value terms.

132. Assuming a maximum (ultimate) increase in funding to the NZRU and PD provincial unions under the factual, the Commission estimated that the net public benefits (in present value terms) would be between \$0 and \$360,000 over five years.

Indirect Benefits

133. The Applicant argued that the Proposed Arrangements would lead to the improved performance of New Zealand's international teams (e.g., the Super 14 teams and the All Blacks), since a more competitive PD will result in the enhancement of player skills and the eventual inward migration of overseas talent (or the retaining of domestic talent). The NZRU argued that this would produce a number of indirect benefits, including:

- greater enjoyment for New Zealand spectators and television audiences of New Zealand international matches;
- greater leverage for NZRU in its negotiations over (international) television rights, sponsorship, and revenue sharing arrangements;
- greater sponsorship expenditure by New Zealand firms spent in New Zealand (with NZRU) instead of being spent overseas via other promotional avenues with no benefit to New Zealand entities;
- improved international trading opportunities for New Zealand firms via the "association with success" factor;
- increased tourism to New Zealand; and
- a "feel good" factor for many New Zealanders.

134. Given the likely weak link between the Proposed Arrangements and these suggested effects, the Commission has not placed significant weight on these claimed indirect benefits.

Balancing Public Benefits Resulting from the Proposed Arrangements

135. The outcome from the identification, quantification (where feasible) and weighing of the benefits and detriments resulting from the implementation of the Proposed Arrangements in the Premier Player Services Market, as compared to the outcome in the counterfactual, is summarised in Table 3.
136. A qualitative assessment of the detriments and benefits not capable of quantification is included. The benefits and detriments have been assessed over a five year period ahead, and the quantified components discounted to present values. These represent the Commission's view, based on the information available to it and the analysis it has conducted.

Table 3: Net Public Benefit

Benefit/Detriment	Estimated Size
Overall Quantified Detriments	\$3,200,000 to \$4,500,000
Overall Quantified Benefits	\$0 to \$12,300,000
Overall Unquantified Detriments	Small*
Overall Unquantified Benefits	Small*
Net Public Benefit/(Detriment)	\$(4,500,000) to \$9,100,000

*Small relative to the sizes of the other benefits and detriments.

137. The potential range of benefits and detriments encompasses the possibility that the Proposed Arrangements either have net benefits or net detriments. Therefore, the determination of whether to grant or decline an authorisation in this instance requires the exercise of finely balanced judgement. The Commission, in exercising its judgement, has taken into account all of the available evidence and analysis put before it and is inclined to take the midpoint of the range as being a reasonable estimate of the likely net public benefit. This indicates a net public benefit in the order of \$2 million, in present value terms over five years.

CONCLUSION

138. In arriving at its conclusion, the Commission has assessed the extent of the impact of the Proposed Arrangements on competition in the relevant markets, and considered the benefits and detriments described above, on the basis of both a quantitative and qualitative assessment. In addition, the Commission has had regard to the cumulative effect of all relevant considerations, in order to ensure that it has in all the circumstances properly taken account of the matters set out in s 61(6) of the Act.
139. The Commission concludes, on the balance of probabilities, that the Salary Cap Arrangement and the Player Movement Regulations would each result or be likely to result in a lessening of competition, or is deemed to result in a lessening of competition, in respect of the premier player services market.
140. Countering this lessening of competition, the Commission acknowledges that the Proposed Arrangements have the potential to deliver the benefits outlined in this Determination. However, the Commission shall not make a determination granting an authorisation unless it is satisfied in all the circumstances that the Salary Cap Arrangement and the Player Movement Regulations, would result, or be likely to result, in a benefit to the public that would outweigh the lessening in competition that would result or be likely to result or is deemed to result.

141. The Commission considers that, in the present situation, the potential benefits outweigh the detriments, although:
- there remains a lack of certainty that the benefits will in fact flow through; and
 - if the benefits do not flow through, the extent of the ensuing net detriment should be limited.
142. Section 61(2) of the Act states:
- “Any authorisation granted pursuant to section 58 of this Act may be granted subject to such conditions not inconsistent with this Act and for such period as the Commission thinks fit.”
143. In considering whether it is satisfied that the benefits of the Proposed Arrangements as they stand outweigh the lessening of competition likely to result from the Arrangements, the Commission has identified three areas where it remains concerned that potential benefits could be placed at risk. The areas for concern are that:
- the Salary Cap Arrangement creates incentives for Provincial Unions to evade or avoid the cap;
 - draft Salary Cap Regulations are intended to include certain financial and non-financial benefits whilst excluding certain other financial and non-financial benefits, but these have not yet been finalised or agreed; and
 - the proposed Salary Cap Arrangement creates a new and untested regime for which quantification of benefits is difficult to assess.
144. The Commission considers that the uncertainty over important elements of the Proposed Arrangements increases the risk that net benefits may not eventuate. Similarly, the nature of indirect benefits, such as spectator and viewer enjoyment, and the likelihood of increased funding when New Zealand teams are successful, are such that they are difficult to predict. The Commission has recognised these risks in its assessment of public benefits and detriments.
145. Should anticipated benefits not eventuate, or are less than anticipated, the extent of the ensuing net detriment can be limited by the Commission placing a finite period on the authorisation. Therefore, this authorisation will expire on the sixth anniversary of the date of the granting of such authorisation.
146. Imposition of the conditions and placing a finite period on the authorisation, as set out below, satisfies the Commission that the Proposed Arrangements will in all the circumstances result, or be likely to result, in a benefit to the public that would outweigh the lessening in competition that would result or be likely to result, or is deemed to result.

DETERMINATION

147. Pursuant to s 61(1)(a) of the Act the Commission grants authorisation to the NZRU, subject to the conditions set out below and for the period set out below, to:
- a. enter into the Salary Cap Arrangement in accordance with clauses 50, and 53 to 59 of the CEA; and
 - b. enter into an arrangement consistent with the Player Movement Regulations; and
 - c. give effect to that Salary Cap Arrangement by implementing and giving effect to salary cap regulations, such authorisation to apply only insofar as the salary cap regulations implement and give effect to clauses 53 to 59 of the CEA; and
 - d. give effect to the Player Movement Regulations.
148. This authorisation extends to the NZRU, Provincial Unions, any current and future rugby players who are or may in future be playing rugby in a Provincial Union which has a team competing in any competition covered by the Salary Cap and the RPC, and is subject to the following five conditions and time period imposed under s 61(2) of the Act:

Condition 1

The NZRU shall implement and give effect to regulations which provide for the effective audit, monitoring and enforcement of compliance with the salary cap regulations;

Condition 2

Except as expressly provided for in clauses 54.2 and 54.3 of the CEA and including the provision for team quarter final bonuses, all remuneration or other financial or non-financial benefits that are received by or on behalf of or paid for a player for or in connection with the provision of playing services to a Provincial Union, irrespective of the source of the remuneration or other financial or non-financial benefit, is included for the purposes of determining compliance with the salary cap for that Provincial Union;

Condition 3

Except as expressly provided for in clauses 54.2 and 54.3 of the CEA and including the provision for team quarter final bonuses, remuneration or other financial or non-financial benefits received by a player that are unrelated to the provision of playing services to a Provincial Union are excluded for the purposes of determining compliance with the salary cap for that Provincial Union. In this

regard, the onus shall be on the Provincial Union to demonstrate that such other remuneration or other financial or non-financial benefit is unrelated to the provision of playing services;

Condition 4

All non-financial benefits shall be accorded a financial value that reflects the fair market value of the non-financial benefit;

Condition 5

The NZRU shall commission and meet the costs of an independent review of the operation of the salary cap and Player Transfer Regulations to be commenced not before the fourth anniversary of the date of the granting of the authorisation and to be completed at least six months prior to the expiry of the authorisation; and

Time Period

Pursuant to s 61(2) of the Act, this Authorisation expires on the sixth anniversary of the date of the granting of the authorisation.

INTRODUCTION

1. The Applicant is the New Zealand Rugby Football Union Incorporated (NZRU).
2. By letter dated 9 November 2005, the Applicant applied to the Commission under section 58 of the Act for authorisation to enter into arrangements to which s 27 (either directly or via s 30) and s 29 of the Act might apply (“the Application”).
3. In June 2005, the NZRU announced the formation of a new domestic competition structure. Commencing in the 2006 season, a new two-tiered domestic competition, comprising the Premier Division (PD) and Modified Division One (MD1), will replace the existing three-division National Provincial Championship (NPC). The primary driver for both the new competition format for the NPC competition and the Proposed Arrangements was the NZRU’s Competitions Review, completed in June 2004.
4. The Competitions Review was a comprehensive study of the status of rugby competitions in New Zealand and concluded that many of the foundations upon which rugby in New Zealand is based are vulnerable, and that action was required to ensure New Zealand rugby remains both competitive and economically sustainable into the future.
5. The Competitions Review concluded that both the form and structure of rugby competitions needed to change. In particular, the review concluded that the NPC was suffering from a significant competitive imbalance whereby semi-final appearances and championship winners were dominated by the few biggest population centres.
6. This imbalance was seen to threaten the fan base, sponsor and broadcaster interest and, ultimately, the outlook for New Zealand rugby.
7. Whilst submitting that no crisis was imminent, the Applicant has argued⁶ that under the current arrangements, it believes there will be a continuation (and acceleration) of the trend towards uneven competitions, lower spectator interest, decreasing revenues and potentially less competitive Super Rugby and All Black performances. This is particularly because the new format of the NPC allows five unions previously in the 2nd Division to be in the Premier Division (two of which - Nelson Bays and Marlborough - have amalgamated so as to compete as a merged team under the name Tasman). These unions (Counties-Manukau, Hawkes Bay, Manawatu, Tasman) are likely to have fewer resources and not as much established talent as the current 1st Division unions.

⁶ NZRU Application, paragraph 18.6.

8. The NZRU states that the Proposed Arrangements are part of the NZRU's response to the recommendations made in the Competitions Review Final Report⁷ and are aimed primarily at:
- creating more competitive domestic competitions thereby, among other things, contributing to more attractive games, greater revenues, increased performance of New Zealand Super Rugby and All Black teams and better cost management within New Zealand rugby; and
 - ensuring New Zealand rugby lives within its means and is financially sustainable.

The Arrangements

9. In brief, the NZRU has asked the Commission to authorise two arrangements (the “Proposed Arrangements”) with the following provisions:

Table 4: “Provisions” of the Proposed Arrangements

Proposed Arrangement	Provision
Salary Cap Arrangement	“ Salary Cap ”: Imposition of a \$2m salary cap per PD union on payment of players in accordance with clauses 50, 53-59 of the Collective Employment Agreement ⁸ , and summarised in NZRU’s table set out in Appendix 1.
Player Movement Regulations	“ Transfer Window ”: Restriction on transfers for the period from 1 October to after the end of the Super 14 final as described at para 2.7(a) of the Notice of Application.
	“ Maximum Transfer Fees ”: The imposition of a \$10,000–\$20,000 maximum fee for transfers from a MD1 union to a PD union, and imposition of a nil fee for transfers between PD unions.

Salary Cap

10. The NZRU stated that, in relation to the Salary Cap Regulations, “the NZRU is not seeking authorisation for the Salary Cap Regulations themselves. Rather it is the Salary Cap framework as contained in the Application and the Collective Agreement for which authorisation is being sought”.⁹ This framework is attached as Appendix 1.

⁷ New Zealand Rugby Union Incorporated, Competitions Review Final Report, July 2004.

⁸ The Collective Employment Agreement between the New Zealand Rugby Union and the Rugby Players Collective, 2006-2008.

⁹ Email from Keith Binnie, General Counsel, NZRU dated 23 December 2005.

11. The salary cap applies to all salary payments paid by a provincial union (including those paid by third parties) to a player (or to a third party on behalf a player). This includes such “non-financial” benefits such as cars, free accommodation or other benefits.
12. The salary cap does not apply to salary payments of \$7,500 or less. Neither does it apply to a range of other forms of remuneration or benefits, including remuneration paid under genuine employment or player agreements¹⁰; player apparel; meals and match tickets; relocation expenses for loan players; relocation expenses up to \$1,500 for relocation of PD players; certain fixed provincial union performance/win bonuses (up to a certain maxima); financial loans and interest¹¹; nor monies paid in settlement of an employment dispute.
13. The level of the salary cap per provincial union participating in the PD of the new NPC competition is \$2.0 million in 2006, \$2.0 million plus a consumer price index (CPI) adjustment in 2007, and subsequently, the previous year’s cap plus the annual CPI adjustment.
14. The salary cap framework proposed by the NZRU has a series of “notional values” attributed to certain players. These players, such as All Blacks¹² and Super 14¹³ players receive NZRU salaries. In recognition of this, notional values for these players are included in a provincial union’s salary cap. The purpose of the notional value system is to reflect the value of the NZRU salaries paid to players in provincial teams and the competitive advantage that comes with having NZRU-contracted players in a team.
15. In addition, for the purposes of calculating the salary cap aggregate, certain discounts are applied to current and former All Blacks and to “veteran” players. Veteran players are defined as players who have played for eight or more years at NPC level. Only the net amount of the All Black/Veteran’s NPC salary after applying the discount is included in the salary cap.
16. The discount for All Blacks is designed to take into account the fact that due to commitments to playing for the All Blacks, it will almost always be the case that All Blacks will be unable to play in a significant number of the NPC matches. Therefore, the provincial union concerned will have to engage and pay for other players to take the place of the absent All Blacks for part of the competition.

¹⁰ An explanation of Genuine Employment Agreements or Genuine Player Agreements is set out in section 19 of the Draft Salary Cap Regulations, (attached as Schedule A to the NZRU Application) and states that in determining whether a genuine agreement exists, NZRU will have regard to whether the amount of remuneration reflects Fair Value remuneration, the form of remuneration (whether lump sum or not), whether the player is required to wear player apparel, etc.

¹¹ Provided interests rates are 2% above NZRU’s bankers’ mortgage interest rates.

¹² For All Blacks with 10+ tests who have played a test in the last three years, the notional value is \$50,000.

¹³ Super 14 Rugby players with 3 years or more experience receive a notional value of \$30,000 while players with less than 3 years experience receive a notional value of \$20,000.

17. Each provincial union must contract at least 26 players on a minimum guaranteed retainer of \$15,000 per annum. This appears to amount to a minimum squad spend of \$390,000 per provincial union and could raise competition issues under the Act. This point is discussed later in the Competitions Effects section.
18. The penalties for exceeding the salary cap are set out in the draft salary cap regulations and would be as follows:
 - \$3.00 for each \$1.00 over the cap for the first offence in the preceding five years;
 - \$5.00 for each \$1.00 over the cap for the second offence in the preceding five years; and
 - \$10.00 for each \$1.00 over the cap for the third offence in the preceding five years.
19. Even though the kinds of arrangements set out above are more correctly referred to as a total player payroll cap – because the cap applies to the total salary bill, not to individual salaries – the term salary cap has been widely adopted and the arrangement will be referred to as such throughout this Draft Determination.
20. The NZRU has advised that, at this point, it is continuing to liaise with the players' representatives with a view to finalising the draft salary cap regulations that were attached to its Application.

Player Transfer Rules

21. In relation to the arrangements concerning player transfer rules, the NZRU has stated that it is seeking authorisation of the Draft Player Movement Regulations provided to the Commission on 21 April 2006. These regulations are attached as Appendix 8 to this Determination.
22. The main features of these proposed rules when compared to the previous Player Transfer Regulations are:
 - the removal of transfer fees (except for representative players from MD1 unions moving to PD unions);
 - the widening of the transfer window, from 1 October of each year to the Friday after the Super Rugby Final in the following year, approximately 34 weeks; and
 - the removal of the quota system whereby a union can accept no more than five players transferring into its union per season (and no more than one All Black). It is proposed that there will no longer be any limitation to the number of transfers that may occur in a season.

Withdrawal of Proposed Changes to rules for Modified Division One Unions

23. In its Application, the NZRU also applied for authorisation of a third arrangement, referred in that document as the Proposed MD1 Arrangements. There were two provisions of relevance – a prohibition on MD1 unions paying players any more than actual expenses, as described at para 2.9(a) of the Application, and a prohibition on MD1 unions engaging players from outside their provincial boundary, except for front row players in certain rare cases, as described at para 2.9(b) of the Application.
24. These proposed arrangements (the MD1 Arrangements) were considered in the Commission's Draft Determination, and the Commission proposed to decline such arrangements. This was because it was not satisfied in all the circumstances that the MD1 Arrangements would or would likely result in a benefit to the public which would outweigh the lessening of competition arising from these arrangements.
25. By letter of 30 March 2006, the NZRU formally advised that it was withdrawing the request for authorisation of the proposed arrangements applying to Modified Division 1 (MD1) as set out in paragraphs 2.8 and 2.9 of its Application.
26. The Commission notified interested parties of the withdrawal of the MD1 Arrangement on 31 March 2006.

FRAMEWORK FOR CONSIDERATION

27. The Commission is responsible for deciding whether to authorise the Application under the relevant provisions of the Commerce Act.
28. In brief, the Commission must determine whether a lessening of competition would result, would be likely to result, or is deemed to result in the market, and, if so, whether the detriments flowing from this lessening of competition are outweighed by the public benefits that result or would be likely to result from the Proposed Arrangements. The Commission considers that a public benefit is any gain, and a detriment is any loss, to the public of New Zealand, with an emphasis on gains and losses being measured in terms of economic efficiency. If the Commission is satisfied that the public benefits outweigh the detriments, it may authorise the Proposed Arrangements.
29. The available evidence and analysis on the basis of which the Commission may be satisfied that authorisation should be granted includes quantitative data and analysis. The Court of Appeal has previously referred to "the desirability of quantifying benefits and detriments where and to the extent it is feasible to do so".¹⁴ Such analyses are desirable rather than indispensable and extensive analysis may

¹⁴ *Telecom v Commerce Commission* (1992) 3 NZLR 429 (CA) at 447, per Richardson J.

not be feasible in every case. Quantitative analysis, to the extent it is feasible, can serve to inform the Commission's deliberations as to whether authorisation should be granted.¹⁵

30. The Commission has estimated the benefits and detriments likely to arise from the Proposed Arrangements being in force for a period of five years, and discounted these benefits and detriments to their year zero present value. The Commission also notes that the Proposed Arrangements may extend beyond a five-year period, but considers that projections based on the Proposed Arrangements continuing beyond this time horizon are too uncertain to be of any value.

COMMISSION PROCEDURES

31. The Application was registered on 9 November 2005. In accordance with s 60(2) (c) of the Act, notice of the Application was provided to all parties who were considered to have an interest in the Application. In addition, notice of the Application was advertised in national newspapers on 15 November 2005. First submissions were requested by 13 December 2005 to assist the Commission in its preparation of the draft determination. By this date, a total of seven written submissions were received from:

- Air New Zealand;
- SKY TV;
- Canwest/Media Works (TV3);
- Northland Rugby Union;
- Manawatu Rugby Union;
- Wanganui Rugby Union; and
- Poverty Bay Rugby Union

32. Further first submissions were also received after this date from;

- North Otago Rugby Union;
- West Coast Rugby Union;
- Buller Rugby Union; and
- New Zealand Rugby League Incorporated.

¹⁵ Commerce Commission, *Decision 511* at {909}, quoted in *Air New Zealand v Commerce Commission (No 3)* (unrep, HC Auckland, Rodney Hansen J, 20 May 2004, CIV 2003-404-6590 para 5).

Draft Determination and Further Submissions

33. Pursuant to s 62 of the Act, the Commission released its Draft Determination on 9 March 2006.
34. The Commission's preliminary conclusions were as follows:
- it determined to authorise the NZRU's Application to implement Regulations and to otherwise enter into and give effect to the Salary Cap Framework and the Player Movement Framework, as specified in Appendix 1 to the Draft subject to the following conditions:
 - the NZRU puts in place robust mechanisms to monitor and enforce compliance with the Salary Cap Framework;
 - That the NZRU ensures that it puts in place mechanisms to ensure that no remuneration is excluded from the calculation of the Salary Cap Remuneration Payments, other than the "excluded remuneration" listed in Appendix 1, Part A;
 - That the NZRU ensure that it puts in place valuation methodologies that are consistent with generally applied valuation conventions; and
 - it determined to decline the NZRU's Application to pass the Regulations or otherwise enter into and give effect to the MD1 Framework specified in Appendix 1 to the Draft.
35. The Commission sought submissions from interested parties in respect of the preliminary conclusions reached in the Draft Determination, and asked parties to notify the Commission if they wished a conference to be held.
36. The Commission did not receive any such request for a conference under section from either the Applicant or any of the interested parties.
37. The Commission received submissions on its Draft Determination from the Applicant and the following interested parties:
- Counties Manukau Rugby Union;
 - East Coast Rugby Union; and
 - SKY TV.

Decision Not to Hold a Conference

38. After reviewing submissions on the Draft Determination and in view of the Applicant's withdrawal of the MD1 arrangements, as mentioned above, the Commission decided not to hold a conference on its own motion.

39. On 6 April 2006, the Commission notified interested parties of the decision not to hold a conference and that it intended to release its final determination on 18 May 2006 or before.
40. Over May 2006, the Commission carried out further econometric work and interested parties were provided with the opportunity to make further submissions by 22 May 2006 (on the econometric study), by 26 May 2006 (on the Commission's possible conditions) and by 29 May 2006 on an alternative approach to modelling for quantification of benefits.

Preparation of Determination

41. In preparing this determination, the Commission has fully considered and given weight to information and analysis from a wide range of sources. It has:
 - reviewed the information and analysis in the Application, including the economic analysis submitted by the Applicant's economic experts;
 - sought further information and clarification from the Applicant on a range of points;
 - considered submissions from interested parties;
 - interviewed the Applicant and a number of provincial unions throughout the country;
 - sought advice from its own legal, economic and industry experts; and
 - conducted its own analysis and modelling.

THE PARTIES

NZRU

42. The NZRU is an incorporated society, and is the administrative body governing the participants involved in the game of rugby union throughout New Zealand. It controls the running of all rugby competitions in New Zealand, both for domestic and international competitions.
43. For the year ended 31 December 2005, the NZRU had total assets of around \$108 million and revenue of around \$146 million. The corresponding figures for the year ended 31 December 2004 were \$84.5 million assets and \$104.9 million revenue. Budgeted revenue for the 2006 year is approximately \$92 million.
44. The members of the NZRU are the Affiliated Unions, Associate Members, Life Members and the New Zealand Maori Rugby Board Incorporated. According to Rule 5.2 of the NZRU constitution, each member (e.g., the provincial unions) is itself bound by the relevant rules and regulations, along with its members (e.g., the clubs) and the member's members (e.g., players, and all persons connected with the

playing or administration of rugby in New Zealand who are affiliated with a provincial union.)

45. The NZRU is managed by a board of nine directors, elected at the NZRU's Annual General Meeting by delegates from the provincial unions, and representatives of the Maori Rugby Board. Voting rights at General Meetings of the NZRU are determined by reference to the number of teams that a provincial union has, and vary from two to five votes. The Maori Rugby Board has two votes.

Provincial Unions

46. Until late 2005, there were 27 provincial unions in New Zealand. However after the recent amalgamation of Nelson Bays and Marlborough into a new union, Tasman, there are now 26 provincial unions.
47. These provincial unions, although affiliated to the NZRU, are also independent incorporated societies. Each provincial union has affiliated clubs mainly consisting of amateur rugby clubs and school teams.

Rugby Players Collective Incorporated (RPC)/New Zealand Rugby Players Association (NZRPA)

48. The RPC is a 400-member registered trade union and an incorporated society. The RPC was the vehicle through which professional rugby players negotiated a collective employment agreement (CEA) with the NZRU. The NZRPA is also a player-representative body, comprising All Black, New Zealand Sevens, Super Rugby, NPC 1st Division, National Representative and academy players. Both organisations have the same membership and board, although the NZRPA was established as the commercial arm for player interests, whilst the RPC is the players' negotiating body.
49. Previously, the NZRPA was receiving annual restraint-of-trade payments from the NZRU as part of an agreement for the NZRPA not to undertake commercial activity on behalf of the players. This agreement ended in September 2005 and was effectively replaced by a player-generated revenue sharing agreement with the NZRU as part of the CEA.
50. Neither of these organisations provides representation for amateur players. Amateur players do not have separate representation at this stage.

Players

51. The NZRU advises that there are approximately 139,000 rugby union players throughout New Zealand at the present time, of which approximately 1,100 are subject to the provisions of its Proposed Arrangements. The vast majority of players are amateurs who play for their local rugby clubs.

Sponsors

52. Sponsors are a key source of revenue for both the NZRU and the provincial unions. For the new NPC competition, the sponsors are Air New Zealand, Vero (sponsorship of referees) and Gilbert Balls.
53. The NZRU lists Adidas as its principal sponsor and Steinlager as a major sponsor of the All Blacks. Its other sponsors include Adecco, Air New Zealand, Canon, Coca Cola, DHL, Ford, Mastercard, Philips, Rebel Sports, Telecom, Weetbix, and Works Infrastructure.
54. Each of the provincial unions also has its own sponsors, usually contributing a substantial proportion of union revenue, both in cash and in-kind. For the 2004 year, cash and in-kind sponsorship accounted for [] of total combined revenue for all the 10 previous Division 1 provincial unions.¹⁶

Broadcasters

55. NZRU lists its broadcasters as News Corporation Limited (News Corp), SKY Network Television Limited (SKY) – which has live rights – and Television New Zealand, which has held the NZ broadcasting rights for the AXA Wellington Sevens.
56. Canwest Global Communications held the "free to air" NZRU rugby rights up until 2005, providing delayed coverage on TV3. Prime Television New Zealand Limited (Prime), recently acquired by SKY, now has these rights.
57. The sale of rugby broadcasting rights, under two agreements negotiated since 1995 by SANZAR, has generated and continues to generate significant revenue for the NZRU. For the latest five year contract, the NZRU has calculated that the NPC component of New Zealand's share of the SANZAR revenue is []

Other Relevant Parties

58. The other relevant parties include:
 - rugby union clubs and rugby union administrators;
 - rugby league clubs and rugby league administrators;
 - agents for rugby union players and for rugby league players;
 - Super 14 Franchises; and
 - Super 14 sponsors.

¹⁶ NZRU application, Schedule J, paragraphs 54, 55.

RUGBY IN NEW ZEALAND

Grass-Roots Rugby

59. The infrastructure of rugby in New Zealand can be thought of as pyramid-shaped, comprising four main tiers of players. The vast majority of the 139,000 registered players in New Zealand make up the bottom tier. Commonly referred to as “grass-roots” rugby, this tier represents those players playing from a young age at local schools, through to players at senior club level.
60. It is generally accepted that it is this substantial tier of players, spread right across New Zealand society, that gives New Zealand rugby its strength, and hence an ability to produce teams that perform well internationally. Rising to the top of this tier of players are various age-group representative teams that culminate in national age-group representative sides, such as New Zealand Secondary Schools, New Zealand Under-19, and New Zealand Under-21 sides. The New Zealand Maori side is another national representative side.
61. The New Zealand rugby season begins in mid-February with the Super 14 rugby competition and ends in early December with the All Blacks’ end-of-year tour. Although overlap occurs from both club rugby and All Black rugby on the Super 14 and NPC competitions respectively, the various rugby competitions are generally designed to flow from one to the next. Super 14 rugby is followed by All Blacks rugby (inbound touring sides), the Tri-Nations competition, the domestic NPC competition and concluding with the All Blacks’ end-of year tour.

NPC Rugby

62. The second tier of players comprises NPC representative sides that are selected from rugby clubs affiliated to a particular provincial union. The NPC is New Zealand’s domestic inter-provincial rugby competition and was first established in 1976. From 1985 onwards, the competition was tiered into three divisions, Divisions 1, 2 and 3, with promotion and relegation between divisions generally based on final league positions. These divisions each have competing teams that were derived from the 27 provincial unions throughout New Zealand.
63. The level of professionalism within the NPC competition varies by division. The 1st Division is considered professional/semi-professional; the 2nd Division is mostly amateur with some semi-professional players, whilst the 3rd Division is considered amateur.
64. Due to their commitments to All Black rugby, All Blacks are unavailable for their NPC teams for a significant portion of the competition and in 2007 will not be available at all due to Rugby World Cup commitments in France.
65. Within the NPC competition, specific rules exist with respect to the lending of players between provincial unions. The lending system enables provincial unions to agree to players playing for provincial unions other than their home unions. This

system is typically used by provincial unions that have a particular weakness in their teams and need to acquire players with particular skills, or by players who are not regularly selected by their home provincial union's team but are likely to be selected by another provincial union.

66. On 3 June 2005, the NZRU announced significant changes to the structure of the NPC competitions for the 2006 rugby season and beyond. These changes were driven by the NZRU's Competitions Review (discussed later in this section) and resulted in the formation of a new 14-team Premier Division (PD) competition and a 12-team Modified Division One (MD1) competition. The PD competition will run from late July until late October each year, whilst the "Premier B" and MD1 competitions will run from mid-August until mid-October each year.

Super 14 Rugby

67. The third tier of players comprises the Super 14 competition. The original Rugby Super 12 competition was developed by the NZRU, the Australian Rugby Football Union and the South African Rugby Football Union (together known as SANZAR) in 1995. The competition originally consisted of 12 teams – the five from New Zealand, four from South Africa and three from Australia.
68. After a number of successful years, which saw the popularity and marketability of the competition grow substantially, SANZAR announced in 2004 an expanded competition, the Super 14, to start in 2006 with two new teams being added, one from Australia and one from South Africa. The Super 14 competition starts in early February and concludes at the end of May each year.
69. The NZRU grants franchises to each of the five New Zealand Super Rugby franchises, allowing each of those franchises to select and manage a Super Rugby team in the Super Rugby competition.
70. Each of the five "host" provincial unions for the Super 14 franchises (Auckland, Waikato, Wellington, Christchurch and Otago) has a "catchment" of a certain number of provincial unions, from which it may source its players through the selection process, and also to which it distributes franchise payments at the end of the season. The size of the payments depends on the success of the franchise during the season. In 2006, the number of 1st Division provincial unions in each catchment, including the host union, varies between two and four.
71. All Rugby Super 14 team members in New Zealand are professional players engaged under NZRU employment contracts. Selection of players is carried out in two stages, and includes input from the All Black selectors. In the first stage, the coaches of the respective Rugby Super 12 teams (or their selectors) select players from the provincial unions contained within their regions. The players who are not selected in the first stage then become part of a draft system. In this second stage, the coaches of each team then 'draft' from the remaining players, regardless of players' usual provincial union affiliation.

All Black Rugby

72. The fourth and top tier of players in New Zealand rugby comprises the national representative side, the All Blacks. These are the most talented players in the country and are effectively filtered through the rugby clubs, NPC sides, and Super 14 teams until they are selected to represent New Zealand rugby internationally. In a normal year, the All Blacks play circa 12 tests against international sides. These tests typically include visiting teams to New Zealand (scheduled by the NZRU) as well as competing in the Tri-Nations rugby competition. The All Blacks also undertake an end-of-year tour in November of each year.
73. The Tri-Nations is a triangular competition comprising national sides from New Zealand, Australia and South Africa. This competition involves the national team of each country competing in two tests against the other competing nations. The Bledisloe Cup (Australia and New Zealand) and the Mandela Trophy (South Africa and Australia) are both played for within the Tri-Nations competition.
74. All Black commitments overlap those of the PD NPC competition, effectively depriving provincial unions of their All Black players for at least half, and often more, of the NPC season.

Revenue Streams

Sponsorship

75. Adidas and Steinlager are currently the key sponsors of the All Blacks. NZRU also enjoys sponsorship from Air New Zealand, Rebel Sports, Philips and a number of others.
76. At this level, the sponsorship usually takes the form of a cash contribution to the NZRU, although in-kind contributions may also be made in exchange for services. For example, Air NZ provides favourable ticketing arrangements for provincial union teams travelling for the NPC competition matches.
77. Sponsorship is also a major source of income for provincial unions, and is more likely to occur in-kind, in addition to cash, at this level. A summary of revenue sources for the 10 Division One unions for the years 2001-2004 shows that sponsorship revenue accounts for approximately half of total revenue for these unions.¹⁷

Broadcasting Rights

78. With the development of the Rugby Super 12 competition in 1995, the rugby unions of New Zealand, South Africa and Australia (SANZAR) signed an exclusive agreement with the News Corporation Limited (News Corp) providing News Corp with the rights to televise all rugby union matches (including NPC, Rugby Super 12

¹⁷ Brown Copeland Report, Schedule J, NZRU application, table between paragraphs 54-55.

and test matches) played in each of the respective countries, for the following ten years. In return, News Corp agreed to pay a total of US \$555 million to the three unions over those ten years. News Corp subsequently on-sold some of these rights to local television networks such as SKY Network Television Limited (SKY) which has further on-sold some of these rights to TVNZ.

79. In December 2004, SANZAR signed a further US\$323 million five year broadcast rights agreement with News Corp and South Africa's Supersport International (Pty) Ltd (Supersport), the provider of pay television sports coverage in Africa. The agreement was signed in anticipation of the expiry of the ten-year agreement in December 2005. News Corp has acquired the rights for New Zealand, Australia and the UK, whilst Supersport acquired the rights for Africa.
80. The new agreement does not include the broadcast market of France, Asia, the Americas or the rest of Europe, and SANZAR is negotiating directly with broadcasters in those markets to further increase the total broadcast rights fee.
81. SANZAR estimates the rights in these additional markets could be worth an additional US\$20 million to US\$30 million, which would raise the value of the entire package to an estimated US\$343 million to US\$353 million. On an average per annum basis, NZRU advises this would represent an increase of 24 to 27 per cent on the previous agreement.
82. The revenue derived from the sale of broadcasting rights are attributed as being instrumental in providing for the further growth and development of rugby in the three countries since 1995.

Gate-takings from spectators

83. The distribution of gate takings between provincial unions, Super 14 Franchise holders and the NZRU differs according to the particular competition involved. Gate takings for NPC competition games are retained by the home union until the competition reaches the semi-finals and finals stages. For finals and semi-finals matches, the home union then distributes a proportion (up to certain maxima) of the gate takings to the visiting team. Similar rules regarding distribution of gate takings apply to the Super 14 semi-finals and finals.
84. For international fixtures, the NZRU retains all the gate takings but pays the hosting union a set fee or percentage of gate takings received.
85. In 2004, total match income for the NPC Round Robin accounted for one third¹⁸ of total combined revenue for the 10 previous Division One unions. Ground signage income from NPC games made up another 5% of total revenue for these unions.

¹⁸ NZRU Application, Schedule J, page 12.

Funding from NZRFU

86. The NZRU pays \$58.50 per registered player to each provincial union or \$150,000 whichever is the greater.
87. Some of the NZRU funding provided to unions is tagged for specific purposes such as: Coach Support, Rugby Education Officer Operations, Rugby Administrator Officer Operations, Academy Grant, NPC Minimum Player Payments and Rugby Administrators in Schools.
88. Other funding which is not tagged includes funding for general distribution and 1st Division NPC support.
89. A one-off allocation of funds was recently made to provincial unions of approximately \$8 million. This was intended to assist all those unions who do not currently enjoy the benefit of having a significant number of NZRU-paid players. It included, but was not limited to, the four unions stepping up from the 2nd Division to the Premier Division. This included a payment of \$20,000 for each non NZRU-paid player up to a total of 26 for each of the Premier Division provincial unions.

Gaming revenue

90. Since 2001, gaming licensing and community trust revenue has emerged as a significant new source of revenue for provincial unions. According to GARAP¹⁹ data provided to the Commission by the NZRU, gaming revenue for the years 2001-2004 makes up at least 10% of total provincial union revenue.

The NZRU Competitions Review

91. As mentioned earlier, the primary driver for both the new competition format for the NPC competition and the Proposed Arrangements was the NZRU's Competitions Review. The objective of the Competitions Review was described in the report as:

“to conduct a comprehensive review of all NZRU competitions (including New Zealand's involvement in international competitions) to ensure they provide the best possible platform for sustaining a winning All Blacks team and maintaining rugby as a game accessible and attractive to all New Zealanders”.²⁰

92. The Competitions Review was a comprehensive study of the status of rugby competitions in New Zealand and concluded that many of the foundations upon which rugby in New Zealand is based are vulnerable, and that action was required to ensure New Zealand rugby remained both competitive and economically sustainable into the future.

¹⁹ GARAP stands for “Generally Accepted Rugby Accounting Principles”.

²⁰ NZRU Competitions Review, June 2004, paragraph 1.2.

93. The Competitions Review concluded that both the form and structure of rugby competitions needed to change. The analysis noted that New Zealand rugby's historical advantages had been eroded with the advent of the professional era and that changes were required to drive competitive innovation.
94. The review also highlighted the current trend towards increasing costs and expenditure, which were considered unsustainable in the absence of new revenue sources or cost reductions.
95. One of the key findings of the Competition Review was that the NPC 1st Division is not a competitively balanced competition. It used two measures of competitive uncertainty to reach this conclusion:
- winning percentages (number of wins divided by games played) over the period 1990 to 2002; and
 - championship wins and semi-final appearances for the period from 1990-2002.²¹
96. As a result of this analysis, it concluded that the NPC competition was suffering from a significant competitive imbalance whereby:
- the championship winners are highly concentrated: Auckland's dominance is undeniable;
 - Auckland's dominance has lessened since the advent of professionalism, but winning is concentrated in Auckland and Canterbury;
 - semi-final appearances and winning champions are dominated by the big population centres; and
 - although there is a wider spread of teams in the semi-finals, the ability of the smaller unions to convert semi-final appearances into championship wins is limited.²²
97. This imbalance was seen to threaten the fan base, sponsor and broadcaster interest and, ultimately, the outlook for New Zealand rugby.

The New Competition Format

98. In June 2005, NZRU announced the formation of a new competition structure. Commencing in the 2006 season, a new two-tiered competition, comprising the PD and MD1 competitions, will replace the existing three-division NPC. The PD will be competing for the newly named "Air New Zealand Cup".
99. The new PD will have 14 teams rather than the ten teams previously making up the 1st Division NPC competition. This competition will be comprised of the existing ten teams of Auckland, Bay of Plenty, Canterbury, North Harbour, Northland, Otago, Southland, Taranaki, Waikato, and Wellington, combined with four teams promoted from the old NPC 2nd Division, including Hawkes Bay, Counties

²¹ Ibid, paragraph 3.76-3.89.

²² Ibid, paragraph 3.88.

Manukau, Tasman (an amalgamation of the previous Nelson Bays and Marlborough provincial unions), and Manawatu.

100. The remaining teams from the previous 2nd and 3rd Division will comprise the new MD1 competition. These 12 teams are Buller, East Coast, Horowhenua-Kapiti, King Country, Mid Canterbury, North Otago, Poverty Bay, South Canterbury, Thames Valley, Wairarapa Bush, Wanganui and West Coast.
101. Provincial unions wishing to participate in either competition were invited by the NZRU to make formal, written applications to be submitted by March 2005. The applications to the NZRU were assessed against eligibility criteria formulated by the NZRU. The eligibility criteria included:
 - Prerequisite Criteria (“A” Team Management Structures, Stadia, Governance and Administration); and
 - Assessable Criteria (Population, Player Numbers, Playing History, Financial Performance and Position, Player Training and Development Structures, Governance and Administration).
102. The Prerequisite Criteria contained a series of minimum standards required against relevant categories for the provincial union to be considered for entry into either competition (although differing standards applied to each competition). The Assessable Criteria contained a series of percentage scores against which an applicant was assessed.
103. Although the NZRU Competitions Review Eligibility Criteria document stipulated a new PD competition of up to 12 teams, ultimately 14 teams were selected for entry into the division. The remaining 12 teams were subsequently accepted into the MD1 competition.

Development of Professionalism/Contracting Environment

104. The previous authorisation, granted to the NZRU in 1996 to authorise its Player Transfer Regulations, occurred soon after the International Rugby Board (IRB) announced that rugby union would abandon its previous amateur status, and instead freely adopt professionalism on a world-wide basis. In its recent Application to the Commission, the NZRU highlighted the development of professionalism within the sport:

“The environment and markets for rugby players and rugby as a form of leisure/work/entertainment in New Zealand and internationally have changed dramatically, in particular the increasing professionalism of all aspects of the game worldwide.”²³

105. Despite the substantial developments of professionalism in the upper levels of rugby, rugby remains an amateur sport for the vast majority of the 139,000 rugby

²³ NZRU Application, para 5.1.1, 9 November 2005.

players in New Zealand. In 1996, for the most part, only All Blacks and Super 14 players were considered able to subsist on their rugby remuneration. Presently, the NPC 1st Division players contain a mix of professional and semi-professional players, whilst the 2nd Division is considered mostly amateur with some semi-professional players, and the 3rd Division is considered amateur.

106. Up until 2000, most players had been engaged by the provincial unions as independent contractors. In 2001, the NZRU started negotiations with the RPC to engage all RPC-member players as employees.
107. The RPC supported the move toward its players being engaged as employees under a CEA as it gave consistency in benefits to its members. The first CEA was signed on 1 January 2002 and ran for three years. Although it had effectively expired, its terms and conditions remained in effect until the new CEA (signed on 1 November 2005) came into effect on 1 January 2006.
108. Under the CEA, all RPC member players are contracted by the NZRU and agree to be bound by the terms and provisions of the CEA, including the salary cap to be applied to the 2006 PD (conditional on obtaining Commission authorisation). The CEA restricts the NZRU and Premier Division provincial unions from engaging non-RPC member players on terms other than those in the CEA.
109. NPC players, although recruited and paid by the Premier Division provincial unions, are contracted under a NZRU contract (called a “Provincial Union Contract”) and players are then seconded by the NZRU to the Premier Division provincial unions.
110. Players who are selected to play for Super 14 teams, New Zealand Sevens, All Blacks, etc., are placed on separate NZRU contracts in respect of these teams. In this way, one player may be a signatory to multiple contracts, such as All Blacks, Super 14 or New Zealand Sevens contracts, in addition to his Provincial Union contract.
111. Key outcomes from the latest CEA were agreements from the NZRU to include revenue sharing for RPC players, as well as guaranteed retainers (e.g., a minimum of \$65,000 for all players contracted under Super Rugby contracts) regardless of whether those players are selected to play. In return for these conditions, the RPC agreed to an acceptable level of total NZRU player spending and minimum retainers as well as a salary cap to be applied to the 2006 Premier Division. The second CEA runs for three years and expires at the end of 2008.
112. The latest CEA also provides that RPC professional players will have a new revenue-sharing arrangement with the NZRU that will ensure 32.4 % of all player-generated revenue goes into an annual player pool, where player-generated revenue is all NZRU broadcasting revenue, sponsorship and match-day revenue. The revenue will be used for player payments and other player welfare initiatives.

113. Clause 60 of the CEA states that the provisions of the Agreement relating to salary cap and transfer will not take effect unless the Commission grants a final authorisation by 1 May 2006²⁴. It also sets out the arrangements as to what will happen if no final authorisation is granted (i.e., that the Player Transfer Regulations will apply and no salary cap will ensue).²⁵
114. The implementation of the revenue-sharing and guaranteed retainer provisions of the CEA are perceived as very significant developments in the player contracting environment, affording players a level of income protection not experienced before. The salary cap proposal was therefore negotiated in this context.

Overview of Services Supplied and Acquired in the Provision of Rugby Matches for Viewing by the Public

115. Before going on to consider the arrangements and their likely effects in detail, it is useful to consider all the various relevant services being supplied and acquired in the process of providing rugby matches/competitions of interest to the viewing public. For the purposes of the analysis, these rugby matches can be thought of as the combined “product”, which are being jointly produced, primarily by the NZRU, the provincial unions, the players, and the broadcasters for consumption by the viewing public.
116. It can be seen that there are a number of different types of transactions occurring between various parties involved, including but not limited to:
- transactions between NZRU and the provincial unions;
 - transactions between the provincial unions and the players;
 - transactions between the NZRU and some of the players;
 - transactions between the NZRU and SANZAR/News Corp and SKY; and
 - transactions between the provincial unions/players providing rugby matches and the public watching these matches, either at the game or on television.
117. Of the services provided by the NZRU to the provincial unions, it is the provision of national, regional and international rugby competitions services which are relevant in this matter. In New Zealand, the NZRU is the sole supplier of these services at present, though it shares both the proceeds from, and the control of the running of, the Super 14 franchise competition with its partners, the rugby organisations of Australia and South Africa, through SANZAR.

²⁴ The NZRU and RPC have subsequently entered into negotiations to allow for a variance of this clause to provide for a later authorisation date.

²⁵ Clause 60 (3) (b) (i) of the Collective Employment Agreement 2006-2008.

118. In respect of the new-look premier domestic rugby competition, the Air New Zealand Cup competition, the NZRU is clearly the controlling body for the running of this competition. The participating PD unions need to acquire competition services in relation to this competition from the NZRU if they wish to be part of this competition.
119. Provincial unions then compete with each other to acquire the services of premier rugby players to make up a representative team which will provide a competitive spectacle at any given match in the competition. From the supply perspective, players compete to supply their services to the Provincial Unions.
120. The final set of transactions is between two classes of viewers and either the provincial unions or the NZRU, as follows:
 - for spectators at the match, the transaction is between the provincial union and those spectators who pay to see the game; and
 - for television viewers, the transaction is between the NZRU/its broadcaster (SKY) and television viewers. Viewers must subscribe to SKY to see live coverage of games or they may view delayed coverage on free-to-air television.
121. Watching rugby is a form of entertainment for which there is clearly competition from other forms of entertainment, particularly sporting entertainment. However, rugby union is the most popular sport followed in New Zealand.
122. With all these transactions in mind, the basic premise of the NZRU is that, a salary cap is needed in order to grow (or retain) audience demand for the premier domestic competition, because it believes this will result in better distribution of player talent, leading to a more even competition which in turn, will be more attractive to both sets of viewers described above. With a more balanced competition and greater interest by audiences, there will be greater opportunities to increase sponsorship and broadcasting revenues, which in turn will ultimately create higher revenues for provincial unions. In other words, NZRU is arguing that, as a result of the salary cap (in combination with the new player movement rules) rugby, as the combined product of the services of the NZRU/the provincial unions/broadcasters and the players, will achieve a greater value to the end consumer, the viewing public. It argues that this will in turn lead to increasing revenues and provide a financially sustainable basis for the future of rugby in New Zealand.
123. The Commission's task, in short, is to assess the likely effects of the salary cap and new player transfer rules on the PD competition, by assessing the likely impact on competition in the relevant markets, and the likelihood or strength of the linkages claimed above. The Commission will then compare this state of affairs, referred to as the factual, with how it considers the PD competition would likely fare with the new competition structure in place, but without the salary cap and new player

movement rules (the counterfactual). A more detailed description of the factual and the counterfactual is provided later in this Determination.

The Purpose of the Proposed Arrangements

124. The NZRU believes that the unbalanced nature of the domestic provincial competition will worsen in the counterfactual, where only the existing transfer regulations would prevail. Indeed, the imbalance is likely to be exacerbated by the recent restructuring of the domestic competition, which saw the promotion of five former 2nd Division teams (with two of them merging) to the Premier Division level. The Applicant argued that failure to intervene to arrest this decline in competitiveness would result in a significant risk that spectator and viewer interest would fall, which would in turn put at risk the considerable sponsorship and broadcasting revenues it relies upon.
125. In the context of Decision 281, the Commission heard very similar arguments in favour of introducing the current Player Transfer Regulations, in that doing so would improve competitive imbalance in the NPC. The NZRU now argues that these Regulations are insufficient as a means of managing the domestic competition and enhancing balance. After considering several intervention tools employed in professional sports leagues overseas (e.g., player drafts, revenue sharing, further transfer restrictions), the NZRU settled on a salary cap as its preferred option. In addition, the new, liberalised Player Movement Regulations are to replace the Player Transfer Regulations.

The Uncertainty of Outcome Hypothesis

126. A key hypothesis in the economics of professional team sports is that demand by spectators and television viewers is stimulated by the uncertainty of the contests, in terms of: the outcomes of individual games; of an individual league season; and of the league in the longer term. The *uncertainty of outcome hypothesis* posits that an unbalanced league causes audiences to lose interest, and league revenues to fall.
127. In contrast, from the perspective of an individual team, the uncertainty attached to the outcomes of its games may be only one determinant of attendances at its games, and hence of its income. The club's own playing success may also be important, as audiences generally are said to prefer to support a winning team rather than a losing team. Thus, a team—at least one that aims to maximise profit or games won—may have an incentive to improve its playing success by hiring the services of better players, which should increase attendances and gate receipts, and sponsorship and television interest. Teams based on geographic regions with large, wealthy populations are likely to be able to generate larger incomes than those based on lower-drawing regions, and so to have an inbuilt advantage in acquiring the services of the best players. Although this benefits the wealthier teams, and improves their playing success, this may be at the expense of the other teams—who are less able to field competitive teams—and of the league as a whole, because the competition becomes unbalanced. In short, the wealthy teams, in the struggle for

success, may disadvantage (technically, impose a detrimental externality on) the poorer teams, and hence the league as a whole.

128. It is often argued that because of the inherent tendency of a professional sports league to become unbalanced in competition terms, with the implication of waning popularity and reducing financial viability, there is an incentive for the league to take steps to preserve uncertainty of outcome by ensuring that teams maintain a reasonable parity in playing strengths. Overseas, this is usually done by setting rules or controls designed (at least in part) to internalise the externality by encouraging (or requiring) each team to take into account the impact of its decisions on the league as a whole. Typically, these measures relate either to player labour markets, where the aim is to ensure that player talent—an important contributor to playing success—is distributed more evenly between teams; or to forms of revenue-sharing designed to reduce the underlying inequalities in incomes between the teams.
129. Payments caps, which entail imposing maximum salary controls, or limiting the total salary bill of each team, fall into the former category. These may contribute to creating league balance by preventing the wealthier teams from spending more to hire the better players. A concomitant of such controls is that they are also likely to have the effect of restricting the rights of players to sell their services to the team that would otherwise value their services most highly, and pay the highest salaries.

General Comments - the NPC Competition and NZRU's Proposed Salary Cap

130. The Commission now proposes to make some general comments on the state of the NPC Competition and discuss some of the potential limitations of NZRU's proposed salary cap as a mechanism to improve competitive balance in that competition.
131. As discussed below, the Commission has identified a number of issues that appear to weaken the claimed link between the Proposed Arrangements and the claimed improvements in competition balance.
132. The Commission's own empirical investigations (which examined the relative standard deviations in winning percentage, championship points, and match points, over time) revealed that there had been a gradual decline in competitive balance in the NPC First Division between 1997 and 2000. However, competitive balance had remained relatively stable, and even shown signs of improvement, between 2000 and 2005.
133. Examination of the relative standard deviation of winning percentage, which is the most widely used measure of competitive balance in the Sports Economics literature, suggests that there was a decrease in competitive balance for the period between 1997 and 2000, but an improving trend for the period between 2000 and 2005, notwithstanding a sharp decrease in 2004. The relative standard deviations of championship points also showed similar trends. The relative standard deviation

of match points tends to decrease over time, indicating that the unions are closing their gaps in terms of match points.

134. This evidence seems to contradict the NZRU's problem definition: that there is a natural trend towards declining competitive balance, which may be arrested by the Proposed Arrangements. Perhaps a more plausible rationale is that the Proposed Arrangements might help to correct the worsening balance expected from the recent promotion of five weaker unions to the PD under the new competition format.
135. The Arrangements proposed by the NZRU involve a so-called "salary cap", under which the total player salary bill for each Premier Division team would be limited to a certain common level, initially to \$2 million in the first year (2006), and index-linked to the CPI in subsequent years. Subsidiary features are that each team must have a squad of at least 26 players, and each of those players must be paid no less than \$15,000 per NPC season.
136. In its Application, the NZRU cited the Australian experience with salary caps in the NRL and AFL as providing examples where payroll restrictions improved competitive balance and the overall financial strength of the league. Reported benefits to those leagues include significant increases in match attendances, sponsorship and broadcasting revenues, and club profitability. In its submission on the Draft Determination the NZRU reiterated this point by arguing that there is recent and compelling Australian evidence of increasing gate takings as competitions become more even.²⁶
137. The NZRU's reference to the experience of the NRL under a salary cap scheme is supported by Ian Schubert (Director, Registration and Salary Cap Auditor – NRL), who stated in his first submission to the Commission that growth in spectator numbers at NRL matches in recent years "... can be put down to the unpredictability of the games and the fact that so many clubs were in contention to make the playoffs in the 2005 season".²⁷
138. Whilst this evidence seems to provide compelling support for a salary cap policy, the Commission notes that the AFL in 1987 adopted a suite of labour market restrictions and revenue sharing (in addition to a salary cap), so it is unclear precisely how much of the AFL's success is attributable to the salary cap alone. The NZRU did not address this point in submissions on the Draft Determination. Similarly, it is unclear from the information provided by the NZRU what role, if any, a range of other factors—such as changes in cultural trends, sporting tastes, population growth, demographic shifts, etc.—might have contributed to increasing the popularity of Australian rugby league and Australian rules.
139. Mr. Schubert stated in a submission on the Draft Determination that:

²⁶ NZRU Submissions in Response to Draft Determination, Part I, para 20.

²⁷ The Application, Schedule I: Ian Schubert, p.8.

... factors such as cultural trends, sporting tastes, population growth and so on have been in existence for far longer than we have been enforcing the Cap but have not provided any noticeable change in the health of the game at any level.²⁸

140. It is not apparent to the Commission that in making this comment, Mr. Schubert has conducted any rigorous empirical analysis that controls for the types of factors mentioned above. As such, it cannot be concluded with any certainty that the salary cap in and of itself has led to the apparently significant growth in spectator interest in Australian rugby league.
141. In fact, inasmuch as the NRL promotes the success of its salary cap as having improved competitive balance and enhanced fan interest, there are detractors of very same scheme, who argue the NRL cap has not been particularly effective at all. A recent (April 2006) Sydney Morning Herald article suggests that in fact the wealthiest clubs in the NRL have remained the most successful under the cap, both in terms of premiership placings and appearances in grand finals.²⁹
142. Even if it were clear that the Australian salary caps have been as successful as claimed by the NZRU, it is not at all clear that comparable schemes applied to rugby in New Zealand would produce similar results. Fort (2003) makes the point that "... quality of competition is simply a preference issue {for fans}, and preferences can change over time. Fans can feel however they want to about competitive balance!"³⁰ Just as preferences may differ over time, it is entirely possible that they may differ across countries. Competitive balance may attract crowds in some countries and not in others. Whilst overseas experience with salary caps may provide useful insights to some extent, it seems likely that the most helpful inferences would be made from New Zealand data. This is discussed in greater detail later.
143. The Commission notes that, in a submission to the Commission, Mr. Schubert stated that the salary cap itself cannot be entirely credited with the fiscal performance of the various NRL clubs. Club administrators had become increasingly efficient at managing their financial affairs and rosters in recent years, in no small part due to the employment of more qualified personnel. This anecdotal evidence suggests that organisational structure has an important part to play in managing the effectiveness of professional sports leagues.
144. A key ingredient to a well-designed salary cap scheme is strong player mobility, since barriers to player movement would undermine the primary aim of a cap – to redistribute player talent between provincial unions to achieve more balanced teams. To this end, the NZRU proposes to relax the current transfer restrictions,

²⁸ Ian Schubert, Submission in response to the Draft Determination, p.1.

²⁹ Sydney Morning Herald, 4 April 2006, "It's a Bit Rich to Say Cap Levels the Field", <http://www.smh.com.au/news/league/its-a-bit-rich-to-say-cap-levels-the-field/2006/04/03/1143916464835.html>.

³⁰ Fort, R., (2003), "Thinking (Some More) About Competitive Balance", *Journal of Sports Economics*, 4(4), pp. 280-3.

remove the current transfer quota, and abolish all transfer fees between unions in the Premier Division.

145. The apparent strong complementarities between the proposed salary cap and changes to the current transfer regulations suggest that it is sensible to analyse together the effect of these two arrangements.
146. However, the Commission has found a number of factors that would appear to weaken the claimed link between the Proposed Arrangements and hoped for improvements in competition balance. These are discussed following the review of the theory of salary caps.

The Economics of Salary Caps

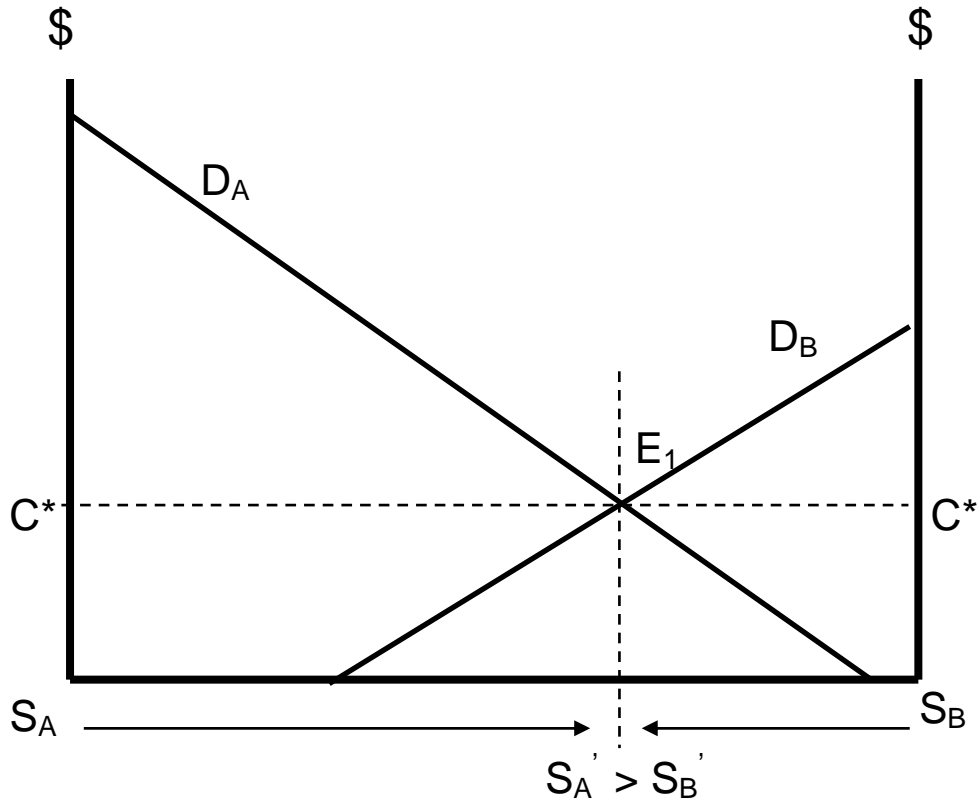
147. The likely impact of a salary cap can be investigated using a relatively simple, stylised model of a “talent” market – that for premier rugby players.³¹ A stylised view of this market is shown in Figure 1. This model is based on the following simplifying assumptions:
- a two-team league, comprising Teams ‘A’ and ‘B’, to allow the use of a graph-based approach;
 - two grades of player are available to the league, ‘regular’ players and ‘star’ players;
 - ‘regular’ players are available in unlimited quantities at the ‘minimum wage’ (assumed to be zero for simplicity);
 - ‘star’ players are available in a fixed supply (S), and all are of the same quality;
 - each team has a downward-sloping demand curve (or marginal revenue product curve) (D), showing the additional revenues per year accruing to the team from the recruitment of each additional ‘star’ player;³²
 - Team A is a higher revenue team than Team B, because it is able to draw on a larger or wealthier regional population base, and this is reflected in a higher talent demand curve ($D_A > D_B$); and
 - each team seeks to maximise profits, and players seek to maximise income.³³

³¹ The model is based on the following papers: Rodney Fort and James Quirk, “Cross-subsidisation, Incentives, and Outcomes in Professional Team Sports Leagues”, *Journal of Economic Literature*, vol. XXXIII, September 1995, pp. 1265-99; and Stefan Kesenne, “The Impact of Salary Caps in Professional Team Sports”, *Scottish Journal of Political Economy*, vol. 47, 2000, pp. 422-430.

³² This assumes that the recruitment of another star player results in more won games, and this in turn generates more revenues from gate receipts and sponsorship, albeit subject to diminishing returns.

³³ A general finding in the sports economics literature is that league imbalance is less in leagues where teams pursue profits, rather than wins. However, it seems unlikely that the provincial unions in the NPC are profit-orientated.

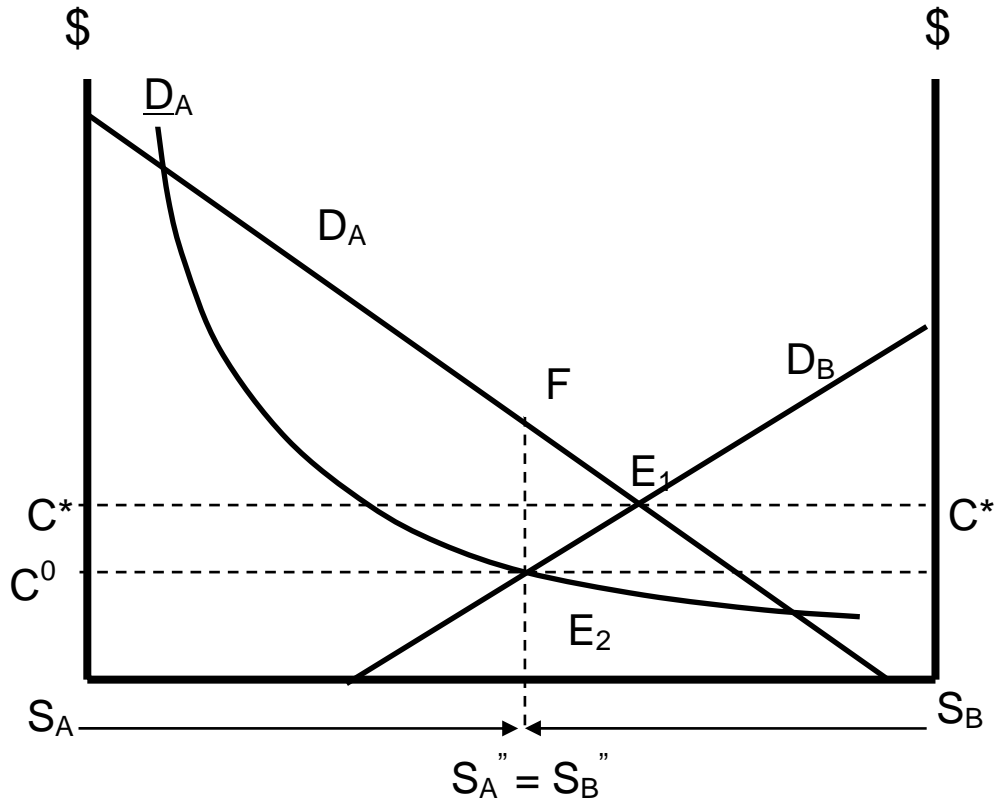
Figure 1: A Stylised Player Market in a Two-team League



148. In the absence of any player transfer restrictions, market equilibrium is found at point E_1 , where the two demand curves intersect. Both teams place the same value on the marginal star player, and so there will be no incentive to trade players, or for players to move to gain a higher salary. The marginal cost of ‘star’ players is C^* , and the total league payroll is represented by the rectangular area SAC^*C^*SB .³⁴ The result is that Team A ends up with more than half of the available ‘star’ players, and by assumption wins more than half of the games.
149. Suppose now that a salary (total player payroll) cap is introduced, in the form of a fixed annual sum per team. The impact is shown in Figure 2. The introduction of the salary cap—assuming that it is binding—causes the nature of the team’s demand curve to change: instead of reflecting what players are worth to the team in additional revenue terms, it indicates what the team can spend as a maximum determined by the cap. Thus, technically speaking, the demand curve becomes a rectangular hyperbola, showing the various combinations of numbers of ‘star’ players and salaries that the cap allows. The new demand curve \underline{D}_A applying to Team A is shown below.

³⁴ It is likely that if the ‘equal-quality’ assumption were relaxed, infra-marginal players would be able to extract higher salaries (some of the rents) from their employing teams.

Figure 2: Impact of the Salary Cap in the Two-team League



150. To be binding, at least one of the curves for the teams must lie below point E_1 , for otherwise that point would be chosen, and the cap would not constrain. Given the initial positions of the demand curves shown in the Figures, it is likely that Team A—given its higher demand curve, D_A —would be bound by the cap and Team B might not be. Team A is indeed bound, at every level of player numbers where the hyperbolic demand curve, D_A , lies below the original linear demand curve, D_A . The new, cap-constrained, market outcome is now found at the intersection between D_A and D_B , at point E_2 .
151. Two likely effects of the cap are immediately obvious: the salary falls from C^* to C_0 , and with it the total payroll cost; and the available ‘star’ players (and, by implication, wins) are now (in this illustrative case) shared equally between the two teams. The salary reduction implies that both teams are likely to experience an increase in profits. For this reason, salary caps overseas have tended to be more popular with owners of teams than with top players. However, to generate these effects it is important that the salary cap constrains teams’ player payrolls, and that they are not capable of being evaded or avoided by teams (i.e., it is a “hard” cap rather than a “soft” cap).

152. The generic economic welfare (efficiency) implications of the cap now need to be considered. First, and subject to a caveat to be considered shortly, the distribution of talent at $SA' = SB'$ is one of disequilibrium, because the value of the marginal 'star' player to Team A is greater (at point F on DA) than its value to Team B (at point E2 on DB). Team A would like to spend more to attract good players from Team B, and those players would wish to move to gain the higher salaries offered. The extent of this misallocation of 'star' players—or allocative inefficiency—is measured by the size of the triangle FE1E2. Clearly, the further the salary cap moves the distribution of talent from E1, the larger will be this loss of allocative efficiency, all else being the same.
153. The conclusion drawn from the analysis in Figure 2, that the intersection between the two teams' demand curves at point E1 is the socially (as well as privately) desirable outcome, is based on the implicit assumption that a team's willingness to pay for a 'star' player, as reflected in the height of its demand (D) curve, is a measure of the social (as well as the private) value of that player. However, this assumption could be suspect in the context of a professional sports team league where, as in Figure 1, the behaviour of one team with a large demand for 'star' players ("the dominant team") could result in the league as a whole becoming competitively imbalanced. As noted above, the impact of imbalance could be felt in a reduction in the audiences for all of the other teams, but this detrimental effect on other teams is not factored into the dominant team's valuation of acquired players. From the wider social perspective, it should be.³⁵
154. If this were accepted, the social demand curve of the dominant team would be lower than the private demand curve illustrated in the Figures, because it would incorporate the adverse externalities imposed on the other teams (e.g., reduced revenues from lower attendances, sponsorship, etc.), which make their demand curves too low. The demand and revenues of the dominant team would fall, but by less than the rise in the combined demands and revenues of the other teams, leading to higher revenues for the league as a whole. In other words, if the free market were allowed to operate without restraint, it would fail to produce an efficient outcome - it would result in some degree of market failure. Hence, it could be argued that some level of restriction could actually improve allocative efficiency, which would constitute a public benefit, without there being any off-setting losses of allocative efficiency.
155. However, a view of this kind would normally be subject to various provisos: that the distortion is large enough to be worth worrying about; that the regulations are relatively low cost; and that the amount of regulation proposed would be more or less the amount necessary to correct for the perceived market distortion. Given the uncertainties in the nature and strength of the linkages involved here between salary cap, player reallocations, degree of competition balance and revenue implications

³⁵ It is also possible that because the players in a team may be expected to complement each other, the whole is better than the sum of the parts considered separately. Hence, the addition of a new star player could cause the team's performance to improve by more than the direct contribution of that player.

(which are explored further below and in the Benefits section), this approach to the analysis would be very difficult to do simultaneously. Consequently, the Commission intends to consider the detriments and benefits separately.

156. As just discussed, a cap, by constraining teams from reaching the distribution of player talent that would occur in a free market, creates incentives for teams to evade or avoid the cap if their aim is to maximise profits (or wins). There have been some notable cases in overseas leagues where teams have been found to have exceeded their salary cap. Hence, to be effective, the league must incur monitoring and enforcement costs (as well as the initial set-up costs) to ensure that the salary cap is adhered to. These costs can be treated as being a productive inefficiency loss from the Proposed Arrangements, in the sense that they represent a use of resources that would not be needed absent the cap.
157. The analysis so far assumes a fixed pool of star talent, which remains unchanged even when the salary cap has the effect of lowering salaries, and of restricting player movements. This raises two issues. First, players may leave to go overseas. Secondly, players whose desire to move between teams may be frustrated by the cap, could become ‘disgruntled’ and sap team morale.
158. A further consideration raised by Professor Fort is that the distribution of salaries within capped teams could become more unequal. This also could give rise to ill-feeling.
159. On top of these factors, allowance also has to be made for; (a) the effective withdrawal of the current Player Transfer Regulations, which will remove an impediment to player movement, and hence potentially add to competitive imbalance; and (b) the introduction of the four ‘promoted’ teams to the new Premier Division, which will also add to competitive imbalance, albeit that this will also be the case in the counterfactual as well. Both of these changes would increase the burden on the salary cap to improve competitive balance beyond what it is today.
160. With this background in mind, we now go on to consider potential limitations of the salary cap proposed by the NZRU.

Potential Limitations of the NZRU’s Proposed Salary Cap

161. The discussion above indicates that the potential impact of a salary cap depends upon the “hardness” of the cap, and (assuming it is “hard”) the degree of constraint it would provide. In addition, there are certain other factors of relevance to consider. In summary these factors are:
 - the proposed cap may not be as ‘hard’ as supposed or intended;
 - initially at least, the cap would constrain only a few provincial unions;

- the apparent significant disparity in incomes of the provincial unions in the Premier Division;
- top players may be resistant to moving between unions to maximise their chances of being selected for Super 14 teams and/or the All Blacks;
- team-specific talent may dampen the impact of player redistributions on competitive balance; and
- limited (or at best, mixed) empirical evidence to suggest that spectators at live matches and television viewers find even competitions more attractive than uneven competitions.

162. Each of these factors is discussed briefly below.

Hardness of the Cap

163. The NZRU asserts in its Application that the proposed cap will be a ‘hard’ one. The cap will be fixed at \$2 million per team in 2006, and then in the subsequent two years will be adjusted according to changes in the Consumer Price Index (CPI). The remuneration included in the cap would be all remuneration payments paid by a provincial union, or by third parties, to a player, together with all non-financial benefits (e.g., educational fees waived and other goods in kind, such as holidays, vehicles, food, insurance premiums and child support payments). Forms of remuneration excluded from the cap include: that paid pursuant to a genuine employment or player agreement; finals team bonuses within agreed maximums; and the reimbursement of various expenses (e.g., relocation expenses for loan players, playing apparel and match tickets). The remuneration in the cap also includes an allowance for NZRU retainers or “notional values”, and discounts for current and former All Blacks and for veterans.
164. In asserting that the proposed cap would be a ‘hard’ rather than ‘soft’ one, the NZRU defines a soft cap as one that “allows teams to spend a proportion of their individual revenues (but no more) on players’ salaries”. Although this is one possible interpretation of a soft cap, the economics literature adopts a more precise definition. For example, Staudohar defines a hard cap as one where no exemptions are allowed on spending above a maximum payroll threshold, whereas a soft cap is one in which some exemptions are permitted.³⁶ These definitions are largely

³⁶ P D Staudohar, “Salary Caps in Professional Team Sports”, *Compensation and Working Conditions*, spring 1998. A commonly cited example of a soft cap is the type employed by the NBA. Under agreements signed in 1983, teams were allowed to retain at any price one player who became a free agent, and that player’s salary would not count against the cap. This concession has become known as the *Larry Bird exemption*, and is often blamed for the apparent ineffectiveness of the salary cap scheme since it allowed teams to retain highly skilled superstar players, who would likely otherwise be effective in balancing the league if redistributed.

consistent with those employed by Professor Fort in his submission in support of the NZRU.³⁷

165. Taking Staudohar's definition, it seems the NZRU's proposal resembles a hard cap more than a soft one, as no union's spending on player salaries (plus notional values, and taking into account the appropriate player discounts) may exceed \$2 million + CPI.
166. However, the Rugby Players Collective (RPC) has commented to the Commission that the cap may in fact be a soft cap, to the extent that there would be scope for wealthy unions to increase legitimate payments to players outside the cap, in order to avoid the limitations imposed by the cap. The Commission understands that remuneration paid pursuant to a "Genuine Employment or Player Agreement" is to be excluded from the cap.³⁸ These payments may include certain fixed team performance bonuses and special payments for promotional appearances or speaking engagements, amongst others. The Commission's concern is that what may fall under the category of "genuine employment" or "player agreements" is so broad that there may be scope for the abuse of this exemption as a means of undermining the cap. The final result might be that the payrolls of wealthy unions may not breach the specified cap, but in effect total player payments may routinely exceed it.
167. In submissions on the Draft Determination, the NZRU argued that the Regulations require provincial unions to demonstrate that any such employment is genuine and the remuneration represents fair market values (i.e., no rorts), and therefore, this exemption is "very hard to cheat". However, it remains that the Regulations are yet to be finalised, and the audit processes and valuation methodologies referred to by the NZRU are presently unclear. As such, it is difficult for the Commission to be satisfied that exemptions such as those discussed above would not be used to soften the proposed salary cap.
168. It is also plausible that wealthy unions could use non-pecuniary benefits to undermine the cap. Indeed, some of the larger unions made this point strongly, arguing that funds could be devoted to better coaches, medical specialists, facilities and the like. Rottenberg, as long ago as 1956, predicted that the intended effect of a salary cap scheme could be undermined by wealthy teams outbidding non-wealthy teams for talent using non-monetary benefits and perquisites, thus leaving the distribution of players between teams unaffected.³⁹ The NZRU suggests in its Application (and supporting statements are made by Professor Fort) that non-financial benefits are to be included under the cap.⁴⁰ For instance, the NZRU intends to include in the yet to be finalised Regulations a valuation policy for motor

³⁷ The application, Schedule H: Dr Rodney Fort Report, para 28.

³⁸ The application, p.5.

³⁹ S. Rottenberg, "The Baseball Players' Labor Market", *The Journal of Political Economy*, 64(3), 1956, p. 257. Rottenberg's comments were made in the context of individual player salary caps, but the same reasoning applies equally to the case of team payroll restrictions.

⁴⁰ The application, p.5; Schedule H: Dr Rodney Fort Report, para 76.

vehicles,⁴¹ and is currently developing a valuation policy for accommodation benefits. The NZRU also stated in submissions that the Regulations would allow it to issue valuation policies on other types of benefits, although these policies have not yet been formulated.⁴²

169. When the possibility of provincial unions using non-financial benefits to circumvent the cap was put to the NZRU, it submitted that it would be very concerned if wealthy unions were to adopt such measures to avoid the cap, and it would respond by carefully auditing the spending behaviour of unions. Apart from increasing monitoring costs, this response does not address the problem of unions making legitimate payments permitted by the Regulations, but that have the effect of undermining the cap.
170. In fact, the NZRU indicated in submissions on the Draft Determination that it had no intention of capping or restraining payments made by unions for the use of players' image rights in promoting local rugby, or the employment of players as coaches, as it considers these to be legitimate business (development) activities. The NZRU went on to say that the salary cap is intended to capture rugby-related payments to players. Payments unrelated to rugby that are "genuine and for valuable consideration" should not be regarded as reducing the hardness of the cap.⁴³
171. Professor Fort has reviewed the proposed salary cap, and reached the conclusion that it is "well designed to avoid loopholes mistakes of the earliest versions of North American league caps"; and that: "The audit process is well-specified and, if pursued with vigour, should be effective in direct relation to the amount of energy and resources devoted to it."⁴⁴ He did caution, however, that the monetary fines might need to be increased, or other types of penalties (e.g., forfeiture of competition points) added to ensure compliance. It is worth noting that the NRL has both features, and yet has experienced two significant (and other lesser) salary cap breaches before the recent allegation concerning a breach by the Warriors team.
172. Team roster instability (season to season variability in playing squads) is also a feature of North American 'capped' leagues, where top players have had to be released when deferred payments became due, and this in turn led to softening of caps. It is possible that similar forces could lead to pressure on the NZRU to "soften" the cap.

⁴¹ It is proposed that there would be three valuation bands based on the market value of the vehicles, which would determine the value to be included in the salary cap. Where a provincial union transfers the ownership of a vehicle to a player, the full market value would be included in the salary cap. It would be incumbent on unions to demonstrate the market value of the motor vehicle, but the NZRU would have the ability to overrule this and apply an alternative value.

⁴² In submissions the NZRU stated that the Regulations would incorporate reference to valuation policies having to be in accordance with "generally accepted valuation policies and procedures", but, with the exception of the motor vehicle valuation policy discussed earlier, failed to specify what those policies and procedures were.

⁴³ NZRU Submissions in Response to Draft Determination, Part II, para 4, 15.

⁴⁴ The Application, Schedule H: Dr Rodney Fort Report, para 89.

173. The qualifications in the last few paragraphs raise doubts as to how ‘hard’ the proposed salary cap really will be over time. Even well-established salary caps seem difficult to manage and monitor, as suggested by recent comments by the coach of the Auckland Warriors (of the NRL),⁴⁵ and the NZRU has no previous experience of operating a salary cap. In addition, it seems to be very difficult in practice to frame rules of sufficient comprehensiveness to cover all possible eventualities, and the Commission has only been provided with Draft Regulations. As noted above, the NZRU stated that it is not seeking authorisation for the Salary Cap Regulations themselves, but rather for the salary cap framework as contained in the Application and the Collective Employment Agreement.
174. Given all these factors, the Commission’s view remains that it cannot be satisfied that the proposed salary cap would be as hard as the NZRU claims. To be in a position to be satisfied that benefits would exceed detriments, the Commission must be satisfied that the cap would work as intended.

Constraint Provided by the Cap

175. The second issue is the degree of constraint the cap would provide, even if it were a hard cap. The original intention was to set the cap at \$2.3 million, which would have been above the highest salary payroll of any of the First Division Unions, and then to reduce the cap in the subsequent two years to \$2.0 million and \$1.7 million respectively. This would have made the cap constrain more swiftly than it is likely to do under the CPI-adjustment formula proposed. The fact that it chose to relax the cap as initially specified might suggest that the NZRU could come under pressure to relax it later when rising income levels may push more unions up to the cap.
176. Moreover, caps in North American professional sports leagues have often taken the form of a revenue-sharing payroll cap. Here, the eligible revenues of the league as a whole are determined, a proportion of that is allotted to salaries, and the resulting figure is then divided by the number of teams to derive the ‘cap’. Each team can spend no more than this figure on player remuneration, and no less than 75% of this figure. The impact of this approach is to produce much less inequality between the teams in the league than the salary cap proposed by the NZRU. Professor Fort considers that under the NZRU-type of cap the adjustment to greater competitive balance will be slower:

Thus, it should be expected that movement toward equal outcomes on the field can only come over time as enhanced balance increases fan spending and lower-revenue teams move toward the level of the pure cap.⁴⁶

177. In his expert economic submission on behalf of the NZRU, Mr. Copeland reported that the NZRU’s analysis of the effects of the salary cap, using 2004 data, showed

⁴⁵ John Matheson, “Gould tells Warriors get out”, 26 February 2006, www.stuff.co.nz.

⁴⁶ The Application, Schedule H: Dr Rodney Fort Report, para 25.

that [] would have exceeded the cap, [] would have fallen just short, and most of the rest would have fallen [].⁴⁷

178. Professor Fort undertook an analysis to predict which provincial unions would be caught by the cap over time.⁴⁸ He assumed that inflation would continue—and hence the cap would rise—at 3% per year, and that salary cap payments by Unions would continue to grow at the nominal rates revealed by data for the period 2001-04. The [] Union was already ‘caught’ in 2005. In 2006 it would be joined by []. He thought there was “a strong chance” that the [] Union would join the group in either 2007 or 2008. Although Professor Fort does not report this, it seems unlikely that any other union would join the capped group of [] for a number of years, since []. Nonetheless, he felt that “the cap is effective in the sense that perennially successful, larger-revenue teams will have to adjust to the cap.”
179. As Professor Fort notes, while this may have the desirable effect that a few of the largest-revenue unions will be constrained by the cap, it may also produce perverse incentives to ‘cheat’ the cap. As Fort and Quirk (1995, op cit) show, and as is evident in Kesenne (2000, op cit), when a cap is binding only on some teams and not on others, constrained teams tend to value the last units of talent hired by unconstrained teams more than the unconstrained teams themselves. Constrained teams will therefore wish to purchase more talent, and unconstrained teams will wish to purchase less talent. This provides ideal conditions for cheating and creates enforcement problems for league operators. It follows from the analysis presented by these authors that the greater the inequality in spending between unions (i.e., the fewer unions constrained by the cap), the stronger are the incentives to cheat, and the greater are the attendant league monitoring costs.
180. Likewise, Mr Copeland considered that “in the next two or three years at least, it seems likely that the salary cap will not restrict the purchase or retention of players for other than, at most, [] provincial unions”, but thought that “further out” the disparity between unions in player payments might reduce if the cap and other measures are successful in lifting the resources of the poorer unions.⁴⁹
181. In terms of Figures 1 and 2, rising union incomes over time would likely cause their player demand (D) curves to shift upwards, resulting in wealthy teams like A becoming even more constrained (the ‘gap’ between the salaries they would like to pay and the cap would increase), and poorer teams like B being able to afford higher salaries. However, it has to be recalled that these effects would be ameliorated by the cap itself also rising with likely increases in the CPI.
182. The RPC has also indicated to the Commission that, given that the CEA is only for three years, it might seek to negotiate a significant increase in the cap in 2009 if the

⁴⁷ The Application, Schedule K: The NZRU Analysis of Impact of Cap.

⁴⁸ The Application, Schedule H: Dr Rodney Fort Report, paras 71-73.

⁴⁹ The Application, Schedule J: Brown Copeland Report, paras 22-24.

cap were significantly to reduce the salaries of lower-ranked players, which suggested that the cap could effectively be raised over time. This raises further concerns in terms of the longevity of the cap in its proposed form.

183. In its Application, the NZRU referred to the experience of the Australian NRL as an example of the effectiveness of a salary cap in improving competitive balance, size of crowds and sponsorship.⁵⁰ The statement by Mr Ian Schubert, the NRL Salary Cap Auditor, provides details.⁵¹ The NRL cap was introduced in 1998 as an antidote to the salary excesses of the Super League era. It applies to the salaries of the top 25 players in each club. Initially, existing salaries over A\$300,000 were counted at A\$300,000 in the club caps, and subsequently at actual levels as player contracts were renewed. This process took until 2001. Over this period the average salary bill for the five top spending clubs (top 25 players only) fell by 19.2% from A\$5,604,082 to A\$4,525,755 in nominal terms (i.e., without any correction for inflation). In comparison, the NZRU's proposed salary cap appears to be weak. It would also be of interest to know how unequal were the revenues of the NRL clubs compared to the Premier Division Unions.
184. On the basis of the preceding information and analysis, the Commission is sceptical about the extent to which the proposed salary cap would constrain, even if it were a 'hard' cap. The cap has been set at a relatively high level initially, and will rise with inflation. There is no provision for revenue-sharing amongst the unions, and so the underlying income inequalities would remain. The Commission's view is that it seems likely that the proposed salary cap would have only a very limited impact initially, and that the impact would increase only slightly in the foreseeable future.

Revenue Disparity

185. It is evident that the provincial unions have very unequal income levels, although empirical investigations conducted by the Commission suggest that the extent of disparity between unions has remained roughly stable, and even shown signs of improvement, since 2000.⁵² Whilst the salary cap may place pressure on some of the wealthy unions to release players, there is no mechanism in the proposed arrangements to raise the spending capacity of the less wealthy unions, so that they could afford to hire those players.
186. Szymanski argued that to be fully effective, a salary cap system needs to ensure that low revenue-generating teams raise their spending to the level of the cap.⁵³ In the

⁵⁰ The Application, para 14.1.

⁵¹ The Application, Schedule I: Ian Schubert Statement.

⁵² The relative standard deviation of union operating income, union operating expenses, and union team management expenses, have all suggested that while the financial balance had declined prior to 2000, there has been relative stability since 2000. All the other measures of financial balance employed by the Commission, including the Gini Coefficient and Hirschman-Herfindahl indices of revenues and expenses, suggested the same.

⁵³ S Szymanski, "The Economic Design of Sporting Contests", *Journal of Economic Literature*, vol. XLI, pp. 1172.

NBA and the AFL, revenue-sharing measures were introduced along with a salary cap scheme to ensure just this. The strategy appears to have been successful in the AFL, but the NBA is reportedly still plagued by competitive imbalance.⁵⁴

187. The model developed by Kesenne (2000 op cit) shows that a salary cap can achieve a more equitable talent distribution, even in the absence of revenue sharing, since payroll restrictions tend to lower the marginal cost of talent. However, both the Kesenne and Fort and Quirk (1995 op cit) models are essentially static; they do not explain how competitive balance may evolve dynamically over time as a consequence of introducing salary cap measures (i.e., how long it would take before cap begins to redistribute players). Intuitively, when large income disparities exist, talent diffusion would be expected to occur more quickly if measures to equalise revenues were also implemented.
188. In responses to the Draft Determination the NZRU argued that it does have some distribution policies in place aimed at reducing the financial disparity between unions, including special grants for non-franchise (small) unions and those unions with few NZRU-contracted players. Such arrangements are akin to the targeted revenue-sharing schemes found in leagues overseas.
189. The NZRU also presented forecasts from all the PD provincial unions that indicates that spending on players is expected to increase significantly in 2006 (except for those unions constrained by the cap).⁵⁵ However, it is unclear how much of these forecast increases in expenditure, to the extent they are accurate, is not driven by the recent “one-off, non-precedent setting” allocation of approximately \$8,000,000 to the PD unions.⁵⁶ Therefore, it is unclear how sustainable these forecast increases in player spend are likely to be beyond the next year or two.
190. The NZRU also noted in submissions that as part of its newly proposed funding model, core distributions to Air New Zealand Cup Provincial Unions are to be calculated based on the number of registered players within a union. Such a policy would be to the comparative advantage of larger, more populated unions.

Multiple Income Stream Incentives

191. The more talented players in the domestic provincial competition also play in the higher Super 14 competition, and the best of those in the All Blacks. Unlike provincial competition player salaries, which are paid by the provincial unions, Super 14 and All Black salaries are paid by the NZRU directly to players, with whom it has separate contracts. These players therefore enjoy multiple income streams.

⁵⁴ Ibid. See also: Zimbalist (2002).

⁵⁵ For instance, it is forecast that player spending for [] would increase by 321% between 2005 and 2006, and [] would see an increase of approximately 94% over the same period.

⁵⁶ NZRU Provincial Union Funding Review, Draft Report, March 2006, p.8.

192. These various levels of competition are not entirely independent of one another. Players seem to use the domestic provincial competition to advance their skills, and to gain public exposure, in hope of being picked to play in the Super 14 competition. Likewise, Super 14 players use that competition to hone their abilities and demonstrate their skills to selectors in the hope of being selected for the All Blacks. Hence, lower levels of professional competition are typically used as ‘launching pads’ into higher levels.
193. Anecdotal evidence suggests that players of equally high ability tend to benefit, in terms of skill development, by playing alongside one another. Noll notes that most players prefer to stay with a strong team (presumably, where the average skill level is high) rather than switch to a weak one.⁵⁷ The positive externality effects of skill exchange and development from top players gravitating towards one another, and mutually benefiting from a superior team performance, helps explain this observation.
194. There are strong economic incentives for players to advance their skills. Apart from the prestige of playing in higher levels of competition, Super 14 and All Black salaries are substantially more lucrative than domestic provincial competition salaries (and may open the door to ancillary endorsement income).
195. Hence, it seems plausible that the most talented players (i.e., those capable of playing in Super 14 and All Black competitions) may be willing to accept a reduction in their provincial competition salaries in order to remain with a union that maximises their exposure to selectors, and skill development, thereby increasing their chances of progression into higher competitions. Mr Copeland, acting on behalf of the NZRU, seems to concede this point when he states that “... a player’s willingness to transfer is not simply a function of price. In particular, Super 14 selection will have an important bearing along with family and lifestyle considerations”.⁵⁸
196. This potential willingness on the part of players to sacrifice a minor part of their income in order to increase their overall earning potential may allow wealthy unions to retain their best talent, even in the face of salary cap restrictions. In the present case, it may be that only the lower-ranked players (i.e., those insufficiently qualified to play at higher levels) are redistributed. There is anecdotal evidence that this is what tends to happen with salary caps. But such an outcome would not help to advance competitive balance, as the better players would be retained by the most successful unions, and the weaker ones would be shared amongst weaker unions.
197. The NZRU also acknowledges that it may face pressure from unions to “top up” the salaries of players that those unions wish to retain, but did not consider that this would undermine the cap because “...the NZRU payment will apply whichever

⁵⁷ R G Noll, “Professional Basketball: Economics and Business Perspectives”, in: P D Staudohar and J A Mangan (eds.), *The Business of Professional Sports*, Illinois: University of Illinois press, 1991, p. 38.

⁵⁸The Application, Schedule J: Brown Copeland Report, para 26.

Provincial Union the player plays for". But, this is precisely the type of conduct that could undermine the salary cap; provincial unions may be able to scale back NPC salaries to star players (to remain within the cap) to the extent that these players can maintain, or even seek increases to, their NZRU salaries. And, it is these top players that would effect the greatest improvement in competitive balance if redistributed.

198. The Commission acknowledges the point made by the NZRU in submissions that often selection at the highest levels of competition happens through players receiving greater game-time, and that this may induce some players to shift from stronger unions to weaker ones that offer them greater playing opportunities. However, the desire of some players to avoid being 'stockpiled' needs to be balanced against the desire of other players to avail themselves of the superior training resources and opportunities offered by stronger unions, as discussed above.

Team-specific Talent

199. Some writers have argued that standard salary cap models are too simplistic in that they ignore the role of team-specific factors, such as complementarities between players' skills (and the quality of coaching and training resources) on individual player's productivity. Vrooman argued that:⁵⁹

... teams are coalitions of individual players for which the collective results are greater than the sum of the individual results. Some team members are more productive in the coalition than they would be elsewhere, some are less productive than they could be with other teams, and some players have talent that is independent of the teams for which they play. If the value of the player is partially attributable to his team, then the player's talent is team-specific.

200. For example, a skilled lineout thrower (hooker) is likely to be more productive and valuable to a union with access to strong lineout jumpers (locks) than a union with poor jumpers. Furthermore, the value of this player to that union is likely to increase over time as these players gain experience playing with one another, thereby enhancing the extent to which they complement one another.
201. Vrooman goes so far as to argue that if playing talent is team specific *to any degree*, then the pursuit of absolute competitive balance would result in a league-inferior redistribution of talent, since any relocated talent would be more productive elsewhere. Balance may be enhanced by the cap, but at the expense of a less efficient allocation of talent.
202. As a corollary, the presence of team-specific talent under a salary cap has implications for player skill development. If the cap forces players away from unions where they might otherwise have been more productive, and benefited from playing alongside team mates with complementary abilities, the development of these players may be hindered in the long-run.

⁵⁹ J Vrooman, "The Baseball Players' Labour Market Reconsidered", *Southern Economic Journal*, vol. 63(2), 1996, p. 344.

Empirical Evidence

203. The empirical support for the uncertainty of outcome hypothesis in relation to live spectators is mixed, at best. The empirical support for this hypothesis in relation to television viewers (a significantly larger group of consumers of sports entertainment than at-match spectators) is even more limited. This evidence calls into question the claim that demanders of PD rugby union matches would be better off as a result of the Proposed Arrangements. The empirical evidence on this issue is discussed in greater detail in the Benefits section.

Summary of Potential Limitations of NZRU’s Proposed Salary Cap

204. To sum up, the Commission has significant doubts about the “hardness” of the cap, and—even if it were “hard”—the extent to which it would constrain. In addition, nothing has been proposed to address the substantial income inequalities between the provincial unions, which are the fundamental underlying cause of the problem of competition imbalance perceived by the NZRU. Doubts have also been expressed about the willingness of top players to move between unions in response to a cut in their NPC salaries, and if they were to do so, whether this might result in a less efficient distribution of talent.
205. These considerations are important, because if the salary cap were ineffective, both the detriments and benefits would be likely to be low, and the Commission would be unlikely to be satisfied that there would be a net public benefit such that the cap could be authorised. The Commission concludes that although there might be some nexus between the Proposed Arrangements and the promotion of a less uneven domestic provincial competition, the link appears to be weaker than that argued by the Applicant. In recognition of this view, the Commission proposes to treat conservatively the possible impact of the Proposed Arrangements on the enhancement of competitive balance. For the purposes of the analysis that follows, it will be assumed that the cap would have some impact sometime in the next few years.

THE APPLICATION FOR AUTHORISATION

206. Under s 58 of the Act, a person may apply for an authorisation for contracts, arrangements or understandings that would or might breach ss 27, 28, 29, 37 or 38. Section 58 allows for the “entering into” and “giving effect to” of such contracts, arrangements or understandings in separate subsections (as relevant):

58. Commission may grant authorisation for restrictive trade practices—

(1) A person who wishes to enter into a contract or arrangement, or arrive at an understanding, to which that person considers section 27 of this Act would apply, or might apply, may apply to the Commission for an authorisation to do so and the Commission may grant an authorisation for that person to enter into the contract or arrangement, or arrive at the understanding.

(2) A person who wishes to give effect to a provision of a contract or arrangement or understanding to which that person considers section 27 of this Act would apply, or might apply, may apply to the Commission for an authorisation to do so, and the Commission may grant an authorisation for that person to give effect to the provision of the contract or arrangement or understanding.

...

(5) A person who wishes to enter into a contract or arrangement, or arrive at an understanding to which that person considers section 29 of this Act would apply, or might apply, may apply to the Commission for an authorisation for that person to enter into the contract or arrangement or arrive at the understanding.

(6) A person who wishes to give effect to an exclusionary provision of a contract or arrangement or understanding to which that person considers section 29 of this Act would apply, or might apply, may apply to the Commission to do so, and the Commission may grant an authorisation for that person to give effect to the exclusionary provision of the contract or arrangement or understanding.

...

207. To recap, on 9 November 2005, the NZRU applied to the Commission for authorisation in relation to three arrangements:

- a salary cap, which is to apply to Provincial Unions competing in the new Premier Division;
- the Player Movement Regulations, to replace the existing Player Transfer Regulations, and to apply to players transferring between Provincial Unions competing in the Premier Division and transferring from Modified Division One in the NZRU’s NPC Competition to Premier Division teams; and
- Modified Division One Regulations, which proposed to prohibit the payment of remuneration to players and the restriction on loan players in Modified Division One.

208. In its Draft Determination, the Commission's preliminary conclusion was that it would determine to decline to authorise the Modified Division One Regulations or to otherwise enter into and give effect to the MD1 framework as specified... On 30 March 2006 the NZRU withdrew its Application for authorisation of the Modified Division One Regulations. Accordingly, the Commission has not considered for authorisation the Modified Division One Regulations or to otherwise enter into and give effect to the MD1 framework in this decision.
209. The NZRU seeks authorisation of the salary cap arrangement and the player movement regulations under s 58(1), (2), (5) and (6) of the Act.⁶⁰ The Commission is required to consider whether to authorise the entering into, or giving effect to a provision of, a contract, arrangement or understanding that is the subject of the Application for authorisation. This section considers the scope of the authorisation that is sought.

The Salary Cap Arrangement

210. The NZRU has entered into an agreement with the RPC on 1 November 2005, entitled the Collective Employment Agreement. The RPC is the official representative of New Zealand professional rugby players and represents the interests of the New Zealand Rugby Players Association. The CEA covers various matters of common interest to the NZRU and to the RPC.
211. One of the matters covered by the CEA is the Provincial Union Salary Cap, which is the subject of clauses 53 to 59 of Part 7 of the CEA.⁶¹ The principal aspect of the salary cap is the imposition of a \$2m cap on payments to players by Premier Division Provincial Unions.
212. Clause 60 of the CEA provides, in effect, that the provisions of Part 7 relating to the salary cap (and transfer) will not come into effect unless authorised by the Commission, or declines to grant authorisation on the grounds that either it does not have jurisdiction to do so (because the provisions do not require authorisation) or the proposed provisions do not breach the Act.
213. The NZRU's authorisation Application was stated to relate to practices of a kind detailed in section 58 of the Act (paragraph 2.1 of the Application) and then provides what are stated to be full particulars in subsequent paragraphs.
214. In relation to the salary cap, the full particulars are stated as follows:

A proposal to enter into and give effect to a Salary Cap with the features set out in the table below {reproduced at Appendix 1} (defined terms are those used in the draft Salary Cap Regulations) and given effect to in the Collective Employment Agreement

⁶⁰ Notice of Application, paras 2.10–2.11, together with the NZRU's subsequent letter of 30 March 2006.

⁶¹ Another matter is *Transfer*, which is the process by which a player alters his agreed Provincial Union, and which is the subject of clause 50 of Part 7 of the CEA. The *Transfer* provision of the CEA is an ancillary to the Salary Cap provisions.

between NZRU and Rugby Players Collective Incorporated dated 1 November 2005, a complete copy of which is attached as Confidential Schedule E (along with the NZRU press release and summary document), and in the Salary Cap Regulations, a current draft of which is attached as Confidential Schedule A.

The key elements of the NZRU Salary Cap have been agreed in clauses 50 and 53-59 of the Collective Employment Agreement (attached as Confidential Schedule E). The Collective Employment was signed by the NZRU and Rugby Players Collective Incorporated on 1 November 2005.

The Draft Salary Cap Regulations as described in Confidential Schedule A have been developed by the NZRU with preliminary consultation undertaken with the Rugby Players Collective. Further consultation will take place subsequent to the filing of this Application and the NZRU will provide the Commission with updated drafts of the Salary Cap Regulations as soon as they are available. Once adopted by the NZRU Board, the Salary Cap Regulations will be binding on those provincial rugby unions affiliated to the NZRU participating in the Premier Division and rugby players in New Zealand subject to the Salary Cap Regulations. The Salary Cap Regulations will come into effect once passed by the Board of the NZRU under Rule 19.1.4 of the NZRU Constitution. The formation and implementation of Regulations under the NZRU Constitution is the standard form of governance for the NZRU.

215. The table referred to in paragraph 2.3 of the Application is attached at Appendix 1.
216. While the particularisation of the conduct for which authorisation has been sought is perhaps somewhat unclear, it is apparent that the NZRU have entered into the CEA, constituent parts of which, that is clauses 50 and 53 to 59, are conditional on authorisation. These clauses are referred to in paragraph 2.4 of the Application as the NZRU Salary Cap. It is noted that clause 50 is entitled “Transfer” and relates to player transfer. Separate authorisation is sought for the Player Movement Regulations, discussed below.⁶² However, it is clear that clause 50 has been included by the NZRU as part of the package of provisions which it refers to as “the key elements” of the salary cap which has been agreed between the parties. The Commission considers clause 50 is appropriately considered as an ancillary supporting provision to the salary cap. Accordingly, in this decision, a reference to the “Salary Cap Arrangement” is a reference to the agreement to introduce a salary cap in accordance with clauses 50 and 53 to 59 of the CEA.
217. Further, through subsequent communications between the NZRU and the Commission, the NZRU has confirmed that:
- it does not seek authorisation for the entire CEA;
 - it does not seek authorisation of the draft Salary Cap Regulations; and

⁶² It is noted that the NZRU and the RPC have, since entering into the CEA, agreed to delete clause 50.9 which provides that the Transfer provision only comes into effect in accordance with clause 60 (the provision requiring authorisation of the Salary Cap and Transfer provisions). Notwithstanding this amendment, the substantive provisions of clause 50 remain in place.

- it is the Salary Cap Arrangement as contained in the Application and the CEA for which authorisation is being sought.
218. It should be noted that while the NZRU seeks authorisation to *enter into* the Salary Cap Arrangement as, it also seeks authorisation to *give effect to* that Salary Cap Arrangement through salary cap regulations.
219. The Commission has considered whether the Salary Cap Arrangement, is properly the subject of an Application for authorisation under the Act. Section 58 permits a person who wishes to enter into a contract, arrangement or understanding to which it considers s 27 or s 29 might apply, to apply to the Commission for authorisation. For the reasons set out in the later section of this decision which discusses Contract, Arrangement or Understanding, the Commission is satisfied that the Salary Cap Arrangement is an arrangement to which s 27 and s 29 of the Act may apply.

The Player Movement Regulations

220. In its Application, the NZRU described the proposed conduct as including Player Movement Regulations and provided the following full particulars:

2.6 A proposal to enter into and give effect to Player Movement Regulations in the form attached as Confidential Schedule B. These regulations would replace the existing Player Transfer Regulations that were the subject of a previous authorisation by the Commission (Decision No. 281) but provide that:

- a. The transfer window be extended from 1 October to the Friday after the Rebel Sport Super 14 final;
- b. Transfer fees only apply for players moving up from Modified Division One to Premier Division; and
- c. There is no limitation on the number of transfers that may occur in a season.

2.7 Key aspects of the proposed changes to the current Transfer Regulations are:

- a. the removal of the current transfer window of 15-31 November and its replacement with a transfer period commencing on 1 October each year and ending on the Friday following the final game in the Super Rugby Competition in the following year;
- b. the deletion of the current quota on players who can transfer during the transfer window; and
- c. the removal of the requirement for any transfer fees for All Blacks (current and former) Super 12/14 players and current NPC Division 1/Premier Division players.

221. The Player Movement Regulations are to be binding on the Premier Division and Modified Division One Provincial Unions by virtue of the NZRU Constitution. In March 2006 the NZRU provided the Commission with revised Player Movement

Regulations to replace those described in para 2.6 of the Application. After further clarification, the Player Movement Regulations the Commission has ultimately been asked to authorise is attached at Appendix 8. In this decision a reference to the “Player Movement Regulations” is a reference to the regulations at Appendix 8.

222. As with the Salary Cap Arrangement, for the reasons set out in the competition analysis section of this decision, the Commission is satisfied that ss 27 and 29 of the Act may apply to the Player Movement Regulations and that the regulations are properly the subject of an Application for authorisation.

Summary of Conduct to be authorised

223. The Commission therefore considers that it has been asked to authorise the following conduct:
- the entering into of an arrangement or understanding between the NZRU and the RPC, being the Salary Cap Arrangement;
 - the entering into of an arrangement or understanding comprising the Player Movement Regulations attached in Appendix 8, which are binding on provincial unions and professional rugby players by reason of the NZRU Constitution;
- (as noted previously, referred to together as the “PD Arrangements”)
- the giving effect to the Salary Cap Arrangement, including through the adoption and implementation of salary cap regulations; and
 - the giving effect to the Player Movement Regulations.
224. The Commission has proceeded on the assumption that there are no other matters in relation to the implementation of the Salary Cap Arrangement or Player Movement Regulations that might infringe any provision of the Act. If this assumption is incorrect, this may cause the Commission to exercise its powers under s 65 of the Act to amend or revoke an authorisation.
225. The Commission also proceeds on the basis that, pursuant to s 58B of the Act, authorisation is being sought to apply to the NZRU, Provincial Unions, any current and future rugby players who are or may in future be playing rugby in a Provincial Union which has a team competing in any competition covered by the Salary Cap Arrangement, and the RPC.

Conditions and Period of authorisation

226. Section 61(2) of the Act provides:

Any authorisation granted pursuant to section 58 of this Act may be granted subject to such conditions not inconsistent with this Act and for such period as the Commission thinks fit.

227. The NZRU has not specified any time period for which the Salary Cap Arrangement or Player Movement Regulations are to be authorised, nor proposed any conditions. The Commission's consideration in relation to whether to grant conditional authorisation and whether to grant authorisation indefinitely or for a specified period is set out later in this decision.

THE FACTUAL AND THE COUNTERFACTUAL

228. In order to assess the competition effects, as well as the detriments and benefits, the Commission compares the factual to the counterfactual for each Proposed Arrangement. The factual is what would happen if a Proposed Arrangement were to proceed. A counterfactual will not necessarily be a continuation of the status quo, but rather encapsulates a pragmatic and commercial assessment of what is likely to happen in the absence of the factual.
229. A comparison between the factual and counterfactual allows a judgment to be made as to:
- whether competition in the factual is likely to be lessened relative to the counterfactual; and
 - the size of the benefits and detriments of the factual relative to the counterfactual.
230. Because the Applicant has applied for authorisation to enter into and give effect to multiple arrangements, it could be appropriate to consider a separate factual and counterfactual in respect of each of those. This may be contrasted with the approach in *Decision 511 (Air New Zealand Limited/Qantas Limited, 23 October 2003)*, where it was considered that analysis of the separate Applications relating to a proposed acquisition and a proposed arrangement, arising in the same commercial proposal and representing a single interdependent business plan, should centre upon the same considerations.
231. The Commission considers that arrangements to implement the proposed Salary Cap Arrangement are closely interrelated with arrangements to implement the proposed Player Movement Regulations and should properly be considered together (these are referred to jointly as the “Proposed Arrangements”). As a result, there will be a single factual and a single counterfactual.

The Factual

232. The factual scenario will therefore involve the following:
- implementation of the new NPC competition structure, comprising the 14 team PD and the 12 team MD1;
 - PD Salary Cap;
 - a transfer window applying to PD and MD1 players, for the period from 1 October to the Friday after the Super 14 Rugby Competition; and
 - transfer fees when players transfer from MD1 unions to PD Unions to be paid by the PD union.

233. The NZRU claims that the above mechanisms will create more competitive domestic competitions, thereby contributing to more attractive games, greater revenues, better performance of New Zealand Super 14 Rugby and All Black teams and better cost management within New Zealand rugby generally. In addition, NZRU submits that by implementing these proposals, New Zealand rugby will remain commercially viable and sustainable.
234. NZRU submits that the introduction of a “salary cap” for the NPC PD unions is a key mechanism to encourage a more even distribution of playing talent, thereby contributing to a more even competition. The NZRU argues that a more even competition will attract greater interest and result in increased spectator enjoyment, larger crowds at matches, increased broadcasting and sponsorship revenues, and greater incomes for provincial unions.
235. The Proposed Arrangements will also have some effects in respect of MD1 players and teams. However, these effects are expected to be relatively minor, and they are unlikely to be significantly affected by the arrangements eventually agreed between the NZRU and the MD1 provincial unions. Where it is necessary to do so, the Commission will assume that the MD1 competition is governed by the existing transfer restrictions and that MD1 union can still pay players.

The Counterfactual

Introduction

236. The Commission, when undertaking assessments of Applications under s 58 of the Act, compares the likely competitive effects of the arrangements in question, and the public benefits and detriments likely to result from the arrangements with those that arise in the ‘counterfactual’. The Commission makes a ‘with’ and ‘without’ comparison rather than a ‘before’ and ‘after’ comparison.
237. The counterfactual is not an arrangement which might be preferred by the Commission or by particular parties with an interest in the industry. Rather the counterfactual is a pragmatic and commercial assessment of what is likely to occur in the absence of the arrangement. In making this assessment the Commission assumes, for the purposes of analysis, that, if the counterfactual scenario might lessen competition, the counterfactual scenario is likely to receive authorisation. For the purposes of this analysis, the Commission assumes that the counterfactual is likely to be authorised for the reasons set out in its *Decision 280*.⁶³
238. Also, the counterfactual need not necessarily be a lower cost or more efficient alternative to the arrangements which are the subject of the Application. The relative efficiencies of the arrangements and the counterfactual are taken into account in the weighing of public benefits and detriments. However, a theoretical

⁶³ Commerce Commission Decision 280 – Electricity Market Company Limited, 13 September 1996, paragraphs 94-100.

alternative which would impact adversely on the viability of the business or project at risk can be usually ruled out as a possible counterfactual because it would not be likely to be put into effect in the absence of the arrangement.

The Applicant's Initial View of the Counterfactual

239. The Applicant proposed in its Application that the counterfactual would consist of the new format for the competition (the 14 team Premier Division competition and the 12 team Modified Division One competition) with no salary cap, but a continuation of the existing Player Transfer Regulations. The key features of these regulations include the following:

- a transfer window of 2 weeks in November of each year;
- player transfer fees to be paid by the union gaining the player to the union losing the player, to certain prescribed maxima; and
- a quota system that a union may acquire no more than 5 players in any one year, with no more than one of those players being an All Black.

240. However, the NZRU has acknowledged in its Application that there are a number of difficulties with this counterfactual, as it believes that such a situation is unsustainable in the medium and longer term. This is because the addition of the four new teams to the Premier Division - a feature of both the factual and the counterfactual - will result in greater unevenness in the competition. The NZRU states (at paragraph 18.6):

Under the counterfactual, the NZRU believes that there will be a continuation (and acceleration) of the trend towards uneven competitions, lower spectator interest, decreasing revenues and potentially less competitive Super Rugby and All Black performances. This is particularly because the new structure of the NPC allows five teams previously in the Second Division to be in the Premier Division (2 of which Nelson Bays and Marlborough are seeking amalgamation so as to compete as a merged team under the name Tasman). Those teams (Counties Manukau, Hawkes Bay, Manawatu, and Tasman) are likely to have fewer resources and not as much built up talent as the current 1st Division unions. This is likely, in the absence of the Salary Cap to lead to less competitive balance in the short term.

241. The Applicant did not put forward an alternative counterfactual, in the event that the Commission does not accept its counterfactual. The NZRU stated that it had previously considered and discounted in its Competition Review process other options to achieve a more competitive competition, such as player drafts. The NZRU said it understood from discussions with the RPC that this and other options explored would be rejected by the players and therefore could not be considered realistic alternatives.

242. The Commission questioned the Applicant's inclusion of the previous transfer regulations in its counterfactual, as these appeared to be more restrictive than needed to promote competition amongst unions under the new competition format. The Applicant responded that it considered, in the absence of the previous transfer

regulations (i.e., the quota system and transfer fees), that wealthy unions could easily purchase a “dream team” and continue to stockpile players thus contributing to a more uneven competition.

243. The view that the NZRU’s counterfactual lacked sustainability was echoed by many of the provincial unions interviewed by the Commission. If the Proposed Arrangements are not authorised, there was a general view that the NZRU would have to either review its new competition format, or it would have to institute mechanisms to regulate the even greater competitive imbalance likely to be created when the larger-resourced unions play against the new, lesser-resourced unions. Provincial unions considered that this may include changes to the funding criteria applied to provincial unions, or other mechanisms, as yet unspecified.

Variation to Application

244. Clause 60 (relating to Commerce Commission authorisation) of the NZRU’s Collective Employment Agreement (CEA) with the RPC provided that if final authorisation occurs on or after 1 May 2006 (or such later date as parties may agree), or if no final authorisation occurs, existing transfer regulations will remain in place, and no salary cap will apply.
245. On 10 February 2006, the Commission advised the NZRU that it considered it was unlikely to be in a position to provide a final Determination by 1 May 2006. On 4 March 2006, the NZRU advised the Commission that it had entered into negotiations with the RPC to set a new date after which the terms and conditions of the CEA will come into effect, with consequent implications for its counterfactual scenario.
246. On 9 May 2006, the NZRU advised that the following arrangements have now been confirmed with the RPC:
- clause 50 of the CEA (relating to player transfers) is to come into effect on 29 May 2006 and the existing Player Transfer Regulations will be suspended until the Friday after the end of the Super 14 Competition in 2007;
 - if final authorisation is not granted prior to 10 June 2006, no salary cap will apply in 2006;
 - if final authorisation is granted after 10 June 2006 and before 1 October 2006, the salary cap as per the Salary Cap Framework/CEA will apply from 1 January 2007; and
 - in the event authorisation is not granted, or is granted after 1 October 2006, the parties will meet to discuss what will happen in terms of a salary cap and transfer regulations – if agreement cannot be reached, it may be referred to the dispute resolution services of the CEA.
247. In short, the existing Player Transfer Regulations have been suspended for one year until the conclusion of the 2007 Super 14 season. Instead, Clause 50 of the CEA

(relating to player transfers) will apply for the intervening year unless/until new regulations replacing Clause 50, are negotiated between NZRU and RPC.

248. The effects of the proposed variation will therefore fall into two periods, being:
- from 29 May 2006 until the Friday after the Super 14 competition in May 2007 (Super 14, 2007); and
 - from that date in May 2007 onwards.
249. The Commission needs to consider what Clause 50 provides, in order to decide whether the impact of this variation will have a material effect on the Commission's counterfactual, and therefore on its competition analysis.
250. Clause 50.5 of the CEA provides that an MD1 union may be entitled to a transfer fee from a PD union in respect of a player transferring from the MD1 union. Clause 50.6 provides for a transfer period that is the same as that set out in the Player Movement Regulations above, from 1 October to the Friday after the Super 14 rugby competition final.
251. Clause 50.5 of the CEA is particularly relevant to the counterfactual. Clause 50.5 provides as follows:
- For the avoidance of doubt, a provincial union which is not listed in Appendix 1 to this Collective Agreement⁶⁴ may be entitled to a transfer fee from a Provincial Union in respect of the Transfer of a Player from it to that Provincial Union.
252. In other words, this clause states a transfer fee *may* be payable when a player transfers from an MD1 Union to a PD Union.
253. The Commission questioned the NZRU and the RPC as to what their intentions were when they agreed to this clause, and what their expectations regarding the payment of transfers fees would be if this clause was to come into effect.
254. The NZRU explained that it has specifically included this clause in the CEA as it has always intended that detailed Player Movement Regulations would be drafted. The points in Clause 50.5 were to agree the key points in relation to these transfers – namely that fees would be payable in situations where players transferred from MD1 unions to PD Unions. The NZRU added that it was not intended that fees would always be payable when a player transferred from an MD1 union to a PD union, especially when the player has moved for his own reasons, related to career opportunities or family reasons, and/or where the PD union has not contracted that player to play in the PD competition in that contract/calendar year.
255. NZRU explained that the level of the fee was not discussed at the time that this clause was agreed to, but NZRU noted that the full fee of \$15,000 has been paid in

⁶⁴ Those provincial unions listed in Appendix 1 to the CEA are the 14 new PD unions. Therefore the unions that are not listed are the MD1 unions.

the last five transfers of this nature, even though it was a maximum only under the existing regulations. NZRU accepts that there are some situations where a lesser fee would be agreed (e.g., where the MD1 union is happy to accept a lesser or no fee as there is a feeder relationship between the two unions that benefits both unions, or there are particular reasons that the player is moving).

256. The RPC confirmed that NZRU included this clause as it wanted to ensure that MD1 unions were compensated for developing players. The RPC agreed that it understood that NZRU would formulate and pass regulations to set rules for the level of the fee and the exact circumstances that it would be paid.
257. Beyond 2007, the likely counterfactual scenario in relation to the player transfer window and fees is more difficult to predict, as it is dependent on negotiations between the parties. However the Commission understands from its discussions with the parties that any negotiated agreement is likely to be of a less restrictive nature than the current regulations prescribe, with fees being paid in limited circumstances only, and the transfer window likely to be significantly wider than the two weeks provided for in the Player Transfer Regulations.
258. The Commission considers that overall the proposed variation will have the effect of reducing the difference between the factual and the counterfactual in relation to the player movement rules, especially during the first year when Clause 50.5 would apply. The effect of the variation on the likely counterfactual in subsequent years is unknown, but again it seems likely that any future negotiated rules governing player transfers will be less restrictive than the existing Player Transfer Regulations. Therefore, a key difference remaining between the factual and counterfactual scenarios, for both time periods specified above, is whether or not a salary cap will apply.
259. The issue arising from this is that the Applicant has made it clear that its intention was to introduce the proposed salary cap in conjunction with the proposed relaxation of the transfer regulations. The possibility of no salary cap in conjunction with a relaxation of player transfer rules raises the possibility of the wealthy unions being able to buy a “dream team”, a possibility that NZRU earlier advised it wished to prevent, especially in view of the new competition format and increased competitive imbalance likely to arise as a consequence.
260. It appears clear that the intent of the NZRU is to introduce a salary cap in conjunction with relaxed player movement regulations as a package, but that if the salary cap is not authorised and not implemented, the NZRU is unlikely to support the degree of relaxation of the current transfer regulations as it would with a salary cap. Therefore, if the Salary Cap Arrangement is not authorised and not implemented, then it is likely that the NZRU would seek more restrictive rules for player transfer, than is the case if the Salary Cap Arrangement is authorised. What will be the final result of negotiations between the NZRU and the RPC on this matter is difficult to predict. However, the Commission does accept that to some

degree it will be a more restrictive set of player transfer arrangements than would be the case if the Salary Cap Arrangement is authorised.

The Commission's View of the Counterfactual

261. In the Draft, the Commission agreed that the addition of the four new teams, with no change to the current authorised transfer arrangements, must result in a greater unevenness of competition in the Premier Division, and hence it expressed real reservations about the sustainability of the Applicant's proposed counterfactual in the medium and longer term.
262. In the Draft, in order to progress the analysis, the Commission accepted the NZRU's counterfactual in the interim and sought submissions. However, submissions were silent on this point. The Commission notes that the Applicant's counterfactual, with the fact that player transfer rules beyond 2007 are unspecified at this point, presents difficulties for the analysis. However for the purposes of the analysis, the Commission proposes to adopt the counterfactual with the characteristics set out below.

Conclusion on the Counterfactual

263. On the basis of the information it has received to date, the Commission considers that the likely counterfactual will have the following characteristics:
- the new competition format;
 - a transfer window from 29 May 06 to the Friday after the Super 14 Competition in 2007, and beyond that, a negotiated transfer window, likely to be significantly wider than the two weeks in the existing Player Transfer Regulations, but to some degree narrower than is proposed in the Player Movement Regulations or would otherwise be the case if a salary cap is implemented; and
 - player transfer fees to be paid by PD unions when a player transfers from an MD1 union to a PD union, from 29 May 2006 to the Friday after the Super 14 Competition in 2007, and beyond that, negotiated player transfer fees at levels and in circumstances to be negotiated. Again, the Commission expects that in this scenario, the circumstances in which fees would be paid would be to some degree wider than proposed in the Player Movement Regulations or would otherwise be the case if a salary cap is implemented.

OVERVIEW OF THE COMMISSION'S ANALYSIS OF THE PROPOSED ARRANGEMENTS

The Commission's Discretion to Authorise

264. Section 58A(1) sets out the effect of an authorisation for “entering into” a CAU, while s 58A(2) sets out the effect of an authorisation for “giving effect to” a CAU

58A. Effect of authorisation—

(1) While an authorisation under subsection (1) or subsection (5) of section 58 of this Act remains in force, as the case may be, nothing in section 27 or section 29 of this Act, as the case may be, shall prevent the applicant from—

(a) Entering into, or in accordance with the authorisation, giving effect to or enforcing any provision of the contract to which the authorisation relates; or

(b) Entering into, or in accordance with the authorisation, giving effect to the arrangement to which the authorisation relates; or

(c) Arriving at, or in accordance with the authorisation, giving effect to the understanding to which the authorisation relates.

(2) While an authorisation under subsection (2) or subsection (6) of section 58 of this Act remains in force, as the case may be, nothing in section 27 or section 29 of this Act, as the case may be, shall prevent the applicant from—

(a) In accordance with the authorisation, giving effect to or enforcing the contract to which the authorisation relates; or

(b) In accordance with the authorisation, giving effect to the arrangement or understanding.

265. Although the Commission cannot authorise conduct in respect of s 36 of the Act, s 36(1) provides that “[]othing in this section applies to any practice or conduct to which this Part applies that has been authorised under Part 5”. Therefore, the effect of an authorisation under s 58 is to exclude s 36 from applying to the authorised conduct.

266. Section 61 details the factors that the Commission must satisfy itself of before granting an authorisation, the relevant provisions of which are set out below.

61. Determination of Applications for authorisation of restrictive trade practices—

(1) The Commission shall, in respect of an Application for an authorisation under section 58 of this Act, make a determination in writing—

(a) Granting such authorisation as it considers appropriate:

(b) Declining the Application.

(2) Any authorisation granted pursuant to section 58 of this Act may be granted subject to such conditions not inconsistent with this Act and for such period as the Commission thinks fit.

(3) The Commission shall take into account any submissions in relation to the Application made to it by the applicant or by any other person.

(4) The Commission shall state in writing its reasons for a determination made by it.

(5) Before making a determination in respect of an Application for an authorisation, the Commission shall comply with the requirements of section 62 of this Act.

(6) The Commission shall not make a determination granting an authorisation pursuant to an Application under section 58(1) to (4) of this Act unless it is satisfied that—

(a) The entering into of the contract or arrangement or the arriving at the understanding; or

(b) The giving effect to the provision of the contract, arrangement or understanding; or

(c) The giving or the requiring of the giving of the covenant; or

(d) The carrying out or enforcing of the terms of the covenant—

as the case may be, to which the Application relates, will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition that would result, or would be likely to result or is deemed to result therefrom.

(6A) For the purposes of subsection (6) of this section, a lessening in competition includes a lessening in competition that is not substantial.

(7) The Commission shall not make a determination granting an authorisation pursuant to an Application under section 58(5) or (6) of this Act unless it is satisfied that—

(a) The entering into of the contract or arrangement or the arriving at the understanding; or

(b) The giving effect to the exclusionary provision of the contract, or arrangement or understanding—

as the case may be, to which the Application relates, will in all the circumstances result, or be likely to result, in such a benefit to the public that—

(c) The contract or arrangement or understanding should be permitted to be entered into or arrived at; or

(d) The exclusionary provision should be permitted to be given effect to.

Overview of Analysis Conducted by the Commission

267. The Commission's approach is to first satisfy itself whether the relevant contract, undertaking, arrangement or provision would result or would be likely to result, or is deemed to result in a lessening of competition.
268. Section 61(6A) provides that the lessening of competition includes a lessening that is not substantial. Once the Commission is satisfied that the relevant contract, understanding, arrangement or provision would result, or would be likely to result, in a lessening of competition, or is deemed to result in a lessening of competition it will go on to assess the benefits and detriments that would, or would be likely to, result from the relevant arrangement or provision. Conversely, if the Commission is not satisfied that there would be a lessening, a likely lessening, or deemed lessening, the Commission considers that authorisation is not required by the Act, and will decline to grant authorisation.
269. In summary, the Commission first considers the relevant markets. It then considers whether any of the provisions of an arrangement are likely to result in a lessening of competition or are deemed to lessen competition in any of those relevant markets. If some of the provisions lessen competition, or contain exclusionary provisions, the Commission then considers the benefits and detriments that are likely to result from parties entering into the arrangement or giving effect to the provisions.

ELEMENTS OF SECTIONS 27 AND 29

Section 27

270. Section 27 of the Act provides:

27. Contracts, arrangements, or understandings substantially lessening competition prohibited.

(1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

(3) Subsection (2) of this section applies in respect of a contract or arrangement entered into, or an understanding arrived at, whether before or after the commencement of this Act.

(4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.

271. Section 30 of the Act deems certain price fixing arrangements to amount to a substantial lessening of competition:

30 Certain provisions of contracts, etc, with respect to prices deemed to substantially lessen competition

(1) Without limiting the generality of section 27 of this Act, a provision of a contract, arrangement, or understanding shall be deemed for the purposes of that section to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market if the provision has the purpose, or has or is likely to have the effect of fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to goods or services, that are—

(a) Supplied or acquired by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other; or

(b) Resupplied by persons to whom the goods are supplied by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them in competition with each other.

(2) The reference in subsection (1)(a) of this section to the supply or acquisition of goods or services by persons in competition with each other includes a reference to the supply or acquisition of goods or services by persons who, but for a provision of any contract, arrangement, or understanding would be, or would be likely to be, in competition with each other in relation to the supply or acquisition of the goods or services.

272. There is no requirement to establish a “market” in proving a breach of s 27 via s 30: s 30 deems that requirement of s 27 to be satisfied.

Section 29

273. Section 29 of the Act provides:

29. Contracts, arrangements, or understandings containing exclusionary provisions prohibited—

(1) Subject to subsection (1A), for the purposes of this Act, a provision of a contract, arrangement, or understanding is an exclusionary provision if—

(a) It is a provision of a contract or arrangement entered into, or understanding arrived at, between persons of whom any 2 or more are in competition with each other; and

(b) It has the purpose of preventing, restricting, or limiting the supply of goods or services to, or the acquisition of goods or services from, any particular person, or class of persons, either generally or in particular circumstances or on particular conditions, by all or any of the parties to the contract, arrangement, or understanding, or if a party is a body corporate, by a body corporate that is interconnected with that party; and

(c) The particular person or the class of persons to which the provision relates is in competition with one or more of the parties to the contract, arrangement or understanding in relation to the supply or acquisition of those goods or services.

(1A) A provision of a contract, an arrangement, or an understanding that would, but for this subsection, be an exclusionary provision under subsection (1) is not an exclusionary provision if it is proved that the provision does not have the purpose, or does not have or is not likely to have the effect, of substantially lessening competition in a market.

(2) For the purposes of subsection (1)(a) and (c), a person is in competition with another person if that person or any interconnected body corporate is, or is likely to be, or, but for the relevant provision, would be or would be likely to be, in competition with the other person, or with an interconnected body corporate, in relation to the supply or acquisition of all or any of the goods or services to which that relevant provision relates.

(3) No person shall enter into a contract, or arrangement, or arrive at an understanding, that contains an exclusionary provision.

(4) No person shall give effect to an exclusionary provision of a contract, arrangement, or understanding.

(5) Subsection (4) of this section applies to an exclusionary provision of a contract or arrangement made, or understanding arrived at, whether before or after the commencement of this Act.

(6) No exclusionary provision of a contract, whether made before or after the commencement of this Act, is enforceable.

274. Unlike s 27, s 29 does not define a breach of the section with reference to a “market”: a breach is instead defined with respect to “goods or services”.

The Requirement for the Proposed Arrangements to Apply to “Services”

275. Because s 27 is defined with reference to a “market”, and s 29 is defined with reference to “services”, it is clear that there cannot be a breach of ss 27 or 29 unless there is a relevant “market” or “services”. It is therefore necessary to consider whether there is any real possibility of a relevant “market” and “services” (respectively) existing for the purposes of the Act.
276. A contravention of s 27 and s 29 requires the establishment of several elements, including:
- the existence of a contract, arrangement or understanding;
 - in relation to the supply of services (relevant to this Application);
 - whether such a contract, arrangement or understanding might otherwise be exempt from the Application of the Commerce Act and if not;
 - whether:
 - in relation to s 29, and the deeming provision in s 30, the contract, arrangement or understanding is between parties two or more of which are in competition with each other in respect of those services; or
 - in relation to s 27, unaided by the deeming provision in s 30, the purpose or effect or likely effect of the contract, arrangement or understanding is to substantially lessen competition in a market.
277. Later in this section, in the Competition Analysis, the Commission considers the question as to whether the Salary Cap Arrangement and the Player Movement Regulations are relevantly a contract, arrangement or understanding. Further, as is required both for the purposes of analysing the Application of s 27 to such arrangements as well as assessing the balance of benefits and detriments, the Commission has separately considered the nature of the markets in which the relevant services are provided and the effect on competition of those arrangements (refer to Market Definition section below and Competition Analysis).
278. In the remainder of this section, the Commission considers whether the subject matter of the Salary Cap Arrangement and the Player Movement Regulations are services within the meaning of that term in the Act and also whether any of the relevant exemptions in the Act may apply.

Is there a Relevant Service?

279. The Act does not define “services” exhaustively. The definition has both inclusive and exclusive components:

“**services**” includes any rights (including rights in relation to, and interests in, real or personal property), benefits, privileges, or facilities that are or are to be provided, granted, or conferred in trade; and, without limiting the generality of the foregoing,

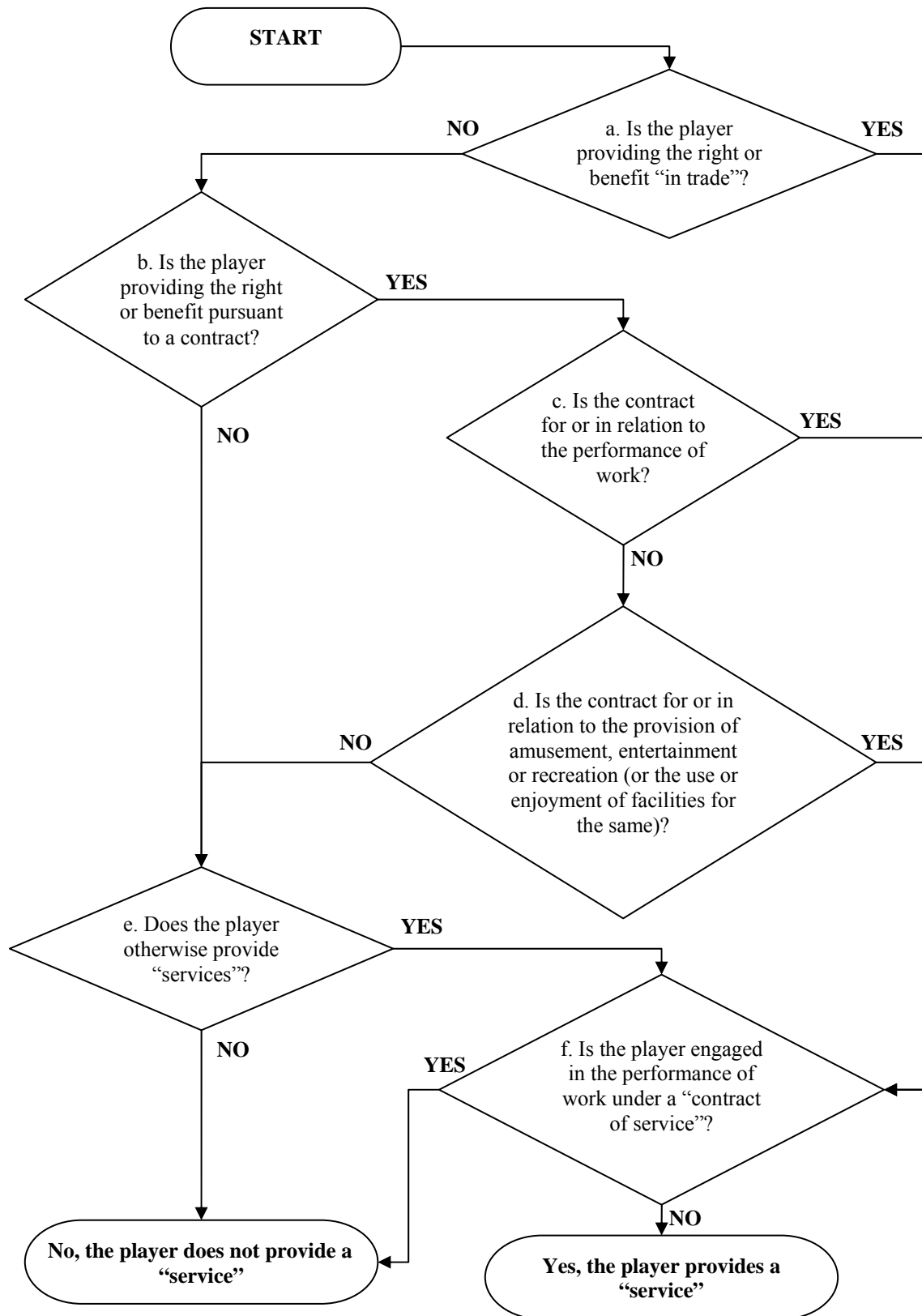
also includes the rights, benefits, privileges, or facilities that are or are to be provided, granted, or conferred under any of the following classes of contract:

- (a) A contract for, or in relation to,—
 - (i) The performance of work (including work of a professional nature), whether with or without the supply of goods; or
 - (ii) The provision of, or the use or enjoyment of facilities for, accommodation, amusement, the care of persons or animals or things, entertainment, instruction, parking, or recreation; or
 - (iii) The conferring of rights, benefits, or privileges for which remuneration is payable in the form of a royalty, tribute, levy, or similar exaction:
 - (iv) To avoid doubt, the supply of electricity, gas, telecommunications, or water, or the removal of waste water:
- (b) A contract of insurance, including life assurance, and life reinsurance:
- (c) A contract between a bank and a customer of the bank:
- (d) Any contract for or in relation to the lending of money or granting of credit, or the making of arrangements for the lending of money or granting of credit, or the buying or discounting of a credit instrument, or the acceptance of deposits;—

but does not include rights or benefits in the form of the supply of goods or the performance of work under a contract of service.

280. The effect is that “services” encompasses every transaction as set out in the first limb provided that it is carried on “in trade”, and all those classes of contract that are set out in the second limb (paras (a) to (d)), regardless of whether or not they are performed “in trade”, together with anything else that is properly regarded as a “service” (since the definition is not exhaustive), except that “rights or benefits in the form of the supply of goods or the performance of work under a contract of service” are specifically excluded from the definition.
281. Of the classes of contract in the second limb, (a)(iii), (a)(iv), (b), (c) and (d) are not relevant to the present Application. The questions which must be addressed to determine whether rugby players provide “services” in terms of the Act are represented in the following diagram.

Figure 3: Services under the Commerce Act, as applied to rugby – analytical framework



Employment Status of Participating Players

282. The Commission finds it helpful to approach the question of whether there exist “markets” for rugby “services” by considering how relevant provisions of the Act apply to:
- players who participate pursuant to a paid employment contract (“**Employees**”); and
 - players who participate on a paid basis as independent contractors (i.e., not in an employer-employee relationship) (“**Contractors**”).
283. “**Employee**” players are those for whom the playing of rugby is “the performance of work under a contract of service”. The definition of “services” expressly provides that “services...does not include rights or benefits in the form of... the performance of work under a contract of service”. Although there exists a “market” for these employees’ services in a commercial sense, there is not a “market” for such services for the purposes of the Act. This has the effect of preventing ss 27, 29 and 36 applying to services provided pursuant to contracts of service (i.e., employees’ services).
284. Players who are not Employees (and neither are volunteers) may be “**Contractors**.” The Commission considers that both Premier Division and non-Premier Division players could potentially participate in rugby as Contractors.
285. The distinction between “Employees” and “Contractors” turns on “the real nature of the relationship” between the parties (Employment Relations Act 2000, s 6(2)). The Court reiterated in *Bryson v Three Foot Six*⁶⁵ that employment status is fact-dependent, and industry practice or contractual form should not be given undue weight. The real nature of the player/union relationship is highly dependent on the circumstances of the particular case. The Commission considers the following a non-exhaustive list of factors relevant to determining the real relationship of players to their provincial unions:
- the intentions of the parties (players, NZRU and provincial unions) as to whether players are employees or not;
 - statements of the parties;
 - control, integration and the “fundamental” test – whether a person providing services is doing so on his own account; and
 - industry practice generally.
286. The following observations were made obiter in *Rugby Union Players’ Association v Commerce Commission*:

⁶⁵ {2005} 3 NZLR 721 (SC), {35}.

Most players in the NPC competitions only receive remuneration subject to their selection to play and not as of right and the provincial union contracts in this case vary enormously so that many of the players are quite likely to be found to be independent contractors under contracts for service rather than employees under contracts of service – see *Cunningham v TNT Express Worldwide (New Zealand) Ltd* {1993} 1 ERNZ 695 (CA). Accordingly, the Commission was of the view, following the Full Federal Court of Australia, that there was a real possibility that there could be competition to engage players otherwise than under a contract of service in the narrowly defined sense. Thus there is clearly room for the Commission’s view that there could be a market for the rights to player services, at least to the extent that some players in the market may be found to be independent contractors.⁶⁶

287. Although the NZRU has expressed a strong preference to employ all players on a contract of service basis, the Commission is also mindful of evidence indicating that other players might in future be engaged as contractors through clause 4.2 of the CEA.⁶⁷
288. The NZRU acknowledges that clause 4.2 of the CEA provides for the possible engagement of players as contractors, but states that there is “no real prospect” that players will be engaged other than under an employment agreement.⁶⁸ The NZRU regards the contracting option as being open only to “star” players and points out that all of the star players (bar one existing contractor) are currently employees, and that the players most likely to be seen as candidates for seeking independent contractor status both signed 3 year contracts at the end of last year as NZRU employees. They do not expect that there would be any “new” independent contractors in the next 2 to 3 years at least.
289. The Commission considers that those players who are engaged pursuant to clause 4.2 could potentially provide their services pursuant to a contract for services, rather than a contract of service. Such players might not be employed or paid directly, but could sell their services to the union via a separate entity. Such players might have other roles and responsibilities for the NZRU in addition to playing rugby, and are likely to have significant sponsorship deals and other commercial arrangements in place, also conducted through the separate entity.
290. Clause 4.2 of the CEA explicitly provides for the possibility that players may be engaged as contractors. It is not possible to predict with certainty the basis on which players will be retained in the future, particularly as the CEA is due to expire in 2008. It is also not possible to conclude by general observations of the industry whether particular players will have an employee or independent contractor relationship.⁶⁹ It may be that more Premier Division players will in future provide their services to the NZRU by way of contracts for services rather than under contracts of service.

⁶⁶ {1997} 3 NZLR 301, 328–329 (HC).

⁶⁷ Interviews with selected players held at the office of the NZRU, Wellington, on 21 December 2005.

⁶⁸ NZRU Application {22.7}, {22.8}.

⁶⁹ *Bryson v Three Foot Six Ltd* {2005} 3 NZLR 721 (SC), {35}.

291. Therefore, the Commission’s conclusion is that:

- there are a number of players who are employed under the CEA,⁷⁰ playing rugby pursuant to a contract of service, terms of which are prescribed in the CEA. The playing of rugby by Employee players, as a service provided to an employer pursuant to a contract of service,⁷¹ does not constitute the provision of a “service” in terms of the Act. Accordingly, the Act does not apply to the extent that the proposed conduct might affect competition in the playing of rugby by Employees; and
- it is plausible that Premier Division players could be engaged otherwise than under a contract of service, potentially as independent contractors under clause 4.2 of the CEA and that, therefore, there is a real possibility of current or future Premier Division players playing rugby in respect of which the exclusion of “performance of work under a contract of service” does not apply.

NPC rugby as “services”

292. The playing of rugby as an Employee is not a “service” in the requisite sense. Whether rugby played by Contractors is a “service” requires consideration of the questions indicated by (a) through (e) in the diagram set out in Figure 3.

a. Is the player providing the right or benefit “in trade”?

293. Rights, benefits, privileges and facilities that are provided, granted or conferred “in trade” are “services” within the scope of the Act. “Trade” is defined in s 2(1):

“**Trade**” means any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or to the disposition or acquisition of any interest in land.

294. “Business” is defined in s 2(1) also:

⁷⁰ Determining whether a relationship is an employment relationship is an issue of substance, not form (s 6(2)–(3) of the Employment Relations Act 2000). Therefore, it is not conclusive that the CEA describes players as Employees. However, the Commission considers that the following factors place this question beyond doubt:

- the CEA is clearly described on its face as an employment agreement. It is between a registered employee union and the NZRU;
- the CEA states that the players engaged pursuant to that agreement (other than under cl 4.2), irrespective of their membership of the RPC, are employees of the NZRU;
- the “real nature” of the relationship between the players and the NZRU as governed by the CEA is one of employer/employee; and
- by operation of the Employment Relations Act, players who are members of the RPC are automatically covered by the CEA.

⁷¹ Decision No. 281, para 88.

“**Business**” means any undertaking –

- (a) that is carried on for gain or reward; or
- (b) in the course of which—
 - (i) Goods or services are acquired or supplied; or
 - (ii) Any interest in land is acquired or disposed of — otherwise than free of charge.

295. While profit making need not necessarily be the dominant objective,⁷² the Commission considers that the relevant dealings must be fundamentally commercial in character to be “in trade”.
296. To the extent that NPC players participate as independent Contractors, the Commission’s view is that such participation occurs in “business” or as an “occupation” and hence is “in trade”. Professional rugby players would consider their playing of rugby to be their occupation or trade and all Contractors participate in rugby for gain or reward.

b. Do players engage in rugby playing activities pursuant to a contract?

297. The second of the inclusive limbs of the definition of “service” refers to contracts “for, or in relation to” four kinds of activities, regardless of whether they are carried on “in trade” or not. The first step in ascertaining whether NPC players provide “services” within the second limb of the definition is to consider whether their participation is pursuant to a contract. In this context, “contract” carries its standard common law definition and can include, for example, collateral contracts.
298. Contractor players participate in rugby playing activities pursuant to a contract for services.

c. Is the contract for or in relation to the “performance of work”?

299. “Work” is not a term that is defined in the Act.⁷³ The *Shorter Oxford Dictionary* definition of “work” includes:
- “A thing done; an act, a deed, a proceeding; *spec.* one involving toil or strenuous effort”;
 - “Purposive action involving effort or exertion, esp. as a means of making one’s living; (one’s) regular occupation or employment. Also, labour, toil;...”; and
 - “Chiefly *SPORT*. Practice, training; exertion or movement proper to a particular sport etc.”

⁷² *In re Ku-Ring-Gai Cooperative Building Society (No. 12) Ltd* (1978) ATPR 40-094 at 17,994 per Deane J.

⁷³ The meaning of “performance of work” in the Consumer Guarantees Act 1993 definition of “services” was considered by Neazor J in *Electricity Supply Association of New Zealand v Commerce Commission* (1998) 6 NZBLC 102,555 (HC). However, this definition focussed on the distinction between “work” as an object and “work” as an act, and is not relevant to the present issue.

300. *Black's Law Dictionary* (7th edn.) defines “work” as “physical and mental exertion to attain an end, esp. as controlled by and for the benefit of an employer; labor.”
301. Whether an activity is carried on for remuneration is not necessarily determinative of whether that activity is “work” in its ordinary meaning. In *Clear v Smith*, the ordinary meaning of “work” was considered in a false representation action. Lord Widgery CJ stated:
- The whole question here on the first argument in this case is whether it makes any difference that the work should be done not for remuneration but done in the matter in which I have described. I think this is, above all, a point for the justices as a question of fact and degree. One cannot possibly lay down as a general proposition that an unpaid activity is not work. As was suggested in argument, no housewife would be ready to accept that proposition with equanimity. On the other hand, it does not follow that every activity which is backed up by remuneration is work. It is a question of fact and degree for the justices to give the work a commonsense meaning in its context as part of a deliberation.⁷⁴
302. The term “work” in s 58(1) of the Social Security Act 1964 was considered by McGechan J in *Re Fehling* (unreported, High Court, 21 July 1997, AP294/96). In that case it was held that, if “work” was given an extensive meaning, then all persons engaged in charitable and homemaking work would be eligible for the unemployment benefit. Such a result could not have been intended by Parliament.
303. The Commission considers that not every remunerated activity necessarily is work and, by the same token, work can encompass activity that is unremunerated. In the present context, however, the Commission considers that whether a player receives monetary reward in return for playing rugby is an important indicator of whether the player is engaged in work or not. The Commission’s view is that “work” and, hence, “services” are provided where rugby is played pursuant to a contract which entails the remuneration of the player.
304. The Commission considers that players who participate in rugby pursuant to a contract for services in return for remuneration over and above their direct expenses do provide rights or benefits under a contract for, or in relation to, “the performance of work”.
305. Given the conclusion in the previous paragraph, it is not necessary for the Commission to reach a view on the questions of whether the contract is for the provision of amusement, entertainment or recreation, and whether players otherwise provide services.

Conclusions

306. In summary, the Commission conclusions on the question of the relevant service are as follows:

⁷⁴ {1981} 1 WLR 399 (QBD) at 406–407.

- **Employees:** Players who engage in playing rugby pursuant to a “contract of service” (e.g., the CEA) do not provide “services,” by reason of the express exclusion in the definition; and
- **Contractors:** Players who participate in playing rugby as independent contractors are likely to be providing “services” on the basis that they satisfy one or both of the first two inclusive limbs of the “services” definition. The exclusion of “performance of work under a contract of service” does not apply. Such players do provide “services” within the meaning of the Act.

APPLICATION OF PART II OF THE COMMERCE ACT

307. The applicants have applied for authorisation of conduct that might breach ss 27 and 29 of the Commerce Act 1986.
308. As ss 27 and 29 are in Part II of the Act, it is necessary first to consider whether this conduct falls within the scope of the exclusions from Part II set out in ss 43–46 of the Act. We do so in the remainder of this part.
309. In the next section we then consider the Application of Part II of the Act.

Section 44 - Exclusion of Part II

310. If rugby players provide “services” in a relevant market, it is necessary to determine whether s 44 of the Act applies to exempt conduct in those markets from Part II of the Act. The relevant paragraphs are 44(1)(c), (f) and (h).
311. Section 44(1) provides that (as relevant):

Nothing in []... of this Act applies—

To the entering into of a contract of service or a contract for the provision of services in so far as it contains a provision by which a person, not being a body corporate, agrees to accept restrictions as to the work, whether as an employee or otherwise, in which that person may engage during, or after the termination of, the contract:

...

(f) To the entering into of a contract or arrangement, or arriving at an understanding in so far as it contains a provision that relates to the remuneration, conditions of employment, hours of work, or working conditions of employees:

...

(h) To any act done, otherwise than in trade, in concert by users of goods or services against the suppliers of those goods or services:

(i) To any act done to give effect to a provision of a contract, arrangement or understanding, or to a covenant referred to in paragraphs (a) to (g) of this subsection.

312. Section 44(1)(c) excludes Part II from applying to entering into a contract of service or a contract for services which contains a provision by which a person (not a body corporate) accepts “restrictions as to the work ... in which that person may engage during, or after the termination of, the contract”.
313. Section 44(1)(f) only applies to the conditions of employment of employees (i.e., contracts of service). It excludes Part II from applying to entering into a contract, arrangement or understanding so far as it contains “a provision that relates to the remuneration, conditions of employment, hours of work, or working conditions of employees.” The NZRU argues in its Application that “the relevant question is whether the provisions relating to the salary cap... can... be said to be a provision ‘that relates to the remuneration ... of employees’”.⁷⁵ For completeness, the Commission also considers the exemption in relation to the other agreements the subject of this authorisation.
314. Section 44(1)(h) applies to exclude Part II from applying to “any act done, otherwise than in trade, in concert by users of goods or services against the suppliers of those goods or services”.
315. Section 44(1)(i) applies to the giving effect to of any of the provisions of a contract, arrangement or understanding affected by paras (c), (f) and (h) of s 44(1).

Application to the Salary Cap Arrangement

Section 44(1)(c)

316. The CEA is a contract between the NZRU and the players in their capacity as employees of, or contractors to, the NZRU.
317. In respect of the Salary Cap, the CEA does not place restrictions on the work in which players may engage. Accordingly, the Commission does not consider the CEA to be exempt from Part II by reason of s 44(1)(c).

Section 44(1)(f)

318. To the extent that the CEA provides for the Salary Cap, the CEA arguably does “relate to the remuneration, conditions of employment, hours of work, or working conditions of employees.” To that extent, it is exempted from Part II by s 44(1)(f). So far as the CEA affects independent contractors (as opposed to employees) s 44(1)(f) does not exclude the Application of Part II.

Section 44(1)(h)

319. Section 44(1)(h) is directed at consumer boycotts. The equivalent Australian provision makes this clearer in its reference to “ultimate users or consumers” rather than “users”. The New Zealand s 44(1)(h) captures a similar notion in its

⁷⁵ NZRU Application para 23.3.

restriction to boycotts “otherwise than in trade”. The Commission therefore does not consider that s 44(1)(h) applies to exclude Part II from applying to the arrangements in issue: even though it is not clear whether all PD players play rugby “in trade” (see earlier discussion, it is highly likely that provincial unions acquire these services “in trade”).

Application to the Player Movement Regulations

Section 44(1)(c)

320. The Player Movement Regulations would restrict the ability of Modified Division One players to transfer to the Premier Division, in that they require payment of a transfer fee to the Modified Division One team from which the player is transferring (and specify a window of time for such transfers).
321. However, players would not be bound by the Player Movement Regulations in their capacity in contracting (whether as employees or otherwise) with the NZRU, but merely by virtue of being members of the NZRU. Hence, the Player Movement Regulations are not an arrangement by which any person who is a party to that arrangement agrees to accept restrictions of the kinds specified. The Commission considers, therefore, that s 44(1)(c) does not apply to exclude the Application of Part II to the Player Movement Regulations.

Section 44(1)(f)

322. The Player Movement Regulations do not relate (except tangentially) to the “remuneration, conditions of employment, hours of work, or working conditions of employees”, in that many players will not be employees (and, indeed, all players who will provide “services” will not be employees) and, in any event, the Player Movement Regulations will only have an indirect effect on conditions of employment. Therefore, s 44(1)(f) does not operate to exclude the potential Application of Part II in respect of the Player Movement Regulations.

Section 44(1)(h)

323. For the reasons in paragraph 319, the Commission is not persuaded that section 44(1)(h) will exclude the Application of Part II to the Player Movement Regulations.

Summary of Effect of s 44 Exemption Provisions

324. The Commission considers that the exclusions in section 44 of the Act do not apply to exempt in their entirety any of the Salary Cap Arrangement or Player Movement Regulations that are the subject of this authorisation Application from Part II (and hence from the jurisdiction of the Commission to grant an authorisation). However, s 44 does exclude the Application of Part II to a limited extent:

- the CEA is exempt from Part II insofar as it provides for the enactment of the Salary Cap Regulations in relation to Employees (but not Contractors); and
- the Player Movement Regulations are exempt from Part II insofar as they might limit transfers of players who are (or would otherwise be) Employees.

325. The Commission also notes that, in accordance with the approach taken in *Re Speedway Control Board of NZ (Inc)* (1990) 2 NZBLC (Com) 104,521 at [], it is legitimate for the Commission, in assessing the effects of agreements over which the Commission has jurisdiction, also to consider the effect of any “interconnected” agreements. (Such an approach appears consistent with s 3(7)(b).)

MARKET DEFINITION

Introduction

326. The purpose of defining a market is to provide a framework within which the competition implications of a restrictive trade practice can be analysed. The relevant markets are those in which competition can be affected by the contract, arrangement or understanding being considered. Identification of the relevant markets enables the Commission to examine whether a lessening of competition would occur as a result of the trade practice and to determine if the magnitude of any detriment from a lessening of competition is outweighed by the public benefits attributed to that practice.

327. Section 3(1A) of the Act defines a market as:

. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.

328. For competition purposes, a market is defined to include all those suppliers, and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the trade practice(s) under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.⁷⁶

⁷⁶ Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association* (1976) 25 FLR 169; *Telecom Corporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 (reversed on other grounds).

The Relevant Markets

329. In Decision 281, which granted authorisation to the NZRU to enter into and give effect to restrictions to the player transfer system, the Commission identified three relevant (New Zealand-wide) markets:

- the provision and acquisition of premier rugby union player services;
- the provision and acquisition of the rights to premier rugby union player services; and
- the provision and acquisition of sports entertainment services.

330. The Applicant argued that the market circumstances have changed to such an extent that the market definitions adopted in Decision 281 no longer apply. In particular, the NZRU contends that the relevant markets for the purposes of the Application are:

- the provision and acquisition of premier rugby union player services (i.e., involving the relationship between players and provincial unions); and
- the provision and acquisition of sports entertainment services.

331. Furthermore, given the so-defined markets, the NZRU submits that:

- the market for player services is not a market for the purposes of the Act because the relevant services are provided under employment agreements. In the alternative if there is such a market it only relates to services under independent contract arrangements and is very small (presently only one player);
- the market for the rights to player services discussed in Commission Decision 281 is not a market for the purposes of the Act and, in the alternative, that market is not sufficiently affected by the Salary Cap and Transfer Regulations to be relevant to the analysis; and, therefore,
- there are no markets for the purposes of the Act and authorisation is not required; or, in the alternative,
- section 44(1)(f) applies to both the market for player services and the market for the rights to player services because the Salary Cap relates to the “remuneration of employees” and therefore authorisation is not required under section 58 of the Act.

332. In the Jurisdiction section, we concluded that the only relevant “services” for the purposes of market definition were those provided by players who play rugby pursuant to a contract. We identified that there are likely to be two types of such players: “elite” experienced All Blacks, former All Blacks and other senior players who are engaged pursuant to clause 4.2 of the CEA, and former 2nd and 3rd Division players who would receive some money in return for playing rugby (e.g.,

to compensate for expenses and lost salary), but for whom the nature of the arrangements does not make them employees.

333. Having regard to the Applicant's arguments and views on the relevant market, the Commission considered, first, whether each of the markets identified in Decision 281 is relevant to the present Application, and, second, whether any other markets not analysed in Decision 281 exist.

Premier Player Services

334. In Decision 281, the Commission found that there was a market in which players compete with each other to supply their skills or services to provincial unions and in which provincial unions compete with each other to acquire them. As recognised by the Commission in that Decision, when the end result of this competition is the entering into of a contract between the provincial union and the player, the nature of this contract between provincial union and player as a contract *of* service or a contract *for* services may be relevant for determining whether a market exists for the purposes of the Act.
335. As outlined in the Jurisdiction section of this Determination, the Commission has determined that a market for player services does exist for the purposes of the Act, to the extent that there presently are, or is the potential in future, for players to provide services to the NZRU under independent contract arrangements.
336. The NZRU notes in its Application that clause 4 of the CEA makes provision for the engagement of contractors, and they would, if so engaged, be caught by the proposed arrangements, albeit that it is the NZRU's strong preference not to engage players in that way except in the most exceptional of circumstances.
337. This clause, and the fact that there is presently at least one independently contracted player, suggests that there is a field of potential transactions between players and the NZRU within the ambit of the Act in which competition may be affected by the proposed arrangements.
338. The Applicant concedes that a market for player services may exist, for the purposes of the Act, in the event that some players provide services under independent contract arrangements to the NZRU. However, the NZRU suggests that this market is so small (at present, it includes only one player) that it does not warrant scrutiny by the Commission.
339. However, the Commission considers that the fact that little or no trade presently occurs in this market does not obviate the need to analyse the impact of the proposed arrangements on competition in that market. Indeed, it has been put to the Commission by a number of industry participants that there are a number of 'superstar' players who could conceivably become independent contractors in future.

340. In *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor*,⁷⁷ the High Court of Australia stated:

... {A} market can exist if there be the potential for close competition even though none in fact exists ... Indeed, for the purposes of the Act, a market may exist for particular existing goods at a particular level if there exists a demand for (and the potential for competition between traders in) such goods at that level, notwithstanding that there is no supplier of, nor trade in, those goods at a given time.

341. In Decision 281, the Commission defined a market for the provision and acquisition of premier rugby union player services on the basis that:

- the skills of players from other sporting codes are not generally substitutable for those of rugby union players (except at the margins in the instance of exceptional athletes); and
- the skills of the vast majority of rugby union players are not substitutable for those of premier rugby union players (who were most directly affected by the proposed transfer regulations).

342. In that Decision, the Commission gave particular consideration to whether rugby league player services were acceptable substitutes for rugby union player services. Whilst the Commission recognised that the skills of rugby league players most closely approximate those of rugby union players, it concluded that, on the evidence provided by interviewed parties, few rugby union players had skills that could be transferred into rugby league. In particular, switching was unlikely to occur amongst rugby union forwards, whose unique rucking and mauling skills were of limited use in rugby league.

343. Provincial unions responding to the Commission's queries have advised that, while in the past (early/mid 1990's) player switching between rugby union and rugby league was commonplace, in recent times, switching is a rare occurrence. Professor Rodney Fort, acting for the Applicant, stated in his submission to the Commission that one possible explanation for this is, according to the advice he had received, "... the fact that rugby union and rugby league involve different types of skills that are not always transferable".

344. In Decision 281, the Commission considered that not only did the services of other sports players fall outside the relevant 'product' market, but that the services of most rugby union players were also excluded. The argument there was that the skills of the great majority of the total rugby union playing population are simply not substitutable for those of premier players. The Commission found evidence in the present case to suggest this still remains true.

345. As noted earlier, one of the proposed reforms to the provincial competition structure is the promotion of the four strongest provincial unions (one formed from

⁷⁷ (1989) ATPR 40-925.

the amalgamation of two adjacent unions) from the existing NPC 2nd Division to the new PD competition. One likely effect of this change will be to widen the gap in skill level between players in the Premier Division and those remaining in the MD1 competition, further reducing the scope for substitution between premier and non-premier rugby union players.

- 346. Indeed, data provided by the Applicant showed that in recent years most player transfers between 2nd Division and 1st Division originated from the five unions now shifting to the new PD. With the anticipated promotion of these unions, the Commission considers it is likely that any substitution at the margin that may have occurred in the past will be significantly reduced.
- 347. There are a number of other characteristics that set premier players apart from non-premier players. For example, according to those provincial unions surveyed by the Commission, premier players are largely professional or semi-professional players, whereas the non-premier players (i.e., those players who will participate in the MD1 or lower competitions) are generally amateur players.
- 348. Also, premier players, through their respective unions, have access to superior training and coaching facilities, and medical/nutritional assistance, than do non-premier players. Table 5 shows that the average union spend on coaching services and facilities for the years 2002–2004, derived from NZRU GARAP data. If expenditure is indicative of quality and the availability of facilities and services to players, Table 5 suggests that players in 1st Division are significantly better equipped in this regard than players in 2nd and 3rd Divisions, with the gap apparently growing over time.

Table 5: Average Spend on Training Facilities and Services by Division

	2002	2003	2004
1 st Division	[\$]	[\$]	[\$]
2 nd Division	[\$]	[\$]	[\$]
3 rd Division	[\$]	[\$]	[\$]

Notes: Figures indicate average union spend on coaching services (incl. bonuses), outfitting, and ancillary A Team expenses. Source: GARAP data, NZRU (2005).

- 349. The Applicant has not disputed the Commission’s reasoning in Decision 281 for defining a discrete market for premier rugby union player services. Nor did the Commission, in its investigation process, find any material change in circumstance within the industry to call into question the reasoning used to define such a market. Therefore, the Commission has adopted for competition analysis purposes a New Zealand market for the provision and acquisition of premier rugby union player services (the ‘premier player services’ market).

350. For the avoidance of doubt, the Commission takes ‘premier’ rugby union players to mean all players, whether contracted to the NZRU or not,⁷⁸ participating in the new NPC PD competition, and in all higher levels of competition.

Non-premier Player Services

351. A group of players not included in the premier player services market defined above, but still impacted upon by the Proposed Arrangements to a small extent, are MD1 rugby union players. In order to provide a framework within which to analyse the competitive effects of the Proposed Arrangements, the Commission sought to define the market in which these players compete to offer their services, and in which provincial unions compete to acquire these players’ services.
352. As with the premier player services, the relevant consideration for the Commission in defining such a market was whether there exist any sufficiently close substitutes to the services provided by MD1 players, such that they could be considered as competing in the same market.
353. MD1 players are typically selected from club sides to represent their respective provincial unions in the MD1 competition. Therefore, MD1 players are in a sense in direct competition with club players to be selected for their union.
354. There are many levels of club rugby ranging from A and B club sides (at the highest levels) through to children’s age group competitions. Of these various tiers of club rugby, the most likely substitutes for MD1 players appear to be players from the A and B teams as it is from this level that MD1 selection is considered.
355. The Commission also understands that in the event of an injury in an MD1 team, and where there is no replacement from within the squad, A or B team club players would be called upon to act as replacements. Hitherto, a union could draw on club players not just from its own province as a substitute, but also from other unions (potentially in higher Divisions) through the loan player scheme. (This system would continue under the counterfactual).
356. Indeed, there is evidence that NPC 1st Division unions have approached unions in lower Divisions to offer club players from within their province as loan players to give these players exposure in competing at the representative level. In many instances unions (such as North Otago RFU) have availed themselves of the opportunity to field skilled out-of-province club players in place of local NPC players. Hence, the Commission considers that it is appropriate to include players from A and B club sides in the same market as MD1 players.

⁷⁸ Clause 41.2 of the CEA prohibits a PD provincial union from engaging a player other than under a Provincial Union Contract (i.e. a contract in the prescribed form between the NZRU and the player). Notwithstanding this prohibition, a PD provincial union might still engage a player directly and such a contract will likely be enforceable as between the provincial union and the player (even if it causes the PD provincial union to breach the CEA).

357. Separate from the club competition is the inter-school competition. It seems very unlikely that players at this school level would compete for MD1 spots as these players are very young and still developing (both physically, and in terms of skill). Talented school players are typically spotted early and directed through to academy and development squads with “aspiration pathways” directly through to the PD level, bypassing the MD1 altogether. Therefore, the Commission does not consider that participants in school rugby should be included in the same market as MD1 players.
358. On the basis of the arguments laid out above, the Commission defined, for the purposes of carrying out the competition analysis, a discrete New Zealand market for the provision and acquisition of non-premier player services provided by MD1 and A and B club side players (the ‘non-premier player services’ market).

Rights to Player Services

359. In Decision 281, the Commission argued that in addition to the transactions that occur between players and provincial unions for player services, there is a field of potential transactions between provincial unions for buying and selling of the rights to use player services. (This largely reflected the focus of that Application on a player transfer system.) On this basis, the Commission defined, for analytic purposes, a New Zealand market for the provision and acquisition of the rights to (premier) rugby union player services (the ‘rights’ market).
360. However, the Applicant has disagreed with the position adopted by the Commission in Decision 281 in defining a discrete rights market, contending that such a market is not separate or distinct from a market for player services. In doing so, the Applicant advanced a number of arguments as to why it would be inappropriate for the Commission, in this Decision, to follow the approach it took in Decision 281 and define a discrete rights market.
361. Firstly, the NZRU argued that under the current transfer system, whenever a player transfers between unions, the provincial union to which the player moves (the ‘receiving union’) does not require the consent of the provincial union from which the player wishes to transfer (the ‘transferring union’). That is, a transferring union cannot refuse consent to a transfer. If a transferring union cannot withhold supply, it follows that it does not supply the right to players’ services. This removes the possibility of union-to-union trade, as would be characterised in a rights market.
362. The Commission notes that there may be some circumstances in which a transferring union may be able to block, or at least delay, a player transfer. As the NZRU notes in its Application, any outstanding and undischarged contractual obligations between the player and transferring union may need to be “bought out” before a transfer can proceed. If no agreement can be reached on the price and terms of the buyout, a union may have grounds to prevent, or at least significantly hinder, the transfer. Also, a union may be able to prevent a transfer if the transferring and receiving unions cannot successfully negotiate a transfer fee, if

such fees apply (e.g., under the counterfactual, or between MD1 and Premier Divisions in the factual). Nevertheless, the Commission agrees that, generally, a transferring union cannot prevent a transfer by refusing consent.

363. Secondly, the key participants in the transfer process are the player and the receiving union. One of these parties typically initiates the transfer process, which is concluded at their mutual agreement. Transferring unions generally have little or no influence on where the player moves. Provincial unions consulted by the Commission generally agreed with this submission. It could be argued that without such influence, it would not be sensible to consider the transferring union as being in trade, and therefore, a participant in the market.
364. For example, suppose a player has a choice of transferring to either Union A or Union B, and that transferring to Union A represents the player's first preference (perhaps for better remuneration, playing or development opportunities, lifestyle, etc.) Provided all transfer requirements are met (e.g., payment of any fees, etc.), the player will move to Union A – the union that provides him with the highest utility – notwithstanding the transferring union's preferences over the identity of the receiving union. If indeed the transferring union were a transactor in the market, one would expect it to exert influence on the player to move to the union that provides the transferring union with the greatest payoff (e.g., the highest transfer fee, or the smallest marginal benefit from acquiring the player). However, the Commission found no evidence that transferring unions are able to exert such influence in practice. Therefore, the real competitive dynamics of interest lie in the player-to-union transaction, which is fully described and captured in the player services market defined earlier.
365. Thirdly, one provincial union cannot sell a player to another provincial union, and provincial unions cannot assign employment contracts. Nor can a provincial union trade a 'right to contract' separately from a player. Either there is a transaction between the receiving union and the player, or there is no transaction at all. If the transactions cannot occur separately, it does not make sense to think of them as occurring in separate markets. The Applicant points out that in Decision 281 the Commission concluded that, from an economic perspective, the player services market and rights market appear merely to represent different sides of the same coin. However, it should be noted that the Commission came to this conclusion only in the context of evaluating the detriments in that case; the Commission analysed the two markets separately when evaluating the competitive impact of the proposed arrangements.
366. Finally, the mechanics of a player transfer suggest that provincial unions are actually in competition with one another for player services, rather than in trade with one another for the rights to services. If a player is contemplating a transfer, then a competitive interaction will be initiated between the various unions vying for that player's services, including the union the player is currently with. The unions would not be competing with one another to purchase the right to obtain the services of the player since, as argued earlier, the transferring union can neither

sell, nor confer, such a right. The provincial unions surveyed by the Commission largely agreed with this proposition, and viewed any union-to-union transfer fees as incidental to a player-to-union transaction, not indicative of a separate rights market.

367. Having given them due consideration, the Commission accepts these arguments advanced by the Applicant, and concludes that it would not be appropriate, in the present case, to define a discrete rights market.

Sports Entertainment Services

368. Rugby union is sold by the NZRU and/or provincial unions as a form of entertainment to spectators and to the media. Rugby union-related merchandise is also sold by rugby union organisations to the public. Finally, corporations purchase advertising rights from rugby union organisations (via sponsorship and direct advertising) and from television and radio stations that have purchased rugby union broadcasting rights. Other sports and forms of entertainment also sell their ‘services’ to many of the same parties.
369. In Decision 281, the Commission found evidence that rugby union competes with other forms of sporting entertainment, and to a lesser extent, with non-sporting entertainment, and on that basis, concluded that there was a market for the provision and acquisition of sports entertainment services.
370. The Commission found evidence to support such a definition of the market for the purposes of the present case, which is summarised below.
371. According to a 10 March 1994 report produced by the Boston Consulting Group, which was commissioned and submitted to the Commission by the NZRU in the context of Decision 281, 15% of New Zealand’s population may be considered dedicated rugby union supporters for whom no other sport or form of entertainment provides an acceptable substitute. An additional 15% of the population are rugby union rejecters. However, the bulk of the population – the remaining 70% – comprised of “theatre goers” for whom rugby union is one of many entertainment choices available (for example, barbecues, golf, reading and movies) The NZRU (in a submission to the Commission dated 23 December 2005) stated that recent market research suggests that there are still a large number of fans who view other forms of entertainment, both sporting and non-sporting, as acceptable substitutes for rugby, and make consumption decisions accordingly.⁷⁹
372. The NZRU submitted that international and provincial union rugby matches are typically scheduled in such a way as to avoid clashes with other major sporting and

⁷⁹ This research, conducted by Colmar Brunton (*Understanding New Zealand Sports Fans and their Relationship with Rugby*, 2005) identified entertaining friends at home, dining out, and attending movies at the cinema as the three most popular entertainment alternatives to watching rugby union. The study also identified the growing popularity of a wider range of sports as competitive threats to rugby union. Netball, cricket, rugby league, and yachting were found to be the most popular sporting alternatives to rugby union.

non-sporting entertainment events (such as concerts, rugby league fixtures, agricultural Field Days and V8 motor races). For example, Counties-Manukau provincial matches are scheduled as much as possible to avoid coincidence with Auckland Warriors rugby league home games. The timing of public holidays and seasonal past-times, such as duck-shooting, is also taken into account when scheduling matches. The provincial unions canvassed by the Commission supported this submission.

373. The NZRU and provincial unions both have regard to other forms of entertainment when pricing spectator tickets. The NZRU notes that although ticket pricing strategies tend to differ between MD1, PD, Super 14, and All Black matches (tickets for high level competitions typically attract higher premiums, and are likely less price elastic), pricing is nevertheless informed by market research. For example, one provincial union advised the Commission that, as a rule-of-thumb, they benchmark the lowest available match ticket to the price an individual could expect to pay to watch a movie at the cinema.
374. According to a 2005 Colmar Brunton study, 78% of “fans” regularly include sport as part of their weekend entertainment, watching, on average, about four hours of sport over a weekend (three hours on average, during weekdays). The study also found that while viewers have access to an increasing variety of sports (both traditional codes, as well as those that have gained relatively recent popularity, such as basketball, motorsport, and X-Air) they are also becoming more “time poor”. As a result, viewers are forced to be more selective in the sports they choose to watch. The NZRU also submitted that there is an increasing tendency for rugby union matches to be broadcast close to prime-time slots alongside other popular programming. (The fact that rugby is increasingly securing such premium time slots suggests that it may be a highly competitive form of entertainment.) These trends mean that rugby now competes with both a growing menu of sports programming, as well as non-sporting programmes broadcast at a similar time.
375. On the basis of this evidence, the Commission concludes that the relevant market is the market for the provision and acquisition of sports entertainment services in New Zealand (the ‘sports entertainment’ market). This is consistent with the views of the Applicant, who has also argued in favour of a sports entertainment market.

Supply of services of organising and running a rugby union competition

376. In addition to the markets described above, the Commission has also considered whether there is an additional market for the supply of the services of organising and running a rugby union competition for various provincial unions and clubs. The NZRU organises competitions, such as internationals, and Super rugby (in combination with the Australian Rugby Union and the South African Rugby Union) as well as the domestic competitions, that is, the Premier Division and Modified Division One. Provincial Unions compete with each other to submit teams to the competitions run by the NZRU and compete in effect to acquire the services of the

NZRU of organising competitions. In turn, the Provincial Unions then compete for the player services in order to field teams in the NZRU competitions.

377. In this way it can be seen that the services that the NZRU undertakes of organising competitions provide the link between the market for sports entertainment services and the market for premier player services. The question arises as to whether the activities of NZRU in organising competitions is an activity which simply takes place in the market for sports entertainment services, or whether the demand for rugby union is so distinct such that there is little constraining effect from other entertainment services. If this were the case, then there may be a separate market for the provision of rugby competition services. This could be important because if there were a distinct market for the provision of rugby competitions, then in this market the NZRU is in the position of the sole supplier which would enable it to exercise market power, including for example to constrain player payments and to increase NZRU surpluses.
378. However, having considered this matter, the Commission does not consider it necessary to form a view as to whether there is a separate market for the provision of rugby competitions, as its analysis of benefits and detriments is ultimately not affected by whether there is such a separate market, and accordingly it is irrelevant for the purposes of this Determination.

Conclusion on Relevant Markets

379. For the purposes of analysing the competitive impact of the proposed arrangements in the Application, the three relevant markets are the New Zealand wide-markets for:
- the provision and acquisition of premier rugby union player services (the ‘premier player services’ market);
 - the provision and acquisition of non-premier rugby union player services (the ‘non-premier player services’ market); and
 - the provision and acquisition of sports entertainment services (the ‘sports entertainment services’ market).

COMPETITION ANALYSIS - SECTIONS 27, 29 AND 30 ANALYSIS

Introduction

380. Under section s 61(6) the Commission must first satisfy itself that the practice, the subject of the Application, would or would be likely to result in a lessening of competition before it proceeds to consider whether the claimed benefits would, or would be likely to, outweigh the lessening of competition. Any such lessening of competition, for the purposes of jurisdiction, does not need to be substantial. Where the Commission considers that the practice in question will or will likely result in a lessening of competition, it will have jurisdiction to proceed to decide whether or not to grant authorisation to the Application. Where no such lessening of competition is found, it will decline jurisdiction in respect of the Application.
381. In determining whether a lessening of competition has occurred, the Commission has assessed the competitive effect or likely effects of the arrangement by comparing competition in the relevant markets with competition in the counterfactual.
382. We have concluded in the previous jurisdiction sections that the rugby played by employee players would not comprise “services” and would therefore not form part of any relevant “market”. We therefore restrict our attention in this section to the effect on markets for (and services provided by) non-employee players.
383. It is also important to emphasise that the purpose of this analysis is to determine the effects, or likely effects, of the proposed arrangements in terms of their impact on the *competitive process* in the *markets* for player services and sports entertainment, as opposed to their effects on the NPC competition itself.
384. Section 61(6) also provides that the Commission may proceed to consider whether the benefits would, or would be likely to, outweigh the lessening of competition if it is satisfied that there is a *deemed* lessening of competition. In this regard, the Commission considers whether there is a contract, arrangement or understanding that has the purpose, effect or likely effect, of fixing, controlling or maintaining prices such that, pursuant to section 30, there would be a deemed lessening of competition.
385. For each of the three markets under consideration, we will analyse each of the Proposed Arrangements under s 27 (in terms of whether there is a lessening of competition), and then under s 30. Section 29 will be dealt separately at the end of this analysis.
386. The framework for this analysis is as follows:
- the market for premier player services:
 - salary cap: s 27 and s 30;

- transfer fee: s 27 and s 30;
 - transfer period: s 27;
 - the market for non-premier player services:
 - transfer fee: s 27 and s 30;
 - transfer window: s 27;
 - the sports entertainment market:
 - all arrangements affecting the premier player services market; and
 - the arrangements such as they affect non-premier player services market.
387. However, the Commission will first consider whether the agreement between the NZRU and the CEA to introduce a salary cap in accordance with Clauses 50 and 53-59 of the CEA constitutes a contract, arrangement or understanding for the purposes of the Act. The conclusions reached to this question will then apply to all provisions being considered in relation to the salary cap arrangement in each of the three relevant markets. Then, in relation to price fixing under section 30, the Commission will consider whether any such contract, arrangement or understanding is between persons who are in competition with each other.
388. Secondly, the Commission will consider whether the Player Movement Regulations constitute a contract, arrangement or understanding for the purposes of the Act. Again, in relation to price fixing under section 30, the Commission will consider whether any such contract, arrangement or understanding is between persons who are in competition with each other.

Contract, arrangement or understanding

389. A contract is an agreement enforceable at law and may be oral or in writing. A contract requires formality. It consists of one party making an offer to another party on certain terms to assume a legal detriment (effectively, to restrict his or her current rights) in exchange for the other party also assuming a legal detriment; and the other party accepting that offer.
390. To constitute an arrangement, two requirements must be met:
- a meeting of the minds; and,
 - that meeting of the minds must give rise to an agreed course of conduct with a clear expectation as to that future conduct.⁸⁰
391. ‘Arriving at an understanding’ is a less formal kind of agreement than ‘entering into an arrangement’. Apart from this distinction, the requirements to establish an understanding are largely the same as those for an arrangement.

⁸⁰ *Commerce Commission v Giltrap City Ltd* {2004} 1 NZLR 608, 613 para 17.

Salary Cap Arrangement

392. As discussed in the earlier section relating to the Application for authorisation, the NZRU's Application is based on the provisions of the CEA it has reached with the RPC in relation to the salary cap (clauses 50 and 53 to 59). These provisions are particularised in the NZRU's Application at paragraphs 2.3 and 2.4 which, to recap, provide:

2.3 A proposal to enter into and give effect to a Salary Cap with the features set out in the table below {reproduced at Appendix 1}... and given effect to in the Collective Employment Agreement between NZRU and Rugby Players Collective Incorporated dated 2 November 2005 ... and in the Salary Cap Regulations....

2.4 The key elements of the NZRU Salary Cap have been agreed in clauses 50 and 53-59 of the Collective Employment Agreement. The Collective Employment was signed by the NZRU and Rugby Players Collective Incorporated on 2 November 2005.

393. The Commission sets out at Appendix 1 the NZRU's summary of the features of the Salary Cap Arrangement.

394. In an email to the Commission on 23 December 2005 the NZRU stated:

... In relation to the Salary Cap Regulations, we can confirm that as advised yesterday the NZRU is not be seeking (sic) authorisation for the Salary Cap Regulations themselves. Rather it is the Salary Cap Arrangement as contained in the Application and the Collective Agreement for which authorisation is being sought. We will continue to liaise with the players throughout January in finalising the Regs but at this stage we are happy that the Commission can rely on the attached version of the Regs to the extent that they are relevant to any of the issues to be covered in its draft determination. ...

395. The arrangement to introduce a salary cap in relation to the premier player services market has been *entered into* through a series of negotiations between the NZRU, the provincial unions and the players (through the RPC), culminating in the entering into of the CEA on 1 November 2005⁸¹. The Commission considers that the agreement between the NZRU and the RPC to introduce a salary cap as provided for in Clauses 53 to 59 of the CEA was clearly a meeting of minds giving rise to an expectation of future conduct. Therefore, the Commission considers the Salary Cap Arrangement constitutes at the least an arrangement or understanding, if not also a contract, for the purposes of ss 27 and 30 of the Act.

396. The NZRU Application also seeks in substance to be able to give effect to the provisions of the Salary Cap Arrangement, including through salary cap regulations (an earlier draft of which was provided as a confidential schedule to the Application).

⁸¹ The NZRU advised in their application, at paragraphs 2.3 and 2.4 that the CEA was signed on 2 November 2005, however the NZRU subsequently advised it was entered into on 1 November 2005.

Player Movement Regulations

397. The Applicant has also requested that the Player Movement Regulations be authorised as a contract, arrangement or understanding (NZRU Application, para 2.10). The Applicant has not requested that the Player Movement Regulations themselves be considered as “giving effect to” some other agreement (whether the NZRU constitution or some other agreement to enter into the regulations).
398. As set out below, the Player Movement Regulations are binding on Provincial Unions and professional rugby players by reason of the NZRU Constitution which requires that member Provincial Unions and, amongst others, the professional rugby player members of the NZRU agreed to be bound by such regulations.
399. Accordingly, the Commission considers that the Player Movement Regulations are each a contract, arrangement or understanding for the purposes of ss 27, 29 and 30 of the Act.
400. It is noted that the proposed Salary Cap Regulations would also constitute a contract, arrangement or understanding between the NZRU, the RPC and Provincial Unions. However, the NZRU has not sought authorisation of the proposed Salary Cap Regulations as such. Rather, the NZRU has sought the authorisation of the Salary Cap Arrangement and to give effect to that subsequently through Salary Cap Regulations. The practical effect of this, if authorisation is granted, is to authorise salary cap regulations but only in so far as they give effect to the Salary Cap Arrangement. To the extent that they go beyond the Salary Cap Arrangement, they would not be authorised.
401. In the next paragraphs, the Commission identifies how NZRU Regulations might be regarded as a contract, arrangement or understanding (for the purposes of s 27, and/or s 27 via s 30 of the Act) and we set out the parties to these agreements.

NZRU Regulations

402. The new regulations include:
- proposed Salary Cap Regulations⁸², which will govern the implementation and Application of the salary cap by the provincial unions; and
 - Player Movement Regulations⁸³, which govern the player transfer period, the player transfer fees and replace the existing Player Transfer Regulations.

403. Section 5 of the NZRU Constitution provides that:

⁸² A draft of proposed Salary Cap Regulations was provided by the NZRU in their application. Subsequent drafts have been provided and the NZRU continues to refine these.

⁸³ As attached at Appendix 2.

“5. MEMBERSHIP

5.1 Membership: The members of the Union are Affiliated Unions, Associate Members, Life Members and New Zealand Maori Rugby Board Incorporated.

5.2 Binding: Each Member:

5.2.1 Is Itself Bound: is bound by the Rules and Regulations;

5.2.2 Its Members are Bound: must ensure that its members agree to be bound by the Rules and Regulations; and

5.2.3 Its Members' Members are Bound: must require in its own rules that its members ensure that their respective Members agree to be bound by the Rules and Regulations, to the intent that all sub-unions and clubs and all other bodies or persons connected with the playing or administration of Rugby within New Zealand who are directly or indirectly affiliated to any Member shall agree to be bound by these Rules and the Regulations.

5.3 Conflict of Rules: Any rule or regulation of a Member or other Rugby playing organisation bound by this Constitution which is in conflict with this Constitution, or with the Laws of the Game or domestic variations or the bye-laws, regulations or resolutions of the IRB, shall be deemed to be inoperative.”

404. Section 5 of the NZRU Constitution has the effect of requiring all affiliated provincial unions, its members (e.g. the clubs), and its members' members (e.g., the players, referees, coaches, etc) to abide by the Regulations. The Commission considers that these Regulations will, therefore, create mutual obligations and expectations between all such provincial unions, and, when passed, would amount to an arrangement or understanding between the unions, the clubs, the players and the NZRU. Therefore, there are a number of ways in which the Regulations might fall within the scope of ss 27, 29 and 30 of the Act.

Conclusion on Contract, Arrangement or Understanding

405. The Commission, therefore, concludes that:

- the Salary Cap Arrangement, is at the least an arrangement or understanding between the NZRU, the Provincial Unions and the RPC, on behalf of professional rugby players;
- the Player Movement Regulations, through the NZRU Constitution, would comprise an arrangement or understanding amongst all of the NZRU, the Provincial Unions and relevantly professional rugby player members of the NZRU;

for the purposes of ss 27, 29 and 30 of the Act.

Supplied or acquired by the parties to the contract, arrangement or understanding (CAU) in competition with each other?

406. In addition, for the purposes of s 30 of the Act, the Commission needs to consider whether *any* of the parties to the CAU are in competition with each other (or would be in competition but for the provision) for the supply or acquisition of the goods or services at issue.

The CEA

407. Notwithstanding the form of any employment contracts⁸⁴ entered into with players, it seems clear that the provincial unions, which operate as separate incorporated societies, are in competition with each other for the acquisition of player services. This is because provincial unions must compete with each other in order to attract, recruit and retain players from the limited pool of player talent available. For the NPC competition, the provincial union pays the salaries of the players it contracts with, so it competes on price of salaries offered, the provision of coaching and training facilities, the provision of medical and physiotherapeutic services as well as factors such as location, lifestyle, etc. The Commission considers that there is a real possibility that provincial unions would compete to acquire the services of non-employee players and hence compete for the acquisition of services.
408. In addition, the RPC represents the interests of all professional rugby players in New Zealand and is recognised as the negotiation arm of the NZRPA. Section 2(8)(a) of the Act deems all players covered by the RPC to be parties to the CEA, including non-employee players. The Commission considers that there is a real possibility that two or more such players will be independent contractors and hence parties to the CEA competing for the supply of services. In particular, those players under or considering entering contracts for services are in competition with other players in this position both in the period prior to entering the contract and also during the period that they are under contract but considering their next contract. The CEA states that due to the operational requirements of the NZRU and the provincial unions,⁸⁵ all players are engaged under fixed term contracts and the Commission was advised that usually the term of these contracts varies between one and three years. This indicates that there is potential for a significant degree of “churn” of players as they negotiate and renegotiate fixed term contracts with the provincial unions.
409. The Commission does not consider it is necessary to show whether other parties to the CEA are in competition with each other.

⁸⁴ In the case of Provincial Union Contracts, the introduction to Appendix 9 of the CEA states that this is an employment agreement under which the player agrees to be employed by the NZRU and then to be seconded to provide his employment services to a particular provincial union for a specified time.

⁸⁵ CEA clause 5.4.

410. Accordingly, it appears that the contract, arrangement, or understanding is between at least two sets of competitors via the CEA, being:

- provincial unions acquiring player services, including non-employee player services; and
- players, including non-employee players, supplying player services.

The Regulations

411. We now consider whether the parties to the Regulations are in competition with each other.

412. Those parties who are bound by the Regulations are as set out in clauses 5.1 and 5.2 of the NZRU Constitution and include the Affiliated Unions (i.e., the PD and MD1 provincial unions), their members (the clubs associated with each provincial union) and those members' members (which includes the players).

413. The PD unions are clearly likely to be competitors for player services (i.e., those services provided by players who are paid but who are not employees). The same is true of MD1 unions: NZRU states that "the purpose of the MD1 competition is to provide an opportunity for players who live and work in that community to represent their province in a national amateur competition".⁸⁶ The Commission considers it is reasonable to assume some level of competition exists amongst unions and MD1 players.

414. Therefore, it appears that there is also an arrangement or understanding between competitors via the Regulations, both in terms of the players providing services (i.e., those players who are paid but who are not employees) and the provincial unions acquiring those services.

Summary regarding whether parties are in competition with each other

415. In summary, the Commission concludes that, through the Regulations, there is a contract, arrangement or understanding amongst at least two sets of competitors (or parties who would be in competition but for the provision) being either:

- PD provincial unions acquiring player services, including non-employee player services; and
- PD players, including non-employee players, supplying premier player services.

⁸⁶ NZRU Response to Commerce Commission Questions dated 23 December 2005.

Effects in the Premier Player Services Market

Will the salary cap provision result or likely result in a lessening of competition under section 27?

The salary cap provision

416. Provisions relating to the salary cap are set out in the Draft Salary Cap Regulations, a copy of which was supplied to the Commission by the Applicant on 9 May 2006.
417. The salary cap is designed to provide a ceiling on the amount each provincial union competing in the Premier Division can spend in total on its players. The salary cap, subject to a series of notional values and discounts, has been set for \$2 million for the 2006 season and is to be adjusted for CPI each year thereafter for the term of the CEA (2006 - 2008).
418. By implementing an agreement between the PD provincial unions limiting the amount they will spend on total player salaries, the salary cap mechanism is designed to constrain the competitive strength of the larger-resourced unions by capping the amount they might otherwise spend in a free market. The aim of the provision is, therefore, to constrain the larger-resourced unions' ability to compete for rugby player services.
419. Although it is important to understand what the salary cap mechanism is designed to achieve, the Commission must also be satisfied that the provision will have, or will be likely to have, the effect of lessening competition in the relevant market.

Effect/likely effect of lessening competition

420. When considering the effect of the provision, the Commission considers what would or would likely result from the provision if it were to be put into effect. It then compares these effects to what would happen under the counterfactual. In relation to the salary cap, the counterfactual is no salary cap but more relaxed transfer arrangements than the existing transfer regulations.
421. In the Application, the Applicant submitted, at paragraph 26.1.4, that the effect of the salary cap will be as follows:
- The Salary Cap, by fixing a monetary limit (of \$2 million in 2006) for each Provincial Union to spend on player salaries, will affect the amount that some provincial unions are able to spend on player salaries. The Salary Cap will constrain a limited number of Provincial Unions in any one year and there will be some provincial unions for which the Salary Cap is not restrictive. That is, the Salary Cap is not likely to restrict all Provincial Unions all the time, rather it is likely to restrict some Provincial Unions some of the time.
422. The Applicant goes on to explain at paragraph 26.3.3 (b) that its own analysis (set out in Confidential Schedule K to the Application) shows:

...[] projected to exceed the Salary Cap [], [] of the salary cap, [] of the Salary Cap and [] of the Salary Cap. Therefore in the next few years at least, it seems unlikely that the Salary Cap will restrict the purchase or retention of players for other than at most [] Provincial Unions.

423. The Commission's investigation has largely supported this forecast. The Chief Executive Officers (CEO) of the [] rugby unions confirmed that their total player payroll for the NPC, with discounts and notional values applied, would exceed the cap, and it would be necessary for them to take action to manage the contracting round for the 2006 season to ensure that they each stayed under the cap. Indeed, these CEOs separately advised the Commission that they were already taking action to manage total player payrolls within the cap, in the event that the salary cap arrangement was authorised.
424. In particular, [] for the [] Rugby Union advised that the [] had contracted with [] players, and intended to contract with up to [] players, which could take it to above the level of the cap. It planned to utilise the loan player regulations to enable it to stay under the cap. [] stated that the effect of the cap will mean that in 2006 the [] Rugby Union will not be contracting as many players as previously, contracting [] players instead of the [] that they contracted last year. The [] Rugby Union stated that it will additionally not be contracting []. The [] Rugby Union's CEO, [], said that, although the Union will not seek to contract fewer players than otherwise planned, it would pay less to those it had. [] estimated that up to [] players would be paid less under the salary cap. He estimated that this amount may total between [] in 2006.
425. The [] Rugby Union's CEO, [], stated he does not anticipate his Union would approach the salary cap limit in the immediate future as current revenue streams were already constraining his union's ability to pay higher salaries. Over time, however, the [] Union hoped to maintain a [] "headroom" within the cap and to manage this figure by structuring new contracts around the normal migration of players moving overseas toward the end of their careers. Although not immediately constrained by the cap, the Commission considers the [] Rugby Union's strategy to subsequently remain under the cap by paying less to replacement players would constitute a likely effect of the competitive constraint resulting from the salary cap.
426. In addition, the Fort Report⁸⁷ forecasts the following teams would, in the absence of the Proposed Arrangements, spend more than, and therefore under the factual be constrained by, the salary cap:
- 2006: [];
 - 2007: []; and

⁸⁷ NZRU Application, Schedule H: Dr Rodney Fort Report.

- 2008: [].

427. It is noted that it is predicted that only a minority ([] of the 14) of unions will be constrained by the cap in the next few years. Over time, however, if smaller-resourced provincial unions are able to expand their revenue base and purchasing power at a rate faster than the CPI, an increasing number will approach, and subsequently be financially constrained by, the salary cap.
428. Based on the Applications made to the NZRU by the PD unions to join the new PD competition (addressing the NZRU's Eligibility Criteria) – a sample of which were reviewed by the Commission – the Commission is satisfied that at least some of the unconstrained unions are likely to have the potential capacity to increase total player salary payments at a rate faster than the CPI.

Conclusion on lessening of competition under section 27

429. The Commission considers that the agreement between all PD provincial unions limiting the amount they will spend on total player salaries reduces the ability of provincial unions to compete for players, including non-employee players. In the Draft, the Commission considered that the salary cap would lessen competition when compared to the counterfactual, by imposing constraints on the mix of both the quality and quantity of player services that certain larger-resourced unions might otherwise acquire in a market constrained only by the existing player transfer regulations but no salary cap.
430. In its submissions on the Draft Determination, NZRU stated that it agreed with the Commission's conclusion that the only relevant transactions for the market for premier rugby services are those transactions with players who are independent contractors.
431. It disagreed that competition for the services of these players, already a very limited number, would be affected by the salary cap proposal, and gave two reasons for this:
- firstly, there are unlikely to be many, if any such players, with the vast majority of players [] signed up to a three year contract under the current CEA; and
 - secondly, that provincial unions tend first to secure star players, who are more likely to have independent contractor status, and then secure the remainder of the team as employees with the remaining funds.
432. However the Commission is not persuaded by these arguments. The Commission considers that the fact that little or no trade presently occurs in this market does not obviate the need to analyse the impact of the proposed arrangements on competition in that market.

433. As noted earlier, in *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor*,⁸⁸ the High Court of Australia stated:

... {A} market can exist if there be the potential for close competition even though none in fact exists ... Indeed, for the purposes of the Act, a market may exist for particular existing goods at a particular level if there exists a demand for (and the potential for competition between traders in) such goods at that level, notwithstanding that there is no supplier of, nor trade in, those goods at a given time.

434. In addition, RPC has advised the Commission that there are a number of ‘superstar’ players who could conceivably become independent contractors in future. The Commission notes that the current CEA has a three year term, beyond which it is not possible to predict what kinds of employment relationships/contracts might eventuate.
435. The Commission remains of the view that the salary cap provision would or would likely result in a lessening competition in the market for premier player services, including non-employee players.

Will the Salary Cap Arrangement have the effect or likely effect of fixing, controlling or maintaining prices under section 30?

Fixing, controlling or maintaining the price

436. The words ‘control or maintain’ are included in s 30 of the Act to allow price fixing to extend to those agreements that, while not prescribing an agreed price or an exact method for determining it, nevertheless interferes with the competitive determination of price.
437. In *ACCC v CC (NSW) Pty Ltd* (1999), Lindgren J said “An arrangement or understanding has the effect of ‘controlling price’ if it restrains a freedom that would otherwise exist as to a price to be charged”.⁸⁹
438. A similar approach to the meaning of control was put forth by Salmon J in *CC v Caltex NZ Ltd* when he said:

{Counsel}’s next submission was the alleged understanding was not price fixing. His argument relied heavily on the meaning of the words ‘fixed’ and ‘maintain’. However, the statute, of course, also uses the word ‘controlling’. Amongst the definitions of the word ‘control’ in the *Shorter Oxford English Dictionary* is the following: ‘To exercise restraint or direction upon the free action of’.⁹⁰

439. Lindgren J rejected the need for a specificity of price in the context of ‘controlling’ in *ACCC v CC (NSW) Pty Ltd*:

⁸⁸ (1989) ATPR 40-925.

⁸⁹ *ACCC v CC (NSW) Pty Ltd* {1999} 165 ALR 468, at p 504.

⁹⁰ *CC v Caltex NZ Ltd* (1999) 9 TCLR 305, p 313.

I do not think that some specificity as to price is a necessary element of the notion of ‘controlling’ price within s 45A. To insist on such a requirement would be to introduce an unauthorised general limitation on the notion and would allow the statutory prohibition to be easily circumvented – a result that cannot have been intended and should not be lightly accepted.⁹¹

440. Salmon J also disputed the need for a specificity of price in *CC v Caltex NZ Ltd*, quoting Elias J in *CC v Caltex NZ Ltd*:

Here, it is said that the removal of the promotion, in the absence of further agreement or understanding as to pricing, did not prevent competition on price and eliminated only one type of discount, leaving the companies free to adopt other promotions in competition with each other. This seems to me, with respect, to be sophistry. If the commission is correct in its contention that the promotion operated as an integral part of petrol or car-wash pricing or was a discount in relation to petrol or car-wash services (which seems to me to be a matter which can only be determined after hearing evidence), then an agreement to withdraw the promotion and increase the price or remove the discount seems to me to be within the scope of ss 27 and 30 irrespective of whether the companies are free to compete on price or discount in other ways in the future. There is no authority for the proposition that in order to establish price fixing or impact upon competition it is necessary to establish a fixed price or agreed discount for the future. I agree with the submission made by {counsel} that if that were so it would be easy to drive a coach and four through the Act. Nor do I think it can be said in the absence of further agreement to fix prices, that the result is ephemeral.⁹²

441. Therefore, previous rulings of the Courts indicate that any agreement which interferes with the competitive determination of prices, even if those prices are not specified, could amount to a ‘controlling’ of price.

The Commission’s approach

442. The Commission takes the view that a price will be fixed, controlled or maintained for the purposes of s 30 where there is some artificial interference with, or constraint on, the finding of a price or prices by competitive forces or processes (in particular the interaction of supply and demand).
443. The Commission considers that its approach is consistent with the relevant case law.

Application to the salary cap provision

444. The Commission considers that the critical question here is whether the Salary Cap Arrangement constitutes an artificial constraint on, or interference with, a competitive determination of prices in relation to the player services market.
445. Clearly, the salary cap sets out to fix a maximum amount on what each union is able to spend on player salaries in aggregate. However, the \$2 million cap does

⁹¹ *ACCC v CC (NSW) Pty Ltd* {1999}, para 176.

⁹² *CC v Caltex NZ Ltd* {1998} 2 NZLR 78; (1998) 6 NZBLC 102,505 at pp 84-85; pp 102,510-102,511.

not, in and of itself, fix any particular player's "price" or salary. It could be argued that rather, the \$2 million cap "controls" what the acquiring union may spend on its players in total. Therefore, it is necessary to consider whether this limit on aggregate player spend per union is likely to interfere with the competitive determination of any individual player's salary such that it can be said to control or maintain prices.

446. At paragraph 26.3.2 in the Application for authorisation, the Applicant states that there will be circumstances where the provincial union who values a player's services the highest is not in a position to contract with that player because of the salary cap, and the player would then need to contract with a provincial union who values the player less.
447. The Applicant sets out these circumstances in paragraph 26.3.3 of its Application, and states that by restricting the amounts provincial unions can spend on their players, there are two ways in which players would not receive their free market price:
- a player not transferring to another union because the Salary Cap prevents the receiving provincial union being able to pay his free market price; or
 - a player having to transfer because the releasing union wants to, but is unable to keep, the player at his free market price because of the Salary Cap.
448. The Applicant then goes on to state that this effect is more likely to occur with players of a lesser status or who are in the "twilight" of their careers.
449. The Commission considers that, regardless of the status of the players concerned, in both situations above, the fact that there will be a difference between what the player would have received without the salary cap in operation, and the amount that he would receive as a result of the operation of the salary cap, plainly amounts to an interference in the competitive determination of that player's "price".
450. In submissions on the draft, NZRU argued that there was no basis for a conclusion that the aggregate salary cap has the purpose or effect of controlling payments to the very limited number of independent contractors, the transactions with whom are the only relevant ones for the purpose of the competition analysis.
451. NZRU seem to be relying here on a similar argument to that it made in relation to the Commission's conclusions on s 27 (i.e., that the numbers of independent contractors are too small or insignificant for the salary cap to have this effect). However, the Commission notes that in order to constitute a price fixing controlling, or maintaining, it is simply necessary to show that a provision has the purpose, effect or likely effect of fixing, controlling prices. The Commission understands that this is exactly what the proposed Salary Cap Arrangement does.
452. Where the salary cap places an upper bound constraint on the level of remuneration that can be paid to players, whether under employment contracts or contracts of

services, it necessarily constrains the freedom of Provincial Unions in determining what they can pay players, under both employment contracts and contracts of services. This is irrespective of whether players on non-employment contracts are contracted first or not. In contracting players on non-employment contracts, a Provincial Union must bear in mind the ultimate salary cap constraint, the remuneration paid under existing contracts, the notional value attributable to players under NZRU contracts and the extent to which it will use the remaining room under the salary cap in signing players under employment or non-employment contracts. It is not realistic to think that a Provincial Union would sign a player under a non-employment contract heedless of the effect that remuneration paid under that contract would have on the remaining room, if any, under the salary cap.

453. Accordingly, the Commission remains of the view that the above effects from the salary cap mean that it amounts to an agreement between acquiring provincial unions that will or will likely result in the controlling, or maintaining (or providing for the controlling or maintaining) of prices to be paid to the players for their services.

Conclusion on whether the salary cap constitutes price fixing under section 30

454. It is clear that the salary cap arrangement is an agreement by all PD provincial unions to ensure that none of them will pay more than \$2m in aggregate to their players at any one time. This will result in situations where certain players will be paid less than they otherwise would in a free market⁹³, and thus constitutes an interference with the competitive determination of prices in the player services market. The Commission considers that this would or would likely amount to controlling or maintaining prices.
455. Such an agreement is deemed, by s 30 of the Act, to have the purpose, effect or likely effect of substantially lessening competition for the purposes of s 27.

Will the transfer fee provision result, or likely result in a lessening of competition under section 27?

456. As noted in Decision 281, the purposes of the existing transfer fee are to compensate a provincial union for developing players, to provide an incentive for provincial unions to invest in developing their players and to encourage the acquisition of lower level players from provincial unions. At the time, the NZRU indicated that the establishment of maximum transfer fees was to ensure that provincial unions receive some compensation for developing players but are not able to unduly restrict player movement, for example, by demanding an unreasonably high transfer fee for a player.

⁹³ To show an effect of price fixing, there is no requirement to compare the effect of the provision to the counterfactual – which is not the free market, due to existing Player Transfer Regulations. Rather all that is necessary is to show that the provision has the purpose, effect or likely effect of fixing prices.

457. In the Draft, the Commission considered that the Player Movement Regulations would substantially reduce the circumstances under which a transfer fee would be paid, i.e., only those relatively few occasions when a representative player from a MD1 union transfers to a PD provincial union. With the salary cap in effect, it would be counter-productive to have a mechanism in place which may have the effect of otherwise inhibiting player mobility (even though, with a reasonable maximum fee, player mobility should not ultimately be prevented). For example, in its submission to the Commission made on 13 December 2005, the Manawatu Rugby Football Union stated:

“...on two occasions this year we have had to withdraw from potential contracts due to the overall costs of the transfer regulations when combined with the market rate for that particular player. On several occasions we have actually offered contracts to offshore players at similar levels as they are “better value” than the NZ market when transfer fees are applied.”

458. Given that the primary function of the transfer fees is to compensate unions for developing players, there is a concern that their removal may undermine the incentives for provincial unions to invest in player development, with potentially negative on New Zealand rugby in general. However, the Player Movement Regulations provide that transfer fees will be paid when an MD1 player transfers to a PD union and becomes a representative player. The Commission was advised that these payments are seen as being of significantly greater value to MD1 unions than PD unions. In a written submission to the Commission on 24 November 2005, the Wanganui Rugby Football Union (a MD1 union) stated:

"Our union accepts and actively 'promotes' that we are a 'feeder Union' for the Premier Unions. The retaining of 'payment of transfer fees' for players who move from our Union to Premier Unions will go a long way to offset the costs we have incurred in developing the player so they have the rugby skills and personal attributes that makes them 'wanted' by Premier Unions. If we do not receive any 'payment of transfer fees', our Union may be forced to spend less money on rugby player development as we would like which would then have the flow on negative impact on less people playing, coaching, refereeing and administering rugby in our province."

459. In contrast with MD1 unions, the majority of PD unions interviewed by Commission staff agreed that under the previous Player Transfer Regulations, the transfer fees (which were paid by all unions when players in specified bands transferred) did not represent a significant income source, as payments and receipts tended to balance each other out, and were not a significant factor in determining expenditure on rugby development at the PD level.

460. The NZRU have supported this argument, stating:

“...in the Premier Competition the Development Compensation Payments have provided so little income that it has not been a significant driver in decisions to develop players and hence its removal will not materially affect decisions around player development. These decisions will continue to be driven by other factors such as the need to build a strong roster to be or remain competitive, the need to have better development opportunities to retain players...”

...In the professional environment of the Premier Division, but with a salary cap in place, provincial unions will no longer be able to build a dream team. Accordingly to improve performance they will have no choice but to invest in player development.”⁹⁴

461. Representatives of the RPC, primarily concerned at the potential for transfer fees to inhibit player mobility, have expressed their concern that any transfer fees may lessen competition in the market for premier player services by imposing an additional cost on an acquiring PD union. If the transfer fees were set at unreasonably high levels, they could have the effect of lessening competition by constraining the lesser-resourced unions’ ability to compete in the market as the fee will represent a disproportionate level of total player cost when compared against a larger-resourced union.
462. The above issues are more relevant to, and are addressed further in, the benefits and detriments section of this authorisation.
463. As previously detailed, the NZRU has revoked the Player Transfer Regulations and replaced these with new Player Movement Regulations. The Player Movement Regulations provide at Clause 6.4, that a “Development Compensation Fee” (hereafter transfer fee) may be payable where a Division One Captured Player transfers to a PD Union (referred to in the regulations as an Air New Zealand Cup Union). Unlike the previous regulations, no fees were payable when a player transfers between PD unions or between MD1 unions.
464. The fees, as set out in Clause 6.4, of the Player Movement Regulations are maximums and a PD union receiving the player may agree (with the MD1 union losing the player) to any transfer fee, including a nil amount. If, however, the PD union agrees to pay the maximum fee for any player, then the losing MD1 union is bound to allow that player to be transferred. In this way, provided the acquiring PD is willing and able to pay the maximum fee, no player may be prevented from transferring.

Transfer Fee - Effect/Likely Effect of Lessening Competition

465. The competition effects which are relevant to the Commission’s assessment are those which would or would likely result from the difference between the proposed transfer fee provisions and the counterfactual. In the Draft, the counterfactual was a continuation of the Player Transfer Regulations. In that case, as the fees to be applied in the factual were not greater than those in the counterfactual, they could not be said to have the effect of lessening competition.
466. Hence, in the Draft, in relation to the proposed transfer fee and the transfer period, the Commission did not consider the Player Movement Regulations would lessen or be likely to lessen competition in this market.

⁹⁴ NZRU Response to Commerce Commission Questions, 23 December 2006, Q. 12.

467. However, since the variation to the CEA, the counterfactual has now changed. In the event that the Proposed Arrangements were not authorised, the existing Player Transfer Regulations would be suspended for one year until the conclusion of the 2007 Super 14 rugby competition season. Instead, Clause 50 of the CEA (relating to player transfers) will apply for the intervening year unless/until new regulations replacing Clause 50, are negotiated between NZRU and RPC.
468. The effects of the proposed variation will therefore fall into two periods, being:
- from 29 May 2006 until the Friday after the Super 14 competition in May 2007 (Super 14, 2007) – during which period Clause 50 of the CEA applies; and
 - from that date in May 2007 onwards, where the rules applying will be the subject of negotiations between the NZRU and the RPC.
469. Clause 50 sets out the terms and conditions relevant to player transfers and in respect of the transfer fee, clause 50.5 of the CEA states:
- “For the avoidance of doubt, a provincial union which is not listed in Appendix 1⁹⁵ to this Collective Agreement may be entitled to a transfer fee from a Provincial Union in respect of the Transfer of a Player from it to that Provincial Union.”⁹⁶
470. In addition, Clause 50.6 provides for a transfer period that is the same as that set out in the Player Movement Regulations above, from 1 October to the Friday after the Super 14 rugby competition final.
471. Clause 50.5 of the CEA is particularly relevant to the counterfactual. This clause states a transfer fee *may* (emphasis added) be payable when a player transfers from an MD1 Union to a PD Union.
472. The Commission reviewed its conclusion in the Draft as a result of the variation to the CEA. The proposed transfer fees and transfer period in the new counterfactual are now much more similar to those proposed in the factual, in the first year at least. In the years following the end of the Super 14 rugby competition in 2007, the transfer rules applying would rely on the outcome of negotiations between the parties.
473. The Commission believes it is likely that, in the absence of a salary cap, the NZRU would seek more restrictive rules for player transfer, than is set out in the Player Movement Regulations. The Commission is also aware of the views of the RPC that, ideally, it would prefer to see no transfer fees of any description. What will be the final result of negotiations between the NZRU and the RPC on this matter is therefore difficult to predict with any degree of certainty. However, on balance,

⁹⁵ Appendix 1 is an Acknowledgement of Terms signed by the 14 PD provincial unions and the New Zealand Super Rugby franchises who agree they will not “contract out of, undermine, or act contrary to any provisions of the CEA...”. By process of exclusion, “a provincial union not listed in Appendix 1”, is a provincial union in the MD1 competition.

⁹⁶ NZRU Application, Schedule E, Collective Employment Agreement, s 50.5.

while the Commission expects that any new player movement rules negotiated beyond the first year may be more restrictive than the (new) Player Movement Regulations, it seems unlikely that they will be as restrictive as the (previous) Player Transfer Regulations.

474. In view of that expectation, the Commission considers that the variation to the counterfactual is unlikely to affect its earlier conclusion, that competition will not be likely to be lessened in this market as a result of the Player Movement Regulations, when compared to either Clause 50 of the CEA or to the outcome of future negotiations between the NZRU and the RPC.

Long-Term Contract Buy-Outs

475. The Commission was informed on 3 March 2006 that the Player Movement Regulations would contain the following clause (cl 4.2):

A Provincial Union may at any time approach a Player and that Player's Captured Union to negotiate the transfer of that Player to the Provincial Union during the Transfer Period. For the avoidance of doubt no player who is a party to a Provincial Union Contract or Provincial Union Development Contract with a Provincial Union may transfer to another Provincial Union under these Regulations during the currency of such contract.

476. The Commission therefore considers that it appears that the Player Movement Regulations may not prevent PD unions from signing players to multiple year, "long-term" contracts. A PD union wishing to acquire a player who has signed to another union on a long term basis has two options: it can wait for that contract to expire, or else negotiate a release from the contract with the player's current union. If this release involves a cash payment, then nothing in the Player Movement Regulations appear to prohibit this payment from occurring.
477. If this interpretation is correct, the effect of the new Player Movement Regulations on PD-to-PD transfers will be to restore a largely "free market" for these transfers. Players will be free to transfer provided the formal requirements set out in the Player Movement Regulations are observed, and subject to a NZRU veto. But players will also be able to commit themselves to a club for a period, and will be unable to move clubs without breaching this contract unless they have bought themselves out of their current term.
478. Because the new Player Movement Regulations will not interfere with unions' ability to tie PD players, and will affect neither the price at which these contracts might be bought out nor players' ability to switch unions (other than through the NZRU veto). If this is correct, the Commission does not consider that the Player Movement Regulations, as they affect PD-to-PD transfers, will have any effect on competition.

Conclusion on whether transfer fee would or would likely lessen competition under section 27

479. The Commission concludes the maximum transfer fees would not have, nor would be likely to have, the effect or likely effect, of lessening competition in the market for premier player services, when compared to the counterfactual.

Will the proposed transfer fees have the effect or likely effect of fixing, controlling or maintaining prices under section 30?

480. The Commission is of the view that the transfer fees proposed do two things:

- in the case of MD1 to PD transfers, including transfers from NZ Colts, NZU19 and NZ Schools, they set the maximum transfer fee which may be paid; and
- in the case of the remainder of transfers, they set a transfer fee of \$0.00. This removes the possibility of unions ever being able to negotiate a transfer fee under any circumstances.

481. In relation to the first point above, although this amount will be only the maximum which may be charged, and provincial unions will be free to negotiate a lower or nil transfer fee, the imposition of a maximum amount interferes with the free market influence on the transfer fee. This is especially so when the maximum is specified as the default in the absence of a negotiated fee.

482. It is a requirement of s 30 that the goods or services, which are the subject of the price fixing provision, are supplied or acquired by the parties to the contract, arrangement or understanding in competition with each other. The issue is whether provincial unions are in competition with each other in relation to the transfer fee. The Commission has already identified that unions are in competition with each other for player services rather than in competition with each other for rights to player services. A provincial union cannot sell a player to another provincial union. It is the transferring player who initiates the transaction. It was for this reason that the Commission did not identify a market for rights to player services.

483. However, we have identified a relationship between the transfer fee and the level of salary that a player is likely to receive. A provincial union is likely to be prepared to pay a certain amount for a player's services, inclusive of any applicable transfer fee. This is supported by the RPC which has submitted that it sees any transfer fees as part of the amount assigned/budgeted to that player – and an unfair limitation on his pay packet. It states that players should be able to attain full market value and not be undermined by a provincial union having to pay a development fee and factoring that into how much they pay the player himself. The RPC considers that transfer fees have had an effect on payments to players, creating unfair discrepancies between different players over the years.

484. This situation has some similarities to that considered in *Australian Competition and Consumer Commission v CC (NSW) Pty Limited*⁹⁷ (“ACCC v CC”). In that case, the parties, a group of concrete firms, arrived at an understanding for the payment of a substantial fee by the successful tenderer to each of the unsuccessful tenderers for a particular building project. The Federal Court of Australia was asked to consider whether this was likely to have the effect of controlling the price charged for the building project. Lindgren J found that the understanding would have the effect of ‘controlling price’ if it restrained a freedom that would otherwise exist as to the price to be charged.
485. The present situation differs from that considered in *ACCC v CC*. In that case, the combined fees, as a cost to the tenderers, could be said to set a level or price floor below which the price charged for the building project would be unlikely to go. The Commission notes that the *ACCC v CC* case, the suppliers were setting a price floor for the supply of services to the acquirers of those services. In the present case, provincial unions, who are acquirers of player services themselves would be in effect, agreeing to fees to be paid by the unions themselves in acquiring those same services.
486. In the present situation, therefore, while the transfer fee does not set a price floor, given each player has a value to a provincial union, the Commission considers it is likely that any transfer fee payable will reduce the amount that a provincial union is willing to pay that player for their services, although the exact amount of that reduction is unspecified.
487. On balance, therefore, the Commission considers that it is likely that the relationship between the transfer fee and the level of salary for an individual player is such that it can be said that an agreement to fix a maximum transfer fee will control the level of salaries paid to transferring players.

Conclusion on whether transfer fees have the effect or likely effect of fixing, controlling or maintaining prices

488. Therefore, the Commission concludes that the setting of maximum transfer fees constitutes an artificial constraint or interference with the free determination of the prices for player services and therefore amounts to a controlling of price.

Will the proposed transfer period result in or likely result in a lessening of competition under section 27?

The Provision

489. The NZRU proposes to repeal the existing Player Transfer Regulations and replace these with new Player Movement Regulations. The Player Movement Regulations provide for a transfer period limiting the time in which a player may register a transfer between unions. Section 5 of the Player Movement Regulations states:

⁹⁷ (1999) ATPR 41-732 (FC).

3. TRANSFER PERIOD

3.1 The transfer of a Player may only occur during the period 1 October in one Contract year to the Friday following the Super Rugby Competition final in the immediately following Contract year. This period is the Transfer Period.⁹⁸

490. In respect of the transfer period, s 50.6 of the CEA states:

“A player may enter into an agreement to Transfer between 1 October in a particular Contract Year and the Friday following the final game of the Super Rugby Competition in the Contract Year immediately following...”⁹⁹

491. In 2007, the Friday following the Super Rugby competition final occurs on 1 June. Consequently, provincial unions will have a little over 34 weeks to transfer players from another union. Currently, the transfer period is from 15-30 November (2 weeks).

492. In a written submission¹⁰⁰ to the Commission, the NZRU stated that the present transfer period has become unrealistically constrained. After consultation with provincial unions and the RPC, the NZRU proposed extending the transfer window to allow:

- an alignment with the proposed provincial eligibility cut-off dates;
- easier non-rugby related movement for players;
- Super 14 draft players to return to their “home” unions prior to making a decision on provincial union affiliation; and
- players to begin PD club competitions and assess their potential to achieve NPC representative honours before choosing a particular union affiliation.

Effect/Likely Effect of lessening competition

493. The competition effects which are relevant to the Commission’s assessment of the transfer period are those which result from the difference between the transfer period provisions and the counterfactual.

494. It is only the registration of the transfer and the physical transfer (in terms of contractual arrangements) of a player that must occur during the transfer period. As is stipulated in the proposed Player Movement Regulations, approaches to players and any subsequent negotiations are free to occur at any time of the year.

495. However, given the transfer period as proposed in the factual is the same as the counterfactual in the first year and likely to be more restrictive in future years, the Commission considers that the proposed transfer period would not result in a lessening of competition in the market for premier player services.

⁹⁸ Player Movement Regulations, Appendix Two.

⁹⁹ NZRU application, Schedule E, Collective Employment Agreement, s 50.6.

¹⁰⁰ NZRU Response to Commerce Commission Questions, 23 December 2006, Q. 14.

Conclusion on whether transfer period would or would likely result in a lessening of competition

496. The Commission concludes the proposed transfer period would not have, nor is likely to have, the effect of lessening competition in the market for premier player services.

Will the transfer period have the effect or likely effect of fixing, controlling or maintaining prices under section 30?

497. It has not been necessary to consider this question under section 30 because the transfer window does not have a pricing element contained within it.

Comment on Minimum Squad Spend

498. As mentioned earlier, each provincial union must contract at least 26 players on a minimum guaranteed retainer of \$15,000 per annum. The Commission has advised the NZRU that this appears to amount to a minimum squad spend of \$390,000 per provincial union and could raise competition issues under the Act.

499. NZRU has acknowledged by letter of 24 January 2006 that this is the case. While it accepts that the Commission is entitled to comment on this minimum squad spend, NZRU advises that it is not seeking authorisation of it, as it does not consider that it is a key aspect of the Arrangements for which it is seeking authorisation.

500. The Commission notes that such a minimum appears to amount to a price floor for acquisition of rugby player services. Therefore, it could act as a focal point for salary negotiations, or it could limit the quantity of the services purchased, such that a rugby union might not be able to afford to purchase the services of an additional rugby player at the margin at that price, where that player might have been willing to supply those services below that price.

501. The Commission considers this price floor may amount to a “controlling” of prices in the context of section 30, even if the individual rugby unions negotiate salaries above that level. However, as this minimum is not part of the Proposed Arrangements for which the Applicant is seeking authorisation, the Commission is not required to consider this point any further.

Overall Assessment of Impact of the Provisions on Competition in the Market for Premier Player Services:

502. The Commission concludes:

- the Salary Cap Arrangement would or would likely result in a lessening of competition in the market for premier player services;
- the Salary Cap Arrangement would or would likely result in a controlling of prices in the market for premier player services;

- the transfer fees would not result, nor would be likely to result in a lessening of competition in the market for premier player services;
 - the transfer fees would or would likely result in a controlling of prices in the market for premier player services; and
 - the transfer period would not result, nor would be likely to result in a lessening of competition in the market for premier player services.
503. The potential competitive impacts of the Regulations on the market for premier player services have been considered individually above. In determining what constitutes effect, s 3(5) of the Act also provides for the aggregation of the effects of other provisions of the contract, arrangement or understanding in question. Such an undertaking is relevant in this case whereby the provisions are being implemented together.
504. The Commission concludes that that the Salary Cap Arrangement and Player Movement Regulations relating to both the transfer fees and transfer period would have, or would be likely to have, the combined or likely combined effect of lessening competition in the market for premier player services.
505. In addition, the Commission concludes that the Salary Cap Arrangement and Player Movement Regulations relating to the transfer fees would have, or would be likely to have, the combined or likely combined effect of controlling or maintaining prices in the market for premier player services.

Effects in the Non-Premier Player Services Market

Player Movement Regulations

506. In this section, the Commission will consider whether the Player Movement Regulations will have the effect, or likely effect, of lessening competition in the market for the supply and acquisition of non-premier player services. The Commission considers that two provisions of these arrangements (transfer period and transfer fee) have the potential to impact on competition in the market and therefore justify consideration. The Commission does not consider the salary cap provision has the potential to affect this market.
507. As descriptions of the transfer fee and transfer period have been provided in the earlier analysis relevant to the market for premier player services, these will not be detailed again in this section. Only an analysis of their effect, or likely effect, on the market for non-premier player services will be provided.

Will the transfer fee provision result or likely result in a lessening of competition in this market under section 27?

The transfer fee provision

508. As mentioned earlier in this section, the NZRU has revoked the Player Transfer Regulations and proposes to replace these with new Player Movement Regulations. These regulations provide for a transfer fee to be applied where certain banded players transfer from a MD1 union to a PD union.

Effect/likely effect of lessening competition

509. As previously explained in the Premier Player Services Market section of the Competition Analysis, in the market for non-premier player services, in which the MD1 unions operate, the fees applicable in the factual scenario are not likely to be greater than those currently in place (the counterfactual). It cannot be said, therefore, that competition has been lessened in this market as a consequence of the proposed implementation of the Player Movement Regulations which govern the Application of transfer fees.

Conclusion on lessening of competition under section 27

510. The Commission concludes the transfer fee provision would not, nor would be likely to result in a lessening of competition in the market for non-premier player services.

Will the proposed transfer fee provision result or likely result in a fixing, controlling or maintaining prices in this market under section 30?

511. For the reasons discussed earlier, the arguments advanced as to whether the transfer fees constitutes an interference in the competitive determination of prices in the premier market also apply in relation to the transfer fee in the non-premier player services market.

Conclusion on whether transfer fees have the effect, or likely effect, of fixing, controlling or maintaining prices

512. The Commission considers that the agreement to set maximum transfer fees, including the imposition of a \$0.00 transfer fee, is likely to have the effect of fixing, controlling or maintaining prices and therefore is deemed, by s 30 of the Act, to have the purpose, effect or likely effect of substantially lessening competition for the purposes of s 27.

Will the transfer period provision have the effect, or likely effect, of lessening competition under section 27?

The transfer period provision

513. As detailed in the Premier Player Services Market section of the Competition Analysis, the NZRU has proposed to repeal the existing Player Transfer Regulations and replace these with new Player Movement Regulations. The Player Movement Regulations provide for a transfer period limiting the time in which a player may register a transfer between unions.

Effect/likely effect of lessening competition

514. As also detailed in the Premier Player Services Market section of the Competition Analysis, given the transfer period as proposed in the factual is the same as the counterfactual in the first year and likely to be more restrictive in future years, the Commission considers that the proposed transfer period would not result in a lessening of competition in the market for non-premier player services.

Conclusion on lessening of competition under section 27

515. The Commission concludes the transfer period provision does not have the effect, or likely effect, of lessening competition in the market for non-premier player services.

Will the transfer period have the effect or likely effect of fixing, controlling or maintaining prices under section 30?

516. It has not been necessary to consider this question under s 30 because the transfer window does not have a pricing element contained within it.

Overall Assessment of Impact of the Transfer Provisions on Competition in the Market for Non-Premier Player Services:

517. The Commission concludes:

- the transfer fee provision would not have, nor would be likely to have, the effect of lessening competition in the market for non-premier player services;
- the transfer fee provision would have, or would be likely to have, the effect of controlling prices in the market for non-premier player services; and
- the transfer period provision would not have, nor would be likely to have, the effect of lessening competition in the market for non-premier player services.

SECTION 29 ANALYSIS

518. As mentioned in the “Jurisdiction” section, the “services” analysis applies to the s 29 analysis¹⁰¹.
519. Section 29 prohibits exclusionary provisions. As mentioned earlier, in order to establish a breach of s 29, it is necessary to establish that:
- a provision of a contract, arrangement or understanding has the purpose of preventing, restricting or limiting the supply of goods or services to, or the acquisition of goods or services from, a particular person or class of persons, by any or all of the parties to the arrangement or understanding; and
 - at least two of the parties to the arrangement or understanding are in competition with each other, and with the particular person or class of persons affected, in relation to the supply or acquisition of the goods or services.
520. However, that the provision of the contract, arrangement or understanding will not be found to be an exclusionary provision if it is proved (by the parties who have allegedly entered into the exclusionary conduct) that the provision does not have the purpose, effect or likely effect of limiting competition.
521. The provisions of the Regulations that might be exclusionary are the salary cap, transfer period and the transfer fee.
522. The NZRU has stated in a letter dated 2 February 2006 that if the Commission holds that there is a market for the rights to player services, it could be argued that the salary cap might breach s 29 in this market as:
- there is a likely to be competition between provincial unions in relation to the supply or acquisition of the rights to player services;
 - the salary cap (or prohibition) arguably has the purpose of preventing, restricting or limiting the acquisition or supply for the rights to player services between provincial unions; and
 - any provincial union restricted from acquiring or supplying the rights to player services, as a result of the operation of the salary cap (or prohibition), is, or is likely to be, in competition with the provincial unions party to the arrangements or understanding in relation to the acquisition or supply of rights to player services.
523. The NZRU states that while it does not necessarily accept that s 29 would apply to the salary cap or prohibition of payment of remuneration to MD1 players, it accepts that there is an argument of a breach of s 29 along the above lines.

¹⁰¹ However, the overall “market” analysis does not, since there is no reference to “market” in s 29.

524. The Commission does not accept the NZRU's argument that a breach of s 29 could only occur in the rights to player services or union-to-union market. Rather, the Commission considers that the exclusionary conduct could also occur in the acquisition and supply of player services market, in which provincial unions compete to acquire player services.
525. The Commission considers it is plausible that a breach of section 29 of the Act could occur in the market for the supply and acquisition of player services. It is in the acquisition of player services by competing unions that relevant competition concerns arise, in the following way;
- all provincial unions would be party to the proposed salary cap agreement by virtue of the NZRU's Constitution;
 - An agreement to be bound by the salary cap arguably has the purpose of restricting the acquisition of player services to a particular provincial union/s by two or more other provincial unions; and
 - there is likely to be competition amongst provincial unions in relation to the acquisition of player services.
526. Therefore, by virtue of the salary cap agreement amongst all provincial unions, a particular provincial union, if constrained by the salary cap, would not be able to obtain the services of one or more players and still stay within the cap. The salary cap can therefore be seen as an exclusionary provision in the market for premier player services.
527. In the Draft, the Commission expressed the view that any further likely effects of lessening competition from a boycotting arrangement amongst competing provincial unions would be slight, as it considered most competition effects of the salary cap in the acquisition of player services have already been captured by the Application of s 27 and s 27 via s 30. However, as explained above, the Commission remains of the view that the salary cap will, or will be likely to result in a lessening of competition under s 29, by the giving effect to an exclusionary arrangement amongst provincial unions competing for player services, even though this effect may be slight.

Conclusion on Section 29

528. The Commission concludes that the salary cap would, or would likely result in a lessening of competition under s 29, by the giving effect to an exclusionary arrangement amongst provincial unions competing for player services.

Effects in the Market for Sports Entertainment Services

Section 27 only

529. The Commission has considered whether any of the Proposed Arrangements have the effect, or likely effect, of lessening competition in the market for sports

entertainment services under s 27 of the Act. There are no s 30 or s 29 issues that arise in respect of this market.

Will the Proposed Arrangements, taken as a whole, result or likely result in a lessening competition in this market?

530. For the purposes of the sports entertainment services market, the Commission has considered all the Proposed Arrangements as a whole, including the salary cap, the transfer fees and the transfer period, when determining whether the a may result in a lessening of competition in this market.
531. In Decision 281, the Commission considered that if the Regulations were to have the effect of promoting an even national rugby competition, then rugby union as an input into the sports entertainment might gain a competitive advantage over other forms of sports entertainment. The Commission also considered that even if this were not to occur and rugby union became less attractive as a spectator sport, this would not necessarily constitute a lessening of competition in this broad market. Ultimately, the Commission considered the Regulations did not have, nor would be likely to have, the effect of lessening competition in this market.
532. In the Market Definition section of this determination, the Commission noted that rugby union now competes with a growing menu of sports entertainment available to the public, highlighting the growth of traditional competing codes (e.g., soccer and cricket), as well as those that have gained relatively recent popularity (e.g., basketball, motorsport and X-Air).
533. Rugby union remains a prominent contributor to the sports entertainment market. However, the Proposed Arrangements impact most directly on the provincial unions competing in the NPC, with attenuated effects on the remainder of rugby union played in New Zealand. The Commission notes that, according to marketing information provided by the Applicant, [
-].¹⁰² As such, given the expansive scope of the sports entertainment market, the Proposed Arrangements would need to have a clear negative impact on not only a particular union, or on the NPC, but also on the attractiveness of rugby union as a whole before it could be said competition could be lessened in this market in more than a minimal way.

Premier Division

534. Some of the PD unions likely to be constrained by the cap have argued that the salary cap could have the effect of constraining their ability to attract and retain quality players, leading to a less-attractive performance and consequently reducing their historical advantage in relation to the less well-resourced, unconstrained

¹⁰² [

provincial unions. However, the provincial unions unconstrained by the cap are larger in number than those who would be constrained. As such, if the unconstrained unions have the ability to attract, acquire and retain these quality players, it would follow that these unions would be likely to be able to improve their performance in the NPC.

535. With respect to the impact of the salary cap on those PD unions that are constrained, the Commission considers the likely improved performance by unconstrained teams is expected to counterbalance any diminished performance by the constrained unions. Subsequently, the entertainment provided by watching NPC and therefore rugby union *as a whole* would not be negatively impacted in the sports entertainment market. As noted previously, based on the Applications made to the NZRU by the PD unions to join the new PD competition (addressing the NZRU's Eligibility Criteria) – a sample of which were reviewed by the Commission – the Commission is satisfied that at least some of the unconstrained PD unions have the potential financial ability to attract, acquire and retain quality players.
536. Other PD unions commented that the inclusion of the five former 2nd Division teams would have the effect of “dumbing down” the PD competition, making the NPC competition less attractive and less competitive in the sports entertainment market. However, for the purposes of this analysis, the changes to the NPC competition structure, in particular the addition of four new teams to the PD competition, are present in both the factual and the counterfactual scenarios. This possible effect on the sports entertainment market is not arising as a likely result of the Proposed Arrangements for which authorisation is being sought, and therefore is not within the Commission's purview for this determination.
537. Therefore, the Commission considers the impact of the provisions applicable to the PD competition will not likely be sufficient to lessen competition in the wider sports entertainment market.

Modified Division One

538. In respect of the effects of the Proposed Arrangements in respect of MD1 games, NZRU advised that the average attendance at MD1 games is 725 people¹⁰³. In addition, according to paragraph 51 of the Brown Copeland report attached as Schedule J to the Application, it is reasonable to assume that the share of TV broadcasting rights revenue attributed to NPC rugby is “principally derived as a consequence of Division 1 of the NPC and therefore is dependent upon maintaining or enhancing interest in the new Premier Division”. The Commission largely accepts this assumption, although it has been advised that there will be additional revenue opportunities (both naming rights and local provincial union sponsors)

¹⁰³ Based on a weighted average (four 2nd Division teams and eight 3rd Division teams) of an average attendance of 1,376 for the NPC 2nd Division teams and 400 for the NPC 3rd Division teams in 2004. (Source: Quantification of Competitive Detriments and Public Benefits of Proposed Arrangements for MD1. Brown, Copeland & Co Ltd, 12 January 2006).

created by future plans to feature MD1 rugby on a “Heartland” rugby programme on SKY and Prime television each week.

Conclusion on effect/likely effect of lessening competition in the sports entertainment market

539. Overall, the Commission considers the impact of the provisions applicable to the MD1 competition will not likely be sufficient to lessen competition in the wider sports entertainment market.

PUBLIC DETRIMENTS AND BENEFITS

Introduction

540. Given the conclusion that the Proposed Arrangements would be likely to result in a lessening of competition, the Commission must consider whether the Proposed Arrangements can be authorised under s 61(1) of the Act.

541. The authorisation procedures under s 61(6) require the Commission to identify and weigh the detriments likely to flow from the lessening of competition in the relevant markets, and to balance those against the identified and weighed public benefits likely to flow from the Proposed Arrangements as a whole. It is important to note that the detriments may only be found in the market or markets where competition is lessened, whereas benefits may arise both in those and in any other markets.¹⁰⁴ Only if the Commission were satisfied that the benefits clearly outweigh the detriments would it be able to grant an authorisation for the Proposed Arrangements.

542. The principles used by the Commission in evaluating detriments and benefits are set out in: *Guidelines to the Analysis of Public Benefits and Detriments* (“the Guidelines”), a revised version of which was issued by the Commission in December 1997.¹⁰⁵ The various issues raised have been discussed in a number of decisions by the Commission and the courts in recent years.¹⁰⁶ In assessing both benefits and detriments, the focus in those decisions has been on economic efficiency. For example, the Court of Appeal stated in *Tru Tone Ltd v Festival Records* that the Act:¹⁰⁷

. . . is based on the premise that society’s resources are best allocated in a competitive market where rivalry between firms ensures maximum efficiency in the use of resources.

¹⁰⁴ Goodman Fielder/Wattie Industries (1987) 1 NZBLC (Com) 104,108.

¹⁰⁵ Although these *Guidelines* have not been updated to reflect the changes in the Act relating to the thresholds in ss. 36 and 47, the economic principles used in assessing benefits and detriments remain the same.

¹⁰⁶ See, for example, *Air New Zealand and Qantas Airways v Commerce Commission and Ors*.

¹⁰⁷ *Tru Tone Ltd v Festival Records* (1988) 2 NZLR 352, at 358.

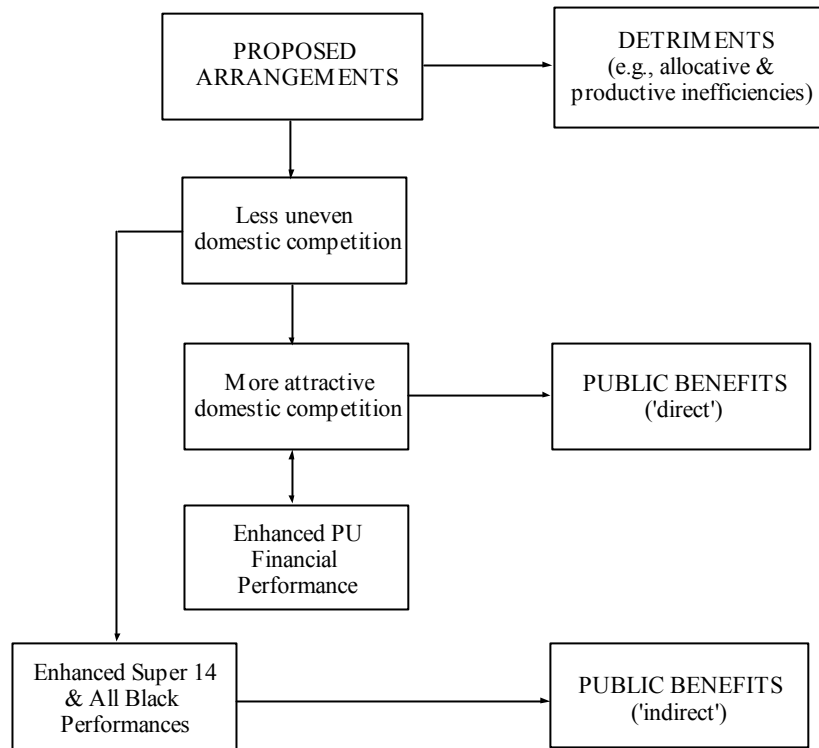
543. The Commission considers that a public benefit is any gain, and a detriment is any loss, to the public of New Zealand, with an emphasis on gains and losses being measured in terms of economic efficiency. In contrast, changes in the distribution of income, where one group gains at the expense of another, are generally not included because a change in efficiency is usually not involved. A further important consideration in the assessment of benefits is that there needs to be a nexus with the Proposed Arrangements.
544. The Commission is also mindful of the observations of Richardson J in *Telecom* on the Commission's responsibility to attempt to quantify benefits and detriments where, and to the extent that it is feasible, rather than to rely on purely intuitive judgment.¹⁰⁸ However, given the inherent difficulties and uncertainties associated with such quantification, the Commission generally establishes the range within which the actual value of a particular detriment or benefit is likely to fall. The Commission uses all available and relevant empirical and qualitative evidence to inform its judgement on an appropriate point along this range.
545. Moreover, it is not correct to say that only those gains and losses that can be measured in dollar terms are to be included in the assessment; those of an intangible nature, which are not readily measured in monetary terms, must also be assessed.
546. In quantifying the likely public benefits and detriments, the Commission adopted a five-year analytical horizon over which these welfare effects are calculated. No possible benefits or detriments beyond this five-year period were considered. In submissions, Professor Rodney Fort and Mr. Michael Copeland (both acting for the Applicant) argued that it is unrealistic to assume that the potential benefits would be exhausted over a five year period, and therefore benefits beyond this horizon ought to be counted.¹⁰⁹
547. Whilst the Commission acknowledges it is possible that any public benefits arising from the implementation of the Proposed Arrangements may continue to flow beyond year five, it is of the view that forecasting the magnitude of any such benefits with a reasonable degree of confidence is very difficult. Therefore, the Commission considers it is appropriate to restrict the analysis to a five-year horizon. The Commission also notes that while the analysis of possible benefits is limited to a period of five years, so too is the analysis of potential detriments.
548. In the following sections the detriments and benefits are considered in turn. In each case the impact of the Proposed Arrangements in the Premier Division—principally the salary cap—are considered separately. As a first step, however,

¹⁰⁸ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1992) 3 NZLR 429,447.

¹⁰⁹ Submission on the Commission's Alternative Approach to Modelling Quality as a Driver of Television Demand for NPC Matches, Professor Rodney Fort (28 May 2006); Submissions on the Draft Determination, Brown Copeland (31 March 2006), paras 6-11.

the nature and potential limitations of the Proposed Arrangements are briefly reviewed.

549. As discussed above in the Introduction to the Public Benefits and Detriments section, the emphasis in assessing public benefits is on efficiency gains to New Zealand, with distributional changes being ignored. These benefits have to be measured as changes relative to the benchmark provided by the counterfactual.
550. The Applicant argues that there is a clear nexus between implementation of the Proposed Arrangements and a range of ‘direct’ public benefits. This nexus, according to the NZRU, may be explained in two steps:
- Firstly, implementation of a salary cap and relaxation of the current transfer regulations will lead to a more even distribution of talent amongst provincial unions, and thereby produce a more balanced domestic provincial competition.
 - Secondly, a more balanced competition will lead to greater public enjoyment of the game, and therefore, to a flow of ‘direct’ public benefits.
551. It is also argued by the Applicant that a more even competition will lead to enhanced performances by New Zealand Super 14 franchises and the All Blacks. From this anticipated outcome flows a range of claimed ‘indirect’ public benefits.
552. The Applicant also recognised that certain efficiency losses (detriments) would also flow from the implementation of the Proposed Arrangements, specifically in relation to allocative and productive inefficiency.
553. A stylised view of the nexus between the Proposed Arrangements and the public benefits claimed by the Applicant, and with the detriments, is given in Figure 4.

Figure 4: Stylised View of Detriments and Claimed Benefits

The Role of Proposed Arrangements

554. As discussed above, the NZRU believes that the unevenness in the domestic provincial competition would worsen in the counterfactual, were only the existing transfer regulations to continue. However, the Commission identified a number of factors that could potentially impede the effectiveness of the proposed cap in promoting balance, as noted above. These were:

- There are doubts as to the ‘hardness’ of the proposed cap, for there appears to be a number of legitimate ways in which it may be circumvented;
- The cap would constrain only a very few provincial unions. This may lead to stronger incentives to ‘cheat’ the cap;
- There appears to be significant disparity between the income levels of various provincial unions in the PD such that low-revenue unions may struggle to attract talent in the short-run;
- Top players face strong incentives to accept a reduction in provincial competition earnings in order to remain with unions that will increase their chances of being selected for Super 14 teams and/or the All Blacks;
- Team-specific talent may dampen the impact of player redistributions on competitive balance; and

- The empirical support for the hypothesis that live spectators of sport find uncertainty of contest outcome attractive is mixed, at best. The empirical support for this hypothesis in relation to television viewers (a significantly larger group of consumers of sports entertainment than at-match spectators) is even more limited.
555. Each of these factors, apart from the last, was discussed earlier in the section entitled “Potential Limitations of the NZRU’s Proposed Salary Cap”. The Commission there concluded that there is some nexus between the Proposed Arrangements and the promotion of a less uneven domestic provincial competition. However, the link is unlikely to be as strong as that argued by the Applicant due to the various countervailing reasons outlined above.
556. The issue of the enforceability of the proposed cap is of particular concern to the Commission. Evidence from abroad, including recent events concerning breaches of the NRL cap, suggest that salary caps are particularly difficult regimes to administer. If the integrity of the cap cannot be preserved by sufficiently strong anti-avoidance mechanisms, monitoring, and enforcement, the likelihood that the claimed public benefits would flow would be further reduced.
557. In recognition of these issues, the Commission proposes to view conservatively any expected public benefits that are claimed would arise following implementation of the Proposed Arrangements in the PD.
558. In addition, the Commission considers it unlikely that any benefits from the implementation of the Proposed Arrangements would flow uniformly over time, at their maximal level from the start, as Mr. Copeland assumes; any benefits are likely to increase gradually over time as the cap begins to constrain more unions over time. Without offering specifics, Mr. Copeland accepted in his submission that the claimed benefits may not fully materialise until several years after the introduction of the Proposed Arrangements.¹¹⁰
559. As noted earlier, the Commission chose a five year horizon over which to assess the likely public detriments and benefits. In the Draft Determination the Commission calculated benefits over this five year period by assuming that a zero to 10% increase in demand would materialise by year five (relative to year zero), and then calculated benefits in each preceding year by assuming that a certain proportion of the year five benefits would materialise in that year (i.e., 80% of the year five gains in year four; 50% of the year five gains in year three; 10% of the year five gains in year two; and no benefits in year one).
560. However, the problem with this approach is that it gives the impression that the entire benefits of a fully effective cap are felt five years after its introduction, but that is an unlikely outcome. It is more likely that such a salary cap would

¹¹⁰ The Application, Schedule J: Brown Copeland Report, para 16.

take a significantly longer period of time to have the desired distributional effects. It is uncertain how long it would take before the proposed cap could be considered fully effective (Professor Fort concedes that he has no basis for quantifying how long it would take for the proposed cap to achieve enhanced balance), but the timeframe is likely to be lengthy, given the various reservations the Commission has raised about the effectiveness of the proposed cap.

561. The Commission therefore considered an alternative approach for setting a build-up profile for benefits. First, the Commission assumed that a fully effective cap would produce a maximum shift in spectator demand in the order suggested by the Applicant, 20%, but only in the very distant future, at an unspecified ‘terminal date’.¹¹¹ Next, the Commission calculated spectators’ benefits commensurate with such an expansion in demand at the terminal date and estimated spectators’ benefits for years one to five by assuming that a certain proportion of the terminal date benefits would materialise in each of those years. In particular, the Commission assumed that benefits would grow gradually over time according to the following profile:

- 5% of the terminal date gains realised in year one;
- 10% of the terminal date gains realised in year two;
- 15% of the terminal date gains realised in year three;
- 25% of the terminal date gains realised in year four; and
- 40% of the terminal date gains realised in year five.

562. Recognising that a dollar today is worth more than a dollar tomorrow (i.e., the principle of the time value of money), it is appropriate to discount the gains as they arise year by year back to their present value.¹¹² In doing this the Commission employed a real discount rate of 6.8% per annum (this assumes a nominal discount rate of 10% and an inflation rate of 3%).¹¹³

¹¹¹ It is assumed that the welfare gains accruing from the Proposed Arrangements plateau out beyond the terminal date.

¹¹² Mr. Copeland suggests that the time profiles of the suggested public benefits and competitive detriments are likely to be reasonably similar, and therefore the relativity between public benefits and competitive detriments may be gauged without discounting (see the Application, Schedule J: Brown Copeland Report, para 18). However, the Commission found no evidence to suggest that this would necessarily be true. In fact, it seems entirely possible that detriments may arise sooner than any significant public benefits. And since the process of discounting places less weight on values in the distant future than values today, the effect of ignoring discounting (when the time profile of benefits and detriments do not coincide) could provide a distorted picture when balancing benefits against detriments.

¹¹³ The Commission adopted the same discount rate employed by Mr. Copeland when assessing “Productive Efficiency Losses” (ibid, para 36).

DETRIMENTS

563. Various kinds of detriments (losses of efficiency) could potentially arise from the Proposed Arrangements in the premier players' services market, relative to the situation in the counterfactual. These are considered below under the following headings: allocative inefficiency, productive inefficiency, loss of player talent, reduction in player skill levels and innovative inefficiency.

Allocative Inefficiency

564. In their response to the Draft Determination, neither the NZRU nor its economic expert, Mr Copeland, raised objections to the Commission's assessment of the allocative inefficiency of the Proposed Arrangements.
565. In his initial submission, Mr Copeland argued that the proposed salary cap had the potential to result in a "misallocation" of players between unions compared to the unrestrained "free market" allocation. Because the cap has the ability to restrict the amounts that provincial unions would be able to spend on players, player movements between unions might be restricted in one of two ways. Either a player would be prevented from transferring by the inability of the potential receiving union to pay his free market salary, or a player would be forced to transfer because the releasing union would be unable to afford his free market salary.
566. However, he considered that the scope for the "misallocation" of players would be limited by a number of factors:
- within at least the next two or three years, the salary cap would constrain only a limited number—"at most, five"—unions;
 - even for a constrained union, the number of players likely to be "misallocated" could be small, because: (a) Provincial Union payments are only a part of the remuneration for players in representative sides; and (b) factors other than salary influence a player's willingness or otherwise to move between unions, including family and lifestyle considerations. The argument seems to be that a player who is paid more than his 'reservation wage' may choose to stay with his union for non-pecuniary reasons, even when another Union offers more for his services;
 - the salary cap is a cap on the total player payroll, not individual salaries, so a union would have considerable flexibility within the cap to allocate salaries in such a way as to retain players it wishes to keep; and
 - the loss caused by 'misallocation' is measured not by the player's salary forgone, but net of the gain to the union that has the player's services.
567. On this basis, Mr Copeland assumed, for the purposes of quantification of the affects of the salary cap, that (a) there would be no more than three player "misallocations" per team, or 42 in total (10% of the players, assuming an average of 30 players per squad), and (b) that the allocative efficiency loss per player would

likely be in the range of \$5,000 to \$15,000, without citing how these figures were derived. This gave a ‘maximum’ loss of between \$210,000 and \$630,000 per year. He went on to make further adjustments by deducting one-third and two-thirds from the top end of the range to produce alternative estimates, and also argued that a deduction should be made for the allocative inefficiencies from the Player Transfer Regulations being avoided, since these would not be present in the factual but would continue in the counterfactual.

568. The Commission broadly accepts Mr Copeland’s approach to estimating allocative inefficiencies, and that the salary cap would be likely to have a limited impact in constraining the recruitment and retention of players by Unions, but notes that this would also imply that the prospective benefits would also be likely to be limited too.
569. In terms of the Commission’s modelling, the allocative efficiency loss is measured in Figure 2 by the size of the triangular area FE1E2. To apply this simplified model in the NPC setting would involve splitting the unions into ‘type A’ and ‘type B’ unions, and aggregating them as appropriate under the respective demand curves (D_A and D_B). However, the first step in quantification—the calibration of the model—is not easy to do. Ideally, the following information would be required:
- the change in the distribution of players with and without the salary cap (the ‘misallocation’ of players, measured by the horizontal distance between E^1 and E^2);
 - the level of the marginal salary at the market equilibrium at E^1 ; and
 - the elasticities (or, roughly, the slopes) of the two demand curves (D_A and D_B) in the relevant ranges.
570. A starting point would be to accept Mr Copeland’s estimate of the number of players ‘misallocated’ of 42 (10% of the assumed sum of Union squads), and assume this figure applies at the time that the Proposed Arrangements become fully effective. The size of the marginal salary (the value of C^*) is uncertain (and current salaries may be distorted to some extent by the presence of the Player Transfer Regulations). Information provided by the NZRU indicates that the total salary bill in 2004 for the 14 Premier Division sides was about \$[] million, which, with an assumed playing squad of 420 players, implies an average NPC salary of \$[].¹¹⁴ But the salaries of individual players are known to vary widely. NZRU salary data for 2004 shows that Super 12 players had an average NPC salary of \$[], whereas for NPC-only players the average was \$[]. The latter figure probably comes close to the value of the marginal salary. It has not been possible to update these salary figures.
571. The final elements required are the elasticities of the two demand curves, which are very difficult to estimate. An alternative approach might be to assume that the maximum impact of the salary cap would be to push down the marginal salary to

¹¹⁴ The Application, Schedule K: NZRU Analysis of Impact of Cap. See also: pp. 40-41.

the floor value of \$15,000, implying a drop of over \$[]. If the slopes of both demand curves were identical in this range, the size of the ‘misallocation’, in terms of the vertical gap at E^2 between the two demand curves, would be of the order of \$[] to \$[]. However, it is the average vertical gap over the relevant range of E^1 to E^2 that is needed to estimate the area of the triangle, which brings the figure back down to over \$[]. This gives an order of magnitude of \$[] for a fully effective salary cap, a rather lower figure than that calculated by Mr Copeland.

572. However, as explained earlier, the Commission considers that it will probably take a lengthy period, extending well beyond the five-year time horizon, for the salary cap to become fully effective. It seems reasonable to assume that the detriments will be roughly proportional to the impact of the cap in the intervening years, reflecting the assumed gradually increasing constraining impact of the cap over time. In spreading the estimates over Years 1-5, the pattern assumed for spectator benefits is used, namely: Year 1, 5%; Year 2, 10%; Year 3, 15%; Year 4, 25%; and Year 5, 40%.
573. The resulting time pattern of allocative inefficiency costs are then as shown in Table 6.

Table 6: Estimate of Allocative Inefficiency by Year

Year	Estimated inefficiency
1	\$9,000
2	\$18,000
3	\$27,000
4	\$45,000
5	\$72,000

574. Although these estimates are necessarily very rough, they indicate that allocative inefficiency detriments are likely to be small. The present value of this detriment over the five year period is \$133,000 (rounded), when discounted at a real rate of 6.8% (this assumes a nominal discount rate of 10% and an inflation rate of 3%). This discount rate has been used throughout in this Decision.

Productive Inefficiency

575. In the analysis conducted in relation to Figure 1 above, it was found that the salary cap—when it constrains—would cause a disequilibrium to arise in the player talent market, such that Team A would value the marginal player more highly than Team B. Team A would like to pay higher salaries than it is allowed under the cap to attract more players, and players from Team B would like to move to take advantage of those higher salaries. In some overseas leagues where the rights to players’ services are owned by clubs, the clubs in this situation would be prevented from engaging in mutually beneficial trades.

576. Hence, a salary cap that is effective is likely to lead to two kinds of pressures or incentives. The first is the incentive to ‘cheat’ on the arrangement by paying salaries in excess of the cap, either directly, or by exploiting loopholes in the regulations. This behaviour would clearly undermine the cap. The second is for pressures to be applied by the constrained unions (which are likely to be the wealthier and perhaps more influential unions), or by the RPC on behalf of the players affected, to soften the cap, perhaps by building in loopholes or exceptions. This likewise would weaken the impact of the cap.
577. For these reasons, salary caps needed to be enforced, and this requires monitoring to ensure compliance. In this context, it is worth noting that salary cap rules can be complex, and hence potentially expensive to enforce. The NRL’s salary cap has been cited by the NZRU as an example of the effective operation of a cap. The NRL’s “Playing Contract and Remuneration Rules” are 143 pages long, of which nearly ten pages alone are devoted to defining terms. Yet even these rules, and the NRL’s centralised auditing processes, have not prevented large breaches of the salary cap. For example, in 2002 the Bulldogs team was penalised all of its competition points and fined A\$500,000 for instigating the competition’s largest and most complex salary cap breach.¹¹⁵
578. Claims of weaknesses in auditing processes in the NRL’s salary cap, and the possibility of there being other as yet undetected breaches, have recently been made by Mr Gould, the coach of the Warriors:¹¹⁶
- . . . the three most significant examples of salary cap breaches to be exposed in rugby league have come from the Cowboys, the Bulldogs and now the Warriors. None of these breaches were discovered by the normal salary-cap auditing processes.
- If normal salary-cap audits failed to detect even these massive illegalities, then who's to say this isn't going on everywhere? I think if you ask the man in the street how he perceives this situation, he would agree the NRL salary cap auditing procedures must be totally inadequate.
579. With regard to the Proposed Arrangements, compliance costs would be imposed on all unions, and enquiry costs would be imposed on both a union alleged to have breached the salary cap, and on the NZRU as the investigating and enforcement body. There might also be productive inefficiencies arising from the incentives upon unions to use up resources to find loopholes in the Regulations, and to lobby for relief from the Regulations (rent-seeking costs). In addition, there are also the initial set-up costs from establishing the regime.
580. A mitigating factor is that only a few teams would initially be constrained, and so the monitoring effort could be focused on them, rather than on all teams.
581. A possible aggravating factor is that the penalties for breaches may not be severe enough. Professor Fort found it interesting that the only proposed penalties are financial ones, although these are substantial. He argued that enforcement could be made more effective by including loss of competition points (as is the case in the

¹¹⁵ The Application, Schedule I: Ian Schubert Statement, p. 3.

¹¹⁶ John Matheson, “Gould tells Warriors get out”, 26 February 2006.

NRL’s scheme), and possibly also other penalties such as suspension of union executives involved in the breach.

582. The Commission’s preliminary estimates of productive inefficiency losses given in the Draft Determination are reproduced in the table below. These were based on today’s prices (i.e., no allowance was made for inflation), and were (with one special exception) not initially discounted to present values (i.e., no initial allowance was made for the time value of money). A five year period was used to assess detriments, as with benefits. The justifications for these, and the responses of the Applicant to them, are now considered.

Table 7: Commission’s Preliminary Estimates of Monitoring and Compliance Costs (per year)

Item	Assessed range
One-off set-up costs	\$150,000 to \$250,000
NZRU annual costs	\$180,000 to \$260,000
First year operating cost premium	\$67,500 to \$97,500
Union breach costs (two inquiries per year)	\$100,000
Union annual compliance costs	\$210,000

583. First, the Commission accepted the estimates of the initial set-up costs proposed by Mr Copeland as being reasonable, but did not accept that they should be annualised over a 20 year period. It considered that as the Player Transfer Regulations had lasted about ten years, it seemed more appropriate to assume that the Salary Cap Regulations would last for the same length of time. Regardless, these costs were allocated to the year in which they fell.

584. In his submission on the Draft Determination,¹¹⁷ Mr Copeland made two points of relevance to the Commission’s approach on the initial set-up costs, as follows:

- The approach of allocating set-up costs where they fall, rather than of amortising them over a longer period, in a setting where a five year time horizon is used, tends to inflate the detriments relative to the benefits (paragraph 8). The Commission accepts that there is force in this argument,

¹¹⁷ M C Copeland, “Comments on Commerce Commission Draft Determination Dated 9 March”.

but notes that a necessary concomitant of any forecasting exercise is that some components that occur sooner are likely to be more certain. The justification for the use of the five year time horizon was discussed earlier.

- Because of the prospective release of this Final Determination well into 2006, the set-up costs will already have been substantially incurred, and so there will be little difference between the factual and counterfactual scenarios (paragraph 20). The Commission accepts that the NZRU, because of the tight time-frame involved in having the salary cap ready for the 2006 competition, has been preparing to implement the Proposed Arrangements in anticipation of an authorisation possibly being granted. Any costs incurred prior to the Commission's final decision will be sunk. However, the Commission has been informed in the Application (paragraph 26.4.4), and had confirmed by the Applicant, that the one-off costs relate to "software development costs" expected to be incurred in "the next 1-3 years". Hence, there seems to be no basis for scaling down or eliminating these costs as proposed by Mr Copeland. The Applicant informed the Commission by email on 18 April that the cost would be unlikely to exceed \$150,000.

585. Secondly, the Commission accepted in the Draft Determination the NZRU's estimate that the annual costs of operating the proposed cap would roughly approximate those incurred by the 15-team NRL (A\$250,000). A range of \$180,000-\$260,000, to cover the costs of a full-time employee, external accounting and legal assistance, and overheads, was used. The Applicant has subsequently reiterated to the Commission that these are the incremental resources that would also complete the work of establishing the salary cap.
586. Thirdly, the Commission added a "first year operating cost premium" to the cost assessment, in acknowledgement of the following comment by Mr Schubert in his submission: "An increase to this annual cost of some 25-50% is likely in the short term due to an intensified effort in keeping control of the utilisation of Intellectual Property by players and third parties, many of which may be Salary Cap related."¹¹⁸ This cost premium was estimated as 37.5% (i.e., (50+25)/2) of the annual operating costs of \$180,000-\$260,000. Neither the NZRU nor Mr Copeland contested the inclusion of this factor in their responses to the Draft Determination.
587. Fourthly, in the Draft Determination the Commission assumed that there would be two breach inquiries a year, at a cost of \$50,000 per inquiry; and ongoing compliance costs on unions of \$15,000 per union per year.
588. The latter figure was based loosely on experience of the NRL salary cap. Mr Schubert reported that there are annual audits of the clubs, as well as spot and mid-year visits, and that the Salary Cap Auditor "has constant contact with the

¹¹⁸ Ibid., p. 10. The presence of these costs also further supports the Commission's reluctance to more heavily discount the initial, set-up costs, as discussed above.

Clubs via their CEO, Financial Controller, Football Manager and Recruitment Managers.” He went on to state that the cost to an average club “is no more than 0.25 of a full-time employee responsible for record keeping, contract preparation, signing, registration etc”, although he appeared to recognise that the time of the Football Manager and Financial Controller is also involved.¹¹⁹

589. In its response to the Draft Determination, the NZRU stated that it was unaware of any Provincial Union that had, or would, employ additional resources to deal with the compliance issues arising from the Proposed Arrangements. The NZRU reported that the CEO or Finance Manager had assumed that responsibility in all cases. Mr Copeland expressed the view that underemployed staff would be used to meet salary cap requirements, the opportunity cost of which would be zero. Both considered that the Commission’s estimate of \$15,000 per union was too high, especially in light of the fact that only a few unions would be constrained by the cap initially. Hence, the NZRU continued to favour its original estimate of compliance costs of \$10,000 per union, based on two breach inquiries per year at a cost of \$70,000 each.
590. The Commission accepts as reasonable the NZRU’s estimate that two breach inquiries per year would be held, and that the cost would be \$70,000 per inquiry, although this might prove to be optimistically low. However, it seems inconceivable that no other compliance costs would be incurred by the Provincial Unions, or that staff time used up in salary cap matters would have a zero opportunity cost. In his response on the Draft Determination (paragraph 4), Professor Fort stated that “the price of the cap’s success is eternal vigilance.”¹²⁰ This implies systematic monitoring activity by the NZRU, and careful auditing by the Unions. The Commission therefore considers that a figure of \$10,000 per union per year is appropriate.
591. Mr Copeland claimed that the virtual removal of the Player Transfer Regulations, and hence of the associated costs, would serve to partially offset the productive inefficiency detriments in this category, but noted that this offset would be “small”. The Commission considers that any such savings might be offset by the non-quantified rent-seeking costs mentioned above.
592. The Commission’s estimates on productive inefficiency costs of the Proposed Arrangements are summarised in the table below.

¹¹⁹ Ibid., pp. 10-11.

¹²⁰ Rodney Fort, “Responses Re: Commerce Commission Draft Determination (Restricted Version)”.

Table 8: Commission’s Estimates of Monitoring and Compliance Costs

Item	Assessed range (per year)
One-off set-up costs	\$150,000
NZRU annual operating costs	\$180,000 to \$260,000
First year operating cost premium	\$67,500 to \$97,500
Union breach costs (two inquiries per year)	\$140,000
Union annual compliance costs	\$140,000

593. On this basis, the Commission’s revised estimate is that the proposed salary cap could cost between \$678,000 and \$788,000 in the first year of operation, and between \$460,000 and \$540,000 per year over Years 2-5 at current prices. These are taken as the measure of the productive inefficiency of the Proposed Arrangements. Discounted at 6.8% over the five years, the present values of the upper and lower bound streams are \$2,100,000 and \$2,458,000 respectively (rounded).

Loss of Player Talent

594. The modelling analysis above indicates that if the salary cap is to achieve its desired impact of constraining at least some provincial unions, average salaries would fall. This raises the question as to whether player migration overseas, or to rugby league, might be increased, and if so, what the economic efficiency consequences might be. In the Draft Determination the Commission considered a range of arguments put forward by various parties as to the likely impact of the Proposed Arrangements on player migration. These were as follows.

595. The NZRU argued in its Application that the salary cap would be unlikely to lead to greater levels of migration because “individual income levels in New Zealand and the disparity between New Zealand and overseas remuneration is unlikely to be affected by the salary cap.”¹²¹ It said that better players would still be likely to receive the same levels of remuneration, and that the cap would simply promote some better players to move to other unions to achieve their full market value. There would be sufficient capacity within the overall salary cap to accommodate all players currently contracted.

¹²¹ NZRU Application, para 26.1.6 (e).

596. Many of the provincial unions interviewed by the Commission said that the migration of premier players overseas was part of their natural playing life cycle. In most cases this happened in the “twilight” of their careers, when players have either come near to the end of their career playing top level rugby, or when they realise that they are never going to achieve selection for the top level. The unions considered that this phenomenon would be unlikely to be affected by the implementation of the salary cap. In particular, they emphasised the desire of players to achieve higher honours, such as Super 14 and All Black selections, and that this would remain a significant motivation for most, regardless of the cap. Unions added that the potential for greater migration by players may be significantly mitigated by the additional playing opportunities offered by the admission of the four new unions to the Premier Division competition. These unions have recently received one-off grants from the NZRU, which have boosted their ability to secure players from existing First Division unions.
597. However, some unions did agree that although better players may retain their full market values, greater financial constraints may be applied to mid-level players, who, as a consequence, may consider migration prematurely. Mr Gould has complained that this is the situation in the NRL:¹²²

What the salary cap does do is force a lot of players into early retirement. It forces players to go to England or rugby in search of their true monetary value. It sees clubs sacking long-serving players who are extremely popular with fans of that club.

By also insisting all payments made to our top players come out of the limited wage pool, average players and youngsters earn less.

598. The RPC considered that the risk that the cap might increase player migration was mitigated by its perception that the cap was ‘soft’, and as such there would be ways to get around it before a player seriously had to look overseas. Overall, the RPC thought that players would not be more likely to migrate overseas as a consequence of the cap. It pointed out that the decision to move can be influenced not only by a union’s NPC salary offer, but also by the often much larger sums paid by the NZRU to those players on separate Super 14 or All Black contracts. This opened avenues for such players to go to the NZRU for extra money to stay in New Zealand.
599. The RPC said that rugby salaries overseas used to be significantly greater than those in New Zealand, but domestic salaries had improved markedly in recent years, and this had reduced the disparity. This, together with the guaranteed retainers for Super 14 and all Black players, has made staying in New Zealand more attractive to players. Nonetheless, the RPC said that if the cap were to begin to bite hard—and the younger and mid-level players were the ones likely to be harmed (as is the case in the NRL in Australia)—players might migrate in larger numbers. In this eventuality, the RPC might seek to negotiate a significant increase in the cap in 2009 when the CEA has to be renewed, or even

¹²² Matheson, *op. cit.*

abandon the model altogether and consider other options (such as revenue-sharing with unions).

600. It is also possible that some players who are unhappy with their salaries might seek a contract to play rugby league, such as in the NRL, to the extent that skill substitutability allows. However, such movements appear not to have happened in recent years, and the unions spoken to considered that the potential for such substitutability was low.
601. In his report, Professor Fort commented repeatedly that a salary cap “reduces pay to players.”¹²³ He also stated that the evidence from North American leagues (the NBA and NFL) is that salary caps cause increasingly uneven pay distributions within teams, and across leagues, with the high-salaried players benefiting at the expense of the middle-to-low salaried players.¹²⁴ He noted the potential for a salary cap in one league in one country to cause migration to other countries where earnings are not capped, assuming players are free to move, although such migration may also be impeded by such non-pecuniary factors as family and lifestyle considerations.¹²⁵ He concluded, on the basis of the sorts of factors mentioned above, and from information supplied by the NZRU, that there is not much of a threat that the cap would increase outward migration of players.¹²⁶
602. Mr Copeland, in discussing the benefits from greater competitive balance, argued that while some unions would be constrained by the cap, others would not, and these latter could potentially increase player salaries. Some unions in the short- to medium-term would need to seek talent overseas, or “perhaps offer increased payments to players who would otherwise head overseas.”¹²⁷
603. In the Draft Determination, the Commission was not persuaded by these arguments. Its preliminary view was that the salary cap, if and when it begins to constrain, would be likely to increase the outward migration of rugby players in the younger and mid-range levels to some degree, albeit that these are less attractive to overseas clubs than more senior players. The evidence from overseas leagues with salary caps suggests that any impact will be felt primarily at the lower end of the salary range, so that these players may be the most likely to migrate overseas. In 2002 it was reported that 650 were playing for pay overseas, including some former All Blacks and some who had been close to All Black selection.¹²⁸ These people have chosen to play rugby overseas even without the potential encouragement provided by the salary cap. The ability of

¹²³ The Application, Schedule H: Dr Rodney Fort Report, paras 22, 24, 25 26 and 31.

¹²⁴ Ibid, paras 37, 47-50.

¹²⁵ Ibid, paras 41-43.

¹²⁶ Ibid, para 85.

¹²⁷ The Application, Schedule J: Brown Copeland Report, para 68.

¹²⁸ According to Paul Verdon, “Is our national game truly losing ground?” *National Business Review*, September 20, 2002. Quoted in: John McMillan, “Rugby: Strategy and Structure”, in: W. Andreff and S. Szymanski (eds.), *The Edward Elgar Companion to the Economics of Sports*, 2005.

the four unions ‘promoted’ to the Premier Division to acquire additional good players to bolster their playing strength, although assisted by one-off payments from the NZRU, was likely to be limited unless their revenues could be increased on a sustainable basis.

604. In its response to the Draft Determination, the NZRU disagreed with the analysis that the Proposed Arrangements would lower average salaries, and that this would increase player migration, on a number of grounds:¹²⁹

- spending on salaries would increase as the incomes of unions rise, caused by a more even and attractive competition, as supported by evidence from the operation of the salary caps in the AFL and NRL competitions in Australia;
- the proposed budgets of the four new Premier Division unions shows that they are all planning to increase player payments very substantially;
- the provincial union salary is only one of a range of factors that determines where a player chooses to play rugby; and
- Professor Fort’s opinion that migration was unlikely to increase, because the cap would apply only to provincial rugby payments, and not for Super 14 and All Black payments, and because the disparity between overall individual income levels in this country and overseas is unlikely to be affected by the cap.

605. Part of the difference in view between the NZRU and the Commission is accounted for by the impact of the promotion of the four unions to the new Premier Division. To gain promotion, these unions had to meet certain financial and other requirements. Also, in order to compete for quality players with the previous First Division unions, they clearly needed to offer higher salaries than heretofore. Newspaper reports suggest that this is happening. However, this change in the structure of the competition is occurring independently of the Proposed Arrangements—it is present in both the factual and counterfactual scenarios—and so its impact cannot be credited to the salary cap. Nonetheless, the fact that the structural change may cause average salaries to rise might fortuitously ‘improve’ salary differentials vis-à-vis the salaries in those countries to which players usually migrate, and thereby reduce the incentives to migrate.

606. In regard to the other points raised by the NZRU, the inducement for players to stay arising from the Super 14 and All Black payments applies only directly to the 150 NZRU-contracted players out of the approximately 420 Premier Division players, or to 35%. The balance of 270 players will only be influenced to the extent that they aspire to attain higher honours. Moreover, the NZRU notes elsewhere that its entry level salary has been \$65,000 for the last ten years,

¹²⁹ NZRU, “Submissions in Response to Draft Determination – Part 1”, paras 6-11.

implying that this component has shrunk in importance relative to provincial union salaries.¹³⁰

607. The NZRU also supplied three newspaper articles to demonstrate that senior club players are moving to provincial unions to take up professional contracts.¹³¹ However, these articles also show that a proportion of such players had departed overseas. In the case of the Wellington clubs it was reported that 23 (49%) had gone to neighbouring provinces, 14 (30%) had gone overseas, and 10 (21%) had either retired or were unavailable due to work commitments.
608. In summary, it is difficult to foresee what the impact of the Proposed Arrangements would be, especially given the magnitude of the changes occurring in the structure of the competition. Also, the Commission remains sceptical that the salary cap will do as much, or as quickly, as the NZRU maintains, in which case the anticipated beneficial impact on the revenues of the provincial unions would be attenuated. Consequently, the Commission considers that the Proposed Arrangements would be likely to have some dampening affect on average player salaries compared to what would otherwise happen in the counterfactual. It also considers that the greater impact is likely to be felt by salaries at the lower end, in line with the evidence of the impact of salary caps overseas, rather than to be spread evenly across all salary levels.
609. It is uncertain how many players might be lost overseas because of the salary cap. Hence, the Commission proposes to use ‘high’ and ‘low’ projections. In addition, allowance has to be made for the gradual impact of the cap, as discussed above. The Commission has arrived at the following projections of high (low) numbers of migrating player: six (three) players would be lost in Year 1 and subsequent years, 12 (six) in Year 2 and subsequent years, 18 (nine) in Year 3 and subsequent years, 24 (12) in Year 4 and subsequent years, and 30 (15) in Year 5 and subsequent years. This is laid out in Table 9 below. As a guide, ten players are equivalent to only about 2.4% of total player numbers in the competition. Moreover, these numbers of migrating players do not seem large compared to the 650 being paid to play rugby overseas cited above.
610. In the Draft Determination, we assumed that once lost, a player would be lost conservatively for a period of five years, and so took into account losses that would accrue in subsequent years. In addition, losses that would be incurred beyond the end of the five year horizon for players migrating during that time frame were also counted. This was done on the following grounds. Once the player has taken the decision within the five year period to migrate overseas, it seems reasonable to assert that the person would stay overseas for the assumed period of five years. In other words, we assume that the decision would not be reversed subsequently according to what happens to the Proposed Arrangements in the meantime. Consequently, the losses would continue to

¹³⁰ NZRU, “Submissions – Part 2”, para 17.

¹³¹ Op. cit., Appendix 1. The articles are dated either 16 March or 1 April, 2006.

flow for the full five years regardless of circumstances, and so—suitably discounted to present values to allow for the time value of money, and then summed—would represent the cost that would flow from the making of that decision.

611. Note that other detriments do not share these characteristics, and so are not treated in this way. They are effectively incurred on an ongoing, year-by-year basis, according to whether the cap continues to be applied or not. Hence, these costs are included only in the year in which they are incurred, without provision for implied continuing costs in subsequent years beyond the five year time horizon. This difference in the approach adopted for quantifying the loss of player talent detriment was not contested by any of the submissions on the Draft Determination.
612. In the Draft Determination the Commission took the view that the economic cost of player migration would be their lost ‘productivity’, which could be measured by their domestic salary over the period of years during which their services would be lost. A salary at the marginal level used for the allocative inefficiency calculation (\$[]) was assumed. Mr Copeland considered that this approach was flawed in principle. He argued that when a player departs overseas, the provincial union no longer needs to pay the salary, so there is no net loss at all, merely a transfer. Another player will then step up to the position, and he gets paid the salary instead.
613. The Commission considers that Mr Copeland’s reasoning is not correct. What matters from a social perspective is the output lost, not the money transfer. One fewer employee in the economy implies a reduced level of output at some point, after all adjustments have been completed.
614. Mr Copeland also argued that the export of player services through New Zealand residents working abroad temporarily is better seen as giving rise to public benefits rather than detriments, in part because typically they return home with savings accumulated abroad that may be used here for purposes such as investment, or the repayment of student loans. The Commission has not been provided with any evidence to substantiate such savings, or how large they might be. The assertion that some savings are brought back to this country by returning players does not seem unreasonable, although the salaries involved for NPC-equivalent players are probably not high. In principle the savings could be treated as an inflow of foreign funds equivalent to the broadcasting payments received by the NZRU. The Commission has decided to give a discount of 10% in recognition of this factor, so the net rounded salary used is \$[].
615. The claim that New Zealand benefits from coaching skills learned abroad can be countered by the argument that those players could have learned the same skills whilst playing here, and so no benefit is discernible.

616. The Commission therefore considers that the broad approach it used in the Draft Determination was appropriate, subject to the changes to the forecast numbers and in the matter of savings indicated above. An illustration of the numerical analysis for the upper bound player numbers is shown in Table 9. Given the Commission’s time horizon, the relevant last ‘cohort’ of migrating players occurs in Year 5, but the losses accruing in Years 6-9 from that cohort’s migration, as well as those of cohorts in earlier years, is also included.

Table 9: Illustration of Estimation of Cost of Player Migration (upper bound calculation)

	Year 1	Year 2	Year 3	Year 4
Cost of lost output (players migrating and staying overseas)	\$104,400(6)	\$104,400(6)	\$104,400(6)	\$104,400(6)
		\$104,400(6)	\$104,400(6)	\$104,400(6)
			\$104,400(6)	\$104,400(6)
				\$104,400(6)
Totals	\$104,400(6)	\$208,800(12)	\$313,200(18)	\$417,600(24)

Cont’d . . .

Year 5	Year 6	Year 7	Year 8	Year 9
\$104,400(6)				
\$104,400(6)	\$104,400(6)			
\$104,400(6)	\$104,400(6)	\$104,400(6)		
\$104,400(6)	\$104,400(6)	\$104,400(6)	\$104,400(6)	
\$104,400(6)	\$104,400(6)	\$104,400(6)	\$104,400(6)	\$104,400(6)
\$522,000(30)	\$417,600(24)	\$313,200(18)	\$208,800(12)	\$104,400(6)

617. Note that the undiscounted losses from player migration shown in Table 9 are truncated, in that the prospective losses from players leaving in Year 6 and beyond are not included, so the argument discussed earlier that the five year horizon disadvantages the Applicant is not entirely correct. An extension of the time horizon would increase player migration losses. In addition, the above calculation credits the savings when they are made, rather than when they are likely to be returned to this country with the returning player, which leads to an understatement of the estimated detriment.

618. When discounted at 6.8%, the present value of the detriment shown in Table 4 is \$1,895,000. The corresponding lower bound estimate of detriment is \$948,000 (both rounded).

Reduction in Player Skill Levels

619. When considering the Player Transfer Regulations in Decision 281, the Commission considered the possibility that player skill levels might be eroded

when players' desire to transfer might be frustrated, or when players were retained as 'back-ups' and got limited game time. This could lead to players becoming disgruntled, with this in turn sapping team morale. The Commission did not attempt to quantify this detriment, but considered that it was likely to be small. A further consideration in this case is that a greater inequality in provincial salaries, the potential for which was noted above, could also lead to team discord.

620. In his submission with the Application, Mr Copeland claimed that the proposed salary cap is not intended to restrict player movements. He argued that the removal of the Player Transfer Regulations would facilitate greater player movements, which would help skill development. The Commission considered that while this may be the case, it has to be recognised that to the extent that these Regulations helped competitive balance, their loss in this aspect could have a negative impact on player skills.
621. Professor Fort argued that remuneration is the driving force that provides the incentive to train, and this would not be much affected by the salary cap. In non-capped teams the incentive to train would be raised if players perceive that their NPC incomes could rise through enhanced performances and improved league competitive balance. Players in capped teams would still have an incentive to train as hard as before, even though their NPC salaries on average would have fallen, in order to preserve their income from endorsements and Super 14 selection, given the pressure from players coming up through the ranks.
622. The Commission considered the possible impact on player skill levels that could arise from the proposed replacement of the existing Player Transfer Regulations with the new Player Movement Regulations. This would entail the elimination of most of the existing transfer fees payable by acquiring unions to ceding unions, otherwise known as "Development Compensation Fees". These fees were intended to compensate ceding unions for the costs they had incurred in developing transferring players. Hence, it could be argued that the ending of this ability to charge fees to acquiring unions would have the effect—at least at the margin—of reducing the incentives for unions to incur the costs of developing players in the first place. The balance would be shifted from developing players to acquiring those already developed.
623. The consensus of views on the evaluation of allocative inefficiency above suggests that some restriction on player movements would, in fact, be an outcome. Consequently, some players might become frustrated that they could not move to gain advantage of a higher salary or playing for a higher profile team. On the other hand, the addition of four new teams to the Premier Division competition will provide the opportunity for more players to play at the highest NPC level, although this will occur in both the factual and counterfactual, and so cannot be counted as an advantage brought by the salary cap. Also, if the cap

were to lead to a more balanced competition, this could serve to hone players' skills to a higher level.

624. Overall, given these countervailing views and arguments, the Commission's preliminary view was that the impact of the Proposed Arrangements on player skill levels was uncertain, but that player development efforts seem likely to be reduced, relative to what would happen in the counterfactual. While this effect was very difficult to quantify, the Commission's preliminary view was that it could be significant.
625. In its submission on the Draft Determination, the NZRU did not agree with the proposition that player skill levels would reduce as a result of the salary cap. It referred to the submission of Mr Wayne Smith, the All Blacks' Assistant Coach, who commented upon his coaching experience at Northampton Saints (England) in 2001-04, when the competition in which it operated was subjected to a salary cap. His observations were that this cap did not have any impact on players' willingness to train; that the team environment is the major determinant of playing success; and that the evenness of the competition was very important in improving skill levels in that competition.
626. The NRZU also pointed out that the conditions for a union's inclusion in the Premier Division is that they have an academy and a "B" team, and that the more even competition expected under the Proposed Arrangements, which would drive player skills through their playing at a higher level.
627. The Commission notes that the first factor applies in the counterfactual as well as the factual, and so any benefits so derived cannot be claimed to flow from the Proposed Arrangements. Nonetheless, the efforts by the NZRU and the unions to enhance player development and players' aspirations to progress to higher levels of competition (or to migrate overseas, using rugby as their career) must count against the possibility of erosion of skill levels from the Proposed Arrangements. The Commission considers that this detriment, if it exists, is likely to be small.

Innovative Efficiency Losses

628. Mr Copeland submitted that the Proposed Arrangements are unlikely to lead to any significant loss of innovative efficiency.
629. One possibility is that unions might be encouraged to divert their energies to devising ways to circumvent the new regulations, or to lobby for changes to weaken the cap, rather than focusing on enhancing their team's competition prospects. These effects have already been considered in part above, in a static sense. The Commission's view is that there is not likely to be any further significant detriment to be considered under this heading.

Conclusions on Detriments

630. The Commission’s assessment and quantification of the detriments has been set out above, and the results are summarised in Table 10. This assessment reflects the evaluation of how effective the Proposed Arrangements would be over the five-year time horizon used by the Commission, in particular, the ‘hardness’ of the cap, and the extent to which it would constrain the unions subject to it.
631. The quantified detriments are those for allocative and productive inefficiency, together with the loss of player talent. These costs have been allocated to Years 1-5 in the manner indicated above, but the ongoing costs of the loss of player talent in Years 6-9 have also been included, on the grounds that a player lost in any year will be lost for a five year period on average. The costs each year were then totalled. Because some of the detriments are estimated as a range each year, the aggregated detriments each year are also a range. The aggregated figures were then discounted at a rate of 10%, the same as used for benefits below.
632. In addition, the Commission has not been able to quantify the detriment from the reduction in player skill levels and the loss of innovative efficiency, but considers these to be small.

Table 10: Aggregation of Detriments Estimates

Type of Detriment	Present values over 5 year period
Allocative inefficiency	\$133,000
Productive inefficiency	\$2,100,000 to \$2,458,000
Loss of player talent	\$948,000 to \$1,895,000
Reduction in player skill levels	Small
Loss of innovative efficiency	Small
Total (rounded)	>\$3,181,000 to >\$4,486,000

633. The estimate of detriments for the five year period in present value terms are of the order of between \$3.2 million and \$4.5 million.

BENEFITS

Competitive Balance and the Uncertainty of Outcome Hypothesis

634. As discussed in the previous section, the first crucial claimed link in the chain of cause-and-effect is between the Proposed Arrangements and the promotion of a less uneven domestic competition. However, there is a second important link, which goes to the heart of the claimed public benefits, namely, that a more

balanced competition is a more attractive one. Hence, in order to assess the public benefits being claimed by the NZRU, it is first necessary to analyse the role competitive balance in professional sports leagues plays in attracting spectators and viewers.

635. It has long been argued overseas, especially in the United States, that a key ingredient of demand for viewing professional team sports is the excitement generated by the uncertainty of the outcome of individual games.¹³² It is contended that few spectators and viewers are purists who enjoy watching the skills exhibited by outstanding athletes; most wish their team to win a close encounter with a strong opponent. It follows, from this argument, that an unbalanced competition causes audiences to lose interest and attendances decline. For example, Professor Fort stated in his submission to the Commission:¹³³

If competitive **imbalance** dominates, fans of the perennial losing teams lose interest in their own team and, quite possibly (and of importance to all teams including the perennial powers), they lose interest in the sport altogether (Rottenberg, 1956; Neale, 1964). This lowers the overall value of the league and the value of the surviving teams. Those fans that lose interest will also not be there at the end of the season to spend their attention and money on the perennial powers. This clearly implies that leagues have a vested interest in taking action to maintain a healthy level of competitive balance (Neale, 1964; Canes, 1974; Sloane, 1976).

636. This proposition has become known in the sports economics literature as the *uncertainty of outcome hypothesis* (UOH).
637. In many professional sports overseas, league administrators have introduced a myriad of rules and labour market restrictions (such as reserve and transfer rules; draft schemes; recruitment zones; and salary and payroll caps).¹³⁴ Many of these restrictions have led to antitrust cases being taken against administrators.
638. A key argument advanced by league operators in numerous antitrust defences appeals to the UOH. The argument typically rests on three core claims:¹³⁵
- inequality of resources leads to unequal competition;
 - fan interest declines when outcomes become less uncertain; and
 - specific redistribution mechanisms produce more uncertainty of outcome.

¹³² See, for instance, Rottenberg (1956), *op. cit.*; Neale, W. C. (1964), "The Peculiar Economics of Professional Sports: A Contribution to the Theory of the Firm in Sporting Competition and in Market Competition", *The Quarterly Journal of Economics*, 78(1), pp.1-14; El-Hodiri, M., Quirk, J. (1971), "An Economic Model of a Professional Sports League", *The Journal of Political Economy*, 79(6), pp.1302-19; Fort, R., Quirk, J. (1995), "Cross-subsidisation, Incentives, and Outcomes in Professional Team Sports Leagues", *Journal of Economic Literature*, 33(3), pp.1265-99; Fort and Quirk (1995), *op. cit.*

¹³³ The Application, Schedule H: Dr Rodney Fort Report, para 9.

¹³⁴ Restrictions have most notably arisen in US professional sports such as baseball, American football, basketball, and ice hockey. European soccer has also been the subject of league restrictions, as has Australian rugby league and Australian rules.

¹³⁵ See Szymanski (2003), *op. cit.*, p.1153.

639. The counterview, often pursued by players and antitrust agencies, is that the true motivation behind such restrictions is to transfer economic wealth from players to their teams (which overseas are often privately-owned).
640. In its submission on the Draft Determination, the NZRU reiterated its support for the UOH. In doing so, the NZRU argued that there exists a body of empirical economic literature that supports the hypothesis (two references in particular, Kesenne (op cit) and Quirk and Fort (1992),¹³⁶ were cited to support this claim). However, the NZRU did not mention any of the studies that actually cast doubt on this hypothesis, of which there are a number.
641. Testing of the UOH has been the subject of much empirical work in recent years, both overseas, and in New Zealand, although very few of these studies have focused on rugby union. The results of this work have been less than conclusive. Szymanski surveyed 22 separate empirical UOH studies that statistically test the determinants of spectator numbers at live games; of these, ten offer clear support for the hypothesis, seven offer weak support, and five contradict it. Downward and Dawson (2000) argued similarly that “the evidence suggests that uncertainty of outcome has been an overworked hypothesis in explaining the demand for professional team sports” (p.149).¹³⁷
642. In his submission on the Draft Determination, Professor Fort disputed the Commission’s preliminary conclusion that since the empirical evidence on the UOH is mixed, it ought to view conservatively any benefits expected to arise from uncertainty of outcome. Professor Fort referred the Commission to one of his recent articles, which argued that the lines of inquiry used in many empirical studies on the subject are flawed for two main reasons:¹³⁸
- few studies offer proper treatment of time series, thereby avoiding biased coefficients and spurious correlations; and
 - none of the empirical studies that do offer a proper treatment of time series include all three aspects of competitive balance (i.e., match uncertainty, seasonal uncertainty, and inter-seasonal uncertainty).¹³⁹
643. Professor Fort in his article cautions that a third shortcoming of the literature is that most UOH studies focus exclusively on major league baseball, so little can be said about the effect of uncertainty in other leagues.
644. Professor Fort went on to say in his submission that, in his assessment, the empirical studies that do overcome the limitations mentioned above suggest that various aspects of the UOH are important in the determination of fan

¹³⁶ Quirk, J., Fort, R. D., (1992), *Pay Dirt: The Business of Professional Team Sports*, Princeton University Press: New Jersey, Chapter 7.

¹³⁷ Downward, P., Dawson, A., (2000), *The Economics of Professional Sports*, Routledge: New York.

¹³⁸ Fort, R. (2006, forthcoming), “Competitive Balance in North American Professional Sports”, in Fizel, J. (ed.), *The Handbook of Sports Economics Research*, M.E. Sharpe: Armonk, New York.

¹³⁹ See, for example, Szymanski, op cit., p.1155.

satisfaction. In fact, however, the conclusion that Professor Fort reaches in his article is somewhat different. His actual conclusion is that, for the reasons outlined above, "... it is too early to make much of UOH findings, particularly to inform competitive balance policy".

645. The Commission notes that the most recent work of the NZRU's own advisor, Professor Fort, suggests that there is more uncertainty about the UOH in the economics literature than suggested in the Application, or by the NZRU and its experts in submissions. Given that so little is known about whether the UOH actually holds in practice overseas, it seems prudent for the Commission to examine any available evidence on rugby union in New Zealand. This evidence is discussed next.

Evidence from New Zealand – Live Spectator Demand

646. In New Zealand, Professor Dorian Owen and Mr. Clayton Weatherston recently conducted two separate econometric studies that examined the effect of match and within-season uncertainty on attendances, one at Super 12 rugby matches (2004a),¹⁴⁰ and the other at NPC rugby matches (2004b).¹⁴¹ Both studies found very little evidence that uncertainty of outcome had any effect on attendance. Instead, they found that factors with a statistically significant effect on attendance mainly reflect habit and tradition, such as previous attendance and traditional rivalries, or are beyond the control of administrators, such as rainfall on match day and team placings.
647. The findings of Owen and Weatherston are consistent with those of Downward and Dawson, who argued that the traditional empirical work suffers from a short-run and average focus. In particular, as longer time horizons are adopted in studies, traditional economic determinants of demand, such as price and incomes, appear to be more significant drivers of attendance than uncertainty of outcome, than had previously been argued (p.130). Uncertainty may matter in the very short-run, but leagues appear to develop in a way such that long-run domination is the norm (p.238).
648. The Commission considered the findings of Owen and Weatherston relevant to the present case for a number of reasons:
- the studies are very recent;
 - the analysis focuses on rugby union, so the potential difficulties with generalising empirical analyses of other sports to rugby union do not arise; and

¹⁴⁰ Owen, D. P., Weatherston, C. R. (2004a), "Uncertainty of Outcome and Super 12 Rugby Union Attendance: Application of a General-to-Specific Modeling Strategy", *Journal of Sports Economics*, 5(4), pp.347-70.

¹⁴¹ Owen, D. P., Weatherston, C. R. (2004b), "Uncertainty of Outcome, Player Quality and Attendance at National Provincial Championship Rugby Union Matches: An Evaluation in Light of the Competitions Review", *Economic Papers*, 23, pp.301-25.

- the analysis is specific to New Zealand, so the potential difficulties with generalising results from other jurisdictions (where country-specific factors, such as cultural influences, may be at play) do not arise.
649. Owen and Weatherston’s results potentially undermine one of the key arguments underpinning the NZRU’s rationale for seeking to introduce the Proposed Arrangements. The public benefits claimed by the Applicant rest largely on the premise that the Proposed Arrangements will improve the evenness of the domestic provincial competition, and that a more balanced competition is more attractive to spectators and viewers. This very recent and relevant empirical work casts doubt on the nexus between evenness of competition and spectator enjoyment; even if the Proposed Arrangements were successful in distributing talent more evenly between unions, it is not obvious that the benefits claimed by the Applicant would follow.
650. In submissions on the Draft Determination, the NZRU’s advisors—Professor Fort, Mr. Copeland and Dr. Adolph Stroombergen—each produced critiques of the Owen and Weatherston papers, and challenged the Commission’s use of the findings in those studies in informing its decision. Professor Fort’s comments, which were the most substantial, focused on three main points:
- the Owen and Weatherston studies concern the Super 12 and the previous version of the NPC, not predictions about the new NPC PD, and there is no reason to accept that the results in either study apply to the new version of the NPC;
 - Owen and Weatherston (2004b), which may be judged of closest relevance to the matter at hand, is yet unpublished and therefore has not passed rigorous peer review; and
 - the econometric models developed in both studies may be prone to specification errors, autocorrelation, collinearity and non-stationarity (which may produce spurious correlations), and this in turn may reduce the precision of the UOH variable estimates. (Dr. Stroombergen echoes most of these methodological concerns in his submission.)
651. Each of these points are discussed in turn below.
652. In response to the first point, it is obvious that data cannot exist for a competition structure that is yet to be introduced, so detailed empirical analysis of data from exactly the proposed structure is impossible. In the absence of such data, evaluation of different arguments about the desirability or otherwise of the Proposed Arrangements has to be informed by:
- qualitative analysis based on a priori reasoning or judgement or theoretical arguments (of the type presented in the section on the “Economics of Salary Caps”); and

- empirical observation and testing based on past experience (of the type presented in the Owen and Weatherston studies).
- 653. The difficulty with relying solely on qualitative and theoretical arguments is that such an approach can produce conflicting results and recommendations (often due to the underlying assumptions employed). In such cases, recourse to empirical analyses of the past may be useful, and the obvious starting point is the nearest possible structure available.
- 654. The Commission considers that in examining the likely role of uncertainty of outcome on attendance in the ‘new’ NPC, there are strong arguments in favour of looking at experience in the ‘old’ NPC.
- 655. Whether looking at the old or the new NPC, the relevant sports entertainment market is essentially the same, as it includes New Zealand rugby fans and their specific set of tastes. Therefore, however far-reaching the proposed changes, it seems incorrect to argue, as Professor Fort does, that evidence on the behaviour of attendees at NPC matches in the relatively recent past has no relevance to their future behaviour.
- 656. A major problem with the argument that ‘nothing is like the new PD except the new PD’ is that it essentially precludes any advice or insight based on empirical results or any previous experience anywhere. Yet, much of Professor Fort’s “considered view” that “...the UOH is an important and highly relevant factor when assessing the likely impact of the salary cap” is based on his research of, and experience with, salary cap schemes in North American, European and, to a limited extent, Australian leagues.¹⁴² Through his various submissions to the Commission Professor Fort makes frequent reference to salary cap outcomes in overseas leagues, but nowhere does he present any substantial empirical analysis relating to rugby union in New Zealand.
- 657. It seems inconsistent to criticise the most recent empirical work available on the determinants of attendance at New Zealand NPC matches as irrelevant, whilst at the same time, applying general results from studies on entirely different sporting codes, in different countries, with different markets and under different institutional structures, to provincial rugby union in New Zealand. As the NZRU makes clear in its Application (para. 12.9) “New Zealand rugby has specific characteristics that differentiate it from other sports {with} a salary cap”.
- 658. Borland and Macdonald caution that the narrow focus of the UOH literature to date warrants caution when extrapolating results beyond soccer and baseball outside the United Kingdom and the United States.¹⁴³ As mentioned earlier, Fort (2006, op cit.) echoes these very same sentiments when warning that

¹⁴² Professor Fort’s Submissions in Response to Draft Determination, para 6.

¹⁴³ Borland, J., Macdonald, R., (2003), “Demand for Sport”, *Oxford Review of Economic Policy*, 19(4), p.483.

empirical investigation of the UOH has focused almost exclusively on major league baseball in the United States.

659. In response to Professor Fort's second concern, the Commission notes that Owen and Weatherston (2004b) has in fact been published in a peer-reviewed journal, *Economic Papers* (a companion journal of the *Economic Record* that is published by the Economic Society of Australia).
660. In addition, the methodology used in Owen and Weatherston (2004b) is more or less identical to that used in Owen and Weatherston (2004a), published in the *Journal of Sports Economics*, and many of the variables in the general unrestricted model (GUM) in the former are similar in motivation and construction to those in the latter.
661. The Commission agrees with Professor Fort's observation that a single publication is nearly never the definitive statement that silences debate on any topic. However, as Owen and Weatherston point out, there is an acute "... lack of analytical and empirical work in the area of sports economics that is specific to rugby union and that could provide a framework for such decisions".¹⁴⁴ To the Commission's knowledge, the Owen and Weatherston studies are the only pieces of empirical work to date that test the UOH in relation to rugby union in New Zealand. As such, the Commission considers that it is reasonable to use the findings in those studies to help inform its decision.
662. Professor Fort and Dr. Stroombergen raised a number of methodological concerns about the Owen and Weatherston studies, which they claim invalidate (or at least significantly weaken) the findings therein. They suggest that the econometric models estimated by Owen and Weatherston in their studies are: misspecified through the omission of some key variables; suffer from the statistical problems of autocorrelation and multicollinearity; were constructed using an inappropriate model selection approach; and provide a poor treatment of the time-series dimension of the data.
663. In assessing these criticisms, the Commission conducted its own analysis of the studies, and invited Professor Owen and Mr. Weatherston to provide responses to the concerns raised by the Applicant's economic experts. The Commission found most of the claims of misspecification to be overstated; that, following further diagnostic work and re-estimation, the claims of autocorrelation and multicollinearity appear to be unfounded; the model selection criterion was appropriate for the intended use; and that the treatment of the time series element was limited, but this was largely constrained by the truncated nature of the available data. A detailed discussion of these methodological issues is presented in Appendix **Error! Reference source not found.**

¹⁴⁴ Owen, P. D., Weatherston, C. R., (2004c) "Professionalization and Competitive Balance in New Zealand Rugby Union" in Fort, R., Fizek, J., (eds), *International Sports Economics and Comparisons*, Praeger: Westport, CT, p.239.

664. The Commission considers that the Owen and Weatherston models, like all models, including those relied upon by Professor Fort, have a number of limitations. However, the Commission takes the view that recourse to empirical analyses of the past is helpful, and the nearest possible structure available is an appropriate starting point. On balance, the Commission is of the view that the findings of those studies are useful in helping to inform its decision on the matter at hand.
665. One limitation of Owen and Weatherston's work, which was identified by Professor Fort and Dr. Stroombergen, is that the relationship between inter-seasonal uncertainty and spectator demand is not investigated. To gain a better understanding in this regard, the Commission undertook its own empirical enquiry. The Commission's approach involved econometrically estimating (using a panel data model) NPC 1st Division crowd attendance as a function of several factors, including:
- market size;¹⁴⁵
 - average weekly income;
 - average ticket prices;¹⁴⁶
 - uncertainty of a union's overall performance in a season;¹⁴⁷
 - certainty of a union's overall performance in a season;¹⁴⁸
 - a union's previous success (or otherwise) in having reached a semi-final;¹⁴⁹
 - a union's marketing expenditure;¹⁵⁰ and
 - some other unobserved union-specific characteristics.
666. Whilst the estimated uncertainty and certainty coefficients were found to have the expected signs—as winning across seasons becomes more persistent, and as seasonal outcomes becomes more certain, crowd attendances are predicted to fall—the coefficients were not statistically significant. That is, there was no evidence in the data to suggest that a more balanced competition (over successive seasons) would lead to stronger crowd attendance. In contrast, factors such as ticket prices, and the historical record of a union being a semi-

¹⁴⁵ Market size was proxied by the population within each union's catchment area.

¹⁴⁶ The average ticket price for a union is calculated by dividing a union's total round robin gate revenue by the total round robin crowd attendance.

¹⁴⁷ 'Uncertainty' was defined as the product of the deviation of the average winning percentage in the past three years from the ideal winning percentage and the deviation of the current winning percentage from the average winning percentage over the past three years. This variable is essentially a measure of the imbalance of the competition over seasons; it is positive when weak unions become weaker and strong unions become stronger, and is negative when weak unions become stronger and strong unions become weaker.

¹⁴⁸ 'Certainty' is defined as the squared deviation of average winning percentage in the past three seasons from the ideal winning percentage in a complete balanced sports league.

¹⁴⁹ This factor is captured using dummy variables for past appearances in semi-final matches.

¹⁵⁰ This variable was included to control for unions' efforts in promoting the game within their provinces.

finalist, were significant in explaining demand. The regression results from this study are presented in Appendix 3.

- In submissions on the Draft Determination, both Professor Fort and Dr. Stroombergen offered critiques of the Commission’s econometric model. They argued that the Commission’s modelling work concerns the ‘old’ NPC competition, and so the estimation results of that model may be suggestive at best of those applicable to the PD; the Commission could employ alternative estimation techniques to those they assume it has presently used; the model omits key variables, which could bias the estimation results; and that the model suffers from multicollinearity.
- The Commission considered their comments in detail and concluded that findings on the ‘old’ NPC do help inform on the likely outcomes under the ‘new’ NPC: for the reasons outlined earlier; the estimation technique employed, and model specification, were appropriate given the hypotheses being investigated; and further diagnostic work on the model did not support the claim that multicollinearity exists. A more detailed discussion of these issues may be found in Appendix 4.
- On this basis, the Commission concluded that its econometric work investigating the effect of inter-seasonal uncertainty on match attendance helps inform the matter at hand, and that some weight ought to be placed on the findings from that work.

Evidence from New Zealand – Television Audience Demand

667. Surprisingly, little empirical work has been performed to evaluate the impact of competitive balance on television viewership.¹⁵¹ To the Commission’s knowledge, the very recent work by Forrest et al (2005) is the first published study that examines the link between uncertainty of outcome and television demand for team sports.¹⁵² That study, which focused on English Premier League football, found uncertainty did matter to television audiences, but only weakly so (‘improving’ outcome uncertainty by one standard deviation, i.e., to not very far from complete equality in the prospects of the two teams in the

¹⁵¹ A number of articles have extended standard match demand studies to test the impact of television broadcasting on live match attendance. The results from these studies have been mixed; some find that broadcasting has a strong negative effect on crowd attendances, some find the opposite result, and still others find no relationship at all. See Borland and Macdonald, *op cit.*, for a useful survey of this literature. Hausman and Leonard (1997) and Kanazawa and Funk (2001) focus on the effect on television audience ratings of, respectively, a match featuring a ‘superstar’ and a match featuring a higher proportion of white players. However, neither of these studies includes uncertainty of outcome measures. (See Hausman, J., Leonard, G. (1997), “Superstars in the National Basketball Association: Economic Value and Policy”, *Journal of Labor Economics*, 15(4), pp.586-624; and Kanazawa, M., Funk, J. (2001), “Racial Discrimination in Professional Basketball: Evidence from Nielsen Ratings”, *Economic Inquiry*, 39(4), pp.599-608.)

¹⁵² Forrest, D., Simmons, R., Buraimo, B., (2005), “Outcome Uncertainty and the Couch Potato Audience”, *Scottish Journal of Political Economy*, 52(4), pp.641-61.

particular match, would raise predicted audience size by only 6.3%).¹⁵³ To date, no empirical studies have investigated this question in relation to rugby union in New Zealand.

668. The fact that such little attention has been given to testing this aspect of the UOH is surprising for a number of reasons. In contemporary sports leagues, television audiences comprise a much greater element of demand than live match spectators. For example, in 2004 total attendance at NPC rugby matches represented approximately only 7% of total television viewership of NPC matches on SKY and TV3.
669. Television audiences are less likely to be home-team biased than spectators at live matches. Therefore, examination of television demand for sport may more clearly reveal viewers' preferences for uncertainty of outcome, if any.
670. In the Draft Determination, the Commission attributed the vast majority of the public benefits claimed to flow from the Proposed Arrangements to greater enjoyment by television viewers. In doing so, it provisionally accepted the NZRU's claim that television audiences find (at least to some extent) uncertainty of outcome desirable—a claim supported by two broadcasters (SKY and CanWest) in submissions. In particular, SKY considered that the Proposed Arrangements would lessen the extent of the present competitive imbalance in the domestic provincial competition, and the more attractive competition that may ensue would attract more television viewers. The Commission indicated at the time that it had to rely on such qualitative considerations given the lack of existing empirical evidence to the contrary, or sufficient viewership data with which the claim could be tested.
671. Since then, however, the Commission was able to obtain sufficient data to allow it to conduct its own inquiry into whether the UOH is likely to hold for NPC rugby television audiences. The Commission's approach involved econometrically estimating a demand equation for televised 1st Division NPC matches, which was specified as a function of outcome uncertainty and contest quality, as well as a number of other control variables. The estimated model was a random effects panel model using data on four NPC seasons (2001 to 2004), each containing 45 round-robin matches.
672. The proxy for television demand for NPC rugby was match-by-match SKY ratings (defined as the percentage of the total New Zealand population over the age of five viewing a match). These data were supplied to the Commission by the Applicant. The independent variables specified in the model were the following:
- total combined population of the two competing provinces in any given match;¹⁵⁴

¹⁵³ Ibid, p.659.

- a measure of the significance of a match in competing in the championship playoff;
- a measure of the significance of a match in competing in a relegation playoff;
- a control variable for the occurrence of Ranfurly Shield matches;
- average household income of the two unions competing in any given match;¹⁵⁵
- a control variable for the availability of delayed coverage on match day (as a possible substitute for live coverage);
- control variables for other major international sporting events broadcast on match day that may act as substitutes for NPC rugby;¹⁵⁶
- control variables for the timing (day-of-the-week and time-of-day) of broadcast matches;
- the number of other NPC 1st Division matches broadcast on match day;¹⁵⁷
- proxy measures of match quality, which included the number of Super 12 players involved in any given contest, and/or each team's weighted average of past and current (pre-match) competition standings;
- a measure of league competitive balance;¹⁵⁸
- team specific measures performance uncertainty (for both home and away teams);¹⁵⁹ and
- one of a number of alternative measures of match uncertainty.¹⁶⁰

¹⁵⁴ This variable was included in the model to capture the possibility that viewers from the provinces involved in the competition may have a special interest in the contest.

¹⁵⁵ Average regional household income was included as a proxy for the ability of viewers to pay SKY subscription charges.

¹⁵⁶ These included Olympic and Commonwealth Games, international rugby league (including NRL) matches international rugby union matches (such as the Tri-Nations competition), international cricket (both one-day and international) matches, and international tennis. Data on motorsport, golf, netball and yachting events were collected, but were omitted from the final estimation since there is very little variation (and therefore informational content) in the constructed dummies for those sports; motorsport and golf events occur too frequently, and netball and yachting events occur too infrequently. (Netball and yachting exhibited little variation even when aggregated into a composite variable.)

¹⁵⁷ This variable was included to capture possible diminishing marginal utility and time allocation effects.

¹⁵⁸ This variable was included to capture within-season uncertainty of outcome.

¹⁵⁹ These variables control for the effect of 'wild-card' teams (i.e., those teams whose future performances are hard to predict from past results). These measures of the volatility of historical performance were calculating using match-by-match win/loss data for each team in the competition.

¹⁶⁰ The uncertainty measures included: the absolute value of the difference in pre-match league standings between the two competing unions, calculated as a weighted average of league standing in the current and previous season; the absolute value of the difference in pre-match percentages of games won by each union, weighted by performances in the current and previous season; the absolute value of the difference in historical winning probability for each team based on pre-match for- and against-scores, weighted by performances in the current and previous season; and the absolute value of the difference in historical winning probability for each union, weighted by performances in the current and previous season. None of

673. Some match-level data, including game dates, kick-off times, and round robin rosters, were supplied to the Commission by the NZRU. Match results (final scores, number of tries scored, etc.) were obtained from publicly available information on the TVNZ website. Household income and provincial population data were obtained from Statistics New Zealand. A fuller description of the data and methodology used in the Commission's study can be found in the consultation document entitled *What Drives Television Demand for NPC Rugby Matches?*¹⁶¹
674. One of the key findings of the Commission's study was that none of the uncertainty of outcome variables specified were statistically significant in explaining the variation in television demand between different NPC matches over the four seasons studied. This suggests that the uncertainty of outcome hypothesis does not hold with respect to television viewers of 1st Division NPC matches. Instead, the modelling results suggest the following factors are important drivers of viewer demand:
- household income – a proxy for ability to pay SKY subscription charges (positive effect);
 - prime-time scheduling of broadcasts (positive effect);
 - spectacle matches, such as Ranfurly Shield challenges (positive effect);
 - the number of other 1st Division matches broadcast on match day (negative effect);
 - Sunday broadcasts (negative effect); and
 - match quality – in particular, the number of Super players involved in a contest (positive effect).
675. The finding on match quality is of particular interest. The regression results suggest that a 10% increase (decrease) in the number of Super players involved in a match would be expected to raise (reduce) viewer ratings by approximately 0.11 points. (The average rating per match across all matches in 2005 (on SKY and TV3) was approximately [] points.) This suggests that there may be some scale economies from re-distributing the most talented players from strong to weak unions. The transfer of a Super player from a strong contest to a weak contest results in an increase in the combined television audience, because the loss of audience in the first is more than offset by the increase in the second. Hence, player redistribution policies, such as a salary cap scheme, may increase viewer demand not because of a more even competition, as proponents of the UOH would claim, but rather because of an increase in the average quality of

these uncertainty measures were included in the same regression, thus avoiding the problems of over-specification and collinearity. All these measures were specified in both linear and quadratic form to accommodate the possibility that the true data generating process may be non-linear.

¹⁶¹ Available at: <http://www.comcom.govt.nz//BusinessCompetition/Anti-competitivePractices/Applications/ContentFiles/Documents/Television%20Viewership%20Study.pdf>

games. The positive impact of quality on audience size has been found to be a significant factor in both some overseas and New Zealand studies.

676. The results of the regression analyses are presented more fully in Appendix 5.
677. In submissions, both Professor Fort and Dr. Stroombergen argued on behalf of the NZRU that the Commission's empirical study suffered from data limitations, incorrect interpretation of some regression variables, and deficiencies in the econometric techniques used, and that these prevent the results of the study being relied upon to reject the UOH. The Commission considered their comments in detail by conducting further diagnostic analyses of the data and model, and seeking the opinion of an independent expert in the area of econometrics, Professor Dorian Owen (Department of Economics, University of Otago) on the merits of the critiques. Having done this further work, the Commission came to the view that most of the criticisms raised were either very weak or unfounded. The major criticisms offered by Professor Fort and Dr. Stroombergen, and responses to them, are discussed in detail in Appendix 6.
678. The Commission acknowledges that all economic models are imperfect to some degree, and provide only a partial view, but considers that this should not preclude their usefulness in informing key decisions. On balance, the Commission considers that the findings of its econometric work provide useful insights on the benefits likely to flow under the Proposed Arrangements.
679. The experts acting for the Applicant also raised a number of non-technical criticisms of the Commission's study in submissions. These are discussed below.
680. Both Professor Fort and Mr. Copeland argued that the Commission's study is limited in its usefulness because it uses historical data on the old NPC 1st Division rather than the newly-structured PD competition (on which, of course, there is no data yet). The same argument was raised by Professor Fort in relation to the match attendance studies on NPC and Super 12 rugby by Owen and Weatherston, and an extensive discussion in the previous section led to it being rejected there.
681. Dr. Stroombergen contended that the entry of four relatively weak unions into the new PD is likely to mean that variation in the number of viewers under the new competition format is likely to be greater than under the old NPC 1st Division in the absence of arrangements that ensure a more even competition. That is, if the new competition is significantly more unbalanced than the old, viewers may be more sensitive to uncertainty of outcome. However, this possibility may be offset to a large extent by the structure of the new competition, which departs from the traditional round-robin format in favour of a pool format competition. The new format is designed to limit the number of times weak unions meet strong unions, ensure that weak unions play each other

more often through a series of repechage matches and, likewise, that strong unions face each other more often through second-round pool matches.

682. Mr. Copeland argued in submissions that the Commission’s econometric investigation into the effect of uncertainty of outcome on television viewership is a single study and does not form part of a body of literature reaching the same undisputed conclusions. He submitted that given this is the case, the Commission’s quantitative findings ought to be checked against all available qualitative evidence.
683. In forming a view, the Commission has weighed up all the available empirical evidence (of which there is not much at this present time), including its own econometric work, having regard to the merits and limitations of that evidence.
684. The Commission acknowledges that a single study is nearly never a definitive statement that resolves debate on a particular issue, especially where there are currently limited data and/or the relationships that require modelling are complex. However, the Commission also recognises that there has been very little empirical work done to examine the link between uncertainty of outcome and television demand for sport internationally, let alone in New Zealand.¹⁶² Consequently, there is even less evidence to support the UOH with respect to television viewers than there is in relation to live spectators. However, this is no reason why the Commission ought not to place weight on its empirical work if it is useful in informing the matter at hand, particularly since that work was reviewed by, Professor Owen, an independent expert in the field, and tested against the criticisms offered by the Applicant’s experts. Therefore, the relevant issue for the Commission is how much weight it should give to the available empirical evidence.
685. The Commission agrees that it ought also to take into account any available qualitative evidence but notes two points in this regard. Firstly, as discussed in the previous section, the problem with relying solely on qualitative arguments is that reasonable arguments can be put forward by different parties that come to different conclusions about the desirability of a course of action. Therefore, recourse to some kind of quantitative analysis of relevant data and outcomes is desirable (and hence, the Commission’s efforts in this area). Secondly, the qualitative evidence provided by the Applicant in support of the UOH has been largely anecdotal.
686. The NZRU cited the submissions from two broadcasters—SKY and CanWest—who expressed support for the UOH. SKY gave examples of a few past instances where viewer ratings appeared to rise during ‘close’ match-ups (in

¹⁶² Commission noted in its consultation document on its econometric study that, to date, only one published study exists that examines this issue, and that study relates to English Premier League football, not rugby union in New Zealand. See Commerce Commission (15 May 2006), “*What Drives Television Demand for NPC Rugby Matches?*”, p.2.

one-day international cricket and All Blacks matches).¹⁶³ However, the analysis provided by SKY does not control for other possible drivers of viewer demand, and ‘uncertainty’, or the ‘closeness’ of contest was ill-defined. Hence, it is difficult to make any meaningful inferences from that information. Mr. Rick Friesen (CEO, TVworks, CanWest) submitted that it was “commonsense” that the UOH holds.¹⁶⁴ However, commonsense is a highly subjective notion, and not a suitably rigorous basis upon which to accept or reject a hypothesis of this nature, especially given the significant and ongoing debate in the economics literature on this issue, at least in respect of live spectatorship.

687. Both Mr. Copeland and Mr. Kevin Cameron (Acting CEO, SKY) argued that broadcasters such as SKY have a direct commercial stake in the attractiveness of the NPC, and therefore their expressed views that UOH holds should be taken into account by the Commission. There are two points to note on this issue. First, it is unclear on what basis broadcasters have come to the conclusion in support of the UOH. Submissions from these parties have, in the main, simply contained opinion (albeit based on experience in scheduling program content) that viewers find uncertainty of outcome attractive. No details of any rigorous analysis to support this view were provided. Second, *ex ante*, there is no way of reliably testing the willingness of broadcasters to pay more for content that features greater competitive balance. As discussed later, SKY currently has a broadcasting agreement with SANZAR in which content fees are fixed for the duration of the contract, which expires only at the end of 2009. Therefore, SKY does not need to reveal its true willingness to pay for a more balanced competition until well after the Proposed Arrangements are authorised or otherwise. Arguably, it is broadcasters’ willingness to pay that reveals the most useful information about the true value placed on uncertainty of outcome by viewers.
688. When deciding how much weight ought to be given to the views expressed by broadcasters, the Commission considers it is useful to consider the strategic incentives that broadcasters may face. It is relatively costless for broadcasters to support the Proposed Arrangements today. If the claimed benefits materialise in the future, then broadcasters are better off as they have a more attractive competition to market. If the claimed benefits fail to flow, nothing has been lost from supporting the Proposed Arrangements. Hence, it is an entirely reasonable economic strategy for broadcasters to argue in favour of the UOH; broadcasters can keep alive the possibility of a positive expected payoff in the future by supporting the claims of the Applicant today.
689. Taking all these factors into account, the Commission is cautious in how much weight it places on the views of broadcasters, who expressed support for the UOH in relation to television viewers. This leads the Commission to place

¹⁶³ Submission on the Application (13 December 2005), John Fellet, CEO, SKY Network Television Ltd.

¹⁶⁴ Submission on “*What Drives Television Demand for NPC Rugby Matches?*” (22 May 2006), Rick Friesen, CEO, TVworks, CanWest, para 2.

more weight on the available empirical evidence, which largely consists of the findings from its econometric study, when forming a view.

690. On the basis of all the quantitative and qualitative evidence before it, the Commission is of the view that it is unlikely the UOH holds with respect to television viewers of PD rugby union. Therefore, the Commission considers that the benefits claimed to flow to television viewers from greater uncertainty of outcome, as a result of implementing the Proposed Arrangements, are unlikely to materialise.
691. However, the Commission's investigations did support the Applicant's claim that demand for matches by television audiences is positively influenced by the quality of contest, as measured by the number of Super players involved in a match. As discussed earlier, this suggests that player redistribution policies, such as a salary cap, may positively influence viewer demand for matches. This is consistent with the testimony provided by Professor Fort, Mr. Copeland and Mr. Schubert, and is supported by several empirical studies both from overseas and New Zealand. The possible contest quality effects of the Proposed Arrangements are explored in further detail in the section below where the likely benefits to television viewers are quantified.

Enhanced Provincial Union Financial Performance

692. The Applicant considered that a more attractive domestic competition would lead to stronger financial performance of the provincial unions, and counted this as a public benefit. This expectation appears to derive from overseas experience; for example, clubs in the NRL and AFL are reported to have substantially improved their solvency as a consequence of implementing salary cap schemes and other related measures. The Applicant suggested that enhanced financial performance is expected through growth in spectator and broadcasting revenues, and sponsorship.
693. The NZRU does not explain why financially stronger provincial unions in itself ought to be considered a public benefit. The Commission expects that the Applicant's reasoning is along the following lines. First, greater financial strength may mean more resources are spent on player development, which in turn may make for a more interesting competition. Second, unions may have greater means to provide better facilities for spectators. Third, as discussed later, unions may enjoy the greater wherewithal to attract talent from overseas and/or keep local talent from migrating abroad.
694. Whilst the Commission accepts all these as possible outcomes, it is of the view that these results in themselves may not necessarily represent net public gains. As mentioned earlier, the Commission does not consider changes in the distribution of income or economic welfare, where one group gains at the expense of another, as 'benefits' when weighing up overall gain to society, since a change in efficiency is usually not involved. All expected gains to

rugby union must be offset against any accompanying costs, including opportunity costs and losses, to other parts of society.

695. For example, increased spectator revenues will represent a gain to rugby union, but will commensurately represent a loss to other forms of sports entertainment, given individuals' finite leisure time. Similarly, an increased allocation of local broadcasting revenues to rugby union means a reduced allocation of broadcasting revenues to other local sectors. (Mr. Copeland suggests that where broadcasting revenues are generated solely from foreign sources, this is a net gain to the New Zealand public.¹⁶⁵) Likewise, increased domestic sponsorship of rugby union must necessarily be to the detriment of other potential recipients of sponsorship, such as charities or the arts. Hence, it would be incorrect to count the full quantum of expected increased revenues as a net public benefit; any relevant offsetting losses must also be accounted for.
696. Nevertheless, the Commission considers it likely that there is some nexus between the enhanced financial performance of provincial unions (and the NZRU), resulting from a more attractive domestic competition, and benefits to the public of New Zealand. It is likely that as provincial unions become more financially secure, they would utilise their additional resources to enhance the attractiveness of the domestic competition.

Conclusion on the Nexus for 'Direct' Public Benefits

697. The empirical evidence suggests that there is, at best, a weak relationship between competitive balance and spectatorship for rugby union in New Zealand, including in the domestic provincial competition. The Commission found no convincing empirical or qualitative evidence to suggest otherwise. On this basis, the Commission proposes to treat conservatively any substantial public benefits to spectators that are expected to flow from any enhancement in competitive balance in the domestic provincial competition.
698. The Commission's empirical investigation into the claimed link between a more balanced competition and increased television viewership suggests that uncertainty of outcome is not a driver of audienceship of NPC rugby. The Commission encountered no convincing empirical or qualitative evidence to contradict these findings. Therefore, the Commission is of the view that little or no public benefits are likely to flow from increased uncertainty of outcome of PD matches under the factual. However, the Commission did find evidence in its econometric study that player redistribution policies aimed at raising the quality of contests, such as a salary cap scheme, can have an overall positive impact on viewer demand. On this basis, the Commission concludes that any benefits likely to flow to television viewers under the factual, relative to the counterfactual, are likely to derive from improved contest quality.

¹⁶⁵ The Application, Schedule J: Brown Copeland Report, para 51.

699. In addition, as the financial performance of provincial unions improves, it is likely that their increased resources would be directed towards producing a more attractive competition (e.g., through player development, improvement of facilities, attracting talent from abroad and/or retaining domestic talent). However, these benefits would only be realised to the extent that the implementation of the Proposed Arrangements did in fact lead to a more attractive competition, and thereby, a greater source of income for unions.
700. Finally, there remain concerns about how hard the salary cap is likely to be in practice, and how quickly the salary cap will constrain various provincial unions. Incentives for strong unions to circumvent the cap, or more likely, to utilise legitimate loopholes, may continue to exist, as could disparity in the ability of various unions to attract and retain high quality players. All these factors contribute to uncertainty over to the extent to which benefits would likely flow under the factual.

Enhanced International Performances

701. The NZRU strongly submitted that as a result of a more even PD competition there would be improvements in the skill factors of the most able rugby players and consequently improved performances and results for New Zealand Super 14 teams, the All Blacks, and other national representative squads. It is argued that this would in turn generate public benefits from overseas (the ‘indirect’ benefits). These benefits would be indirect because they would arise from enhancing the performance of New Zealand representative sides, which is likely to be promoted only indirectly by the Proposed Arrangements.
702. The NZRU claimed that the expected improvement would occur for a number of reasons. First, a more even domestic competition is expected to produce a higher quality contest; players would need to train harder in order for their respective unions to succeed, and this would necessarily have flow-on benefits to higher levels of competition.
703. Second, by avoiding ‘stockpiling’ of players, they would get more match-time, which in turn would aid skill development. Whilst the Commission largely accepts this proposition, it considers that this must be balanced against the natural preference for good players to associate with strong unions over weak unions. As discussed earlier, players face strong incentives to join unions that would maximise their chances of progressing to higher competitions. For a few players, this may mean that they would prefer to remain with a strong union (where they can benefit from superior coaching and training resources) even if this means playing less frequently, if the alternative is to play for a poorly equipped union. Players may also prefer to remain with a strong union over a weak one if they consider that their ability to display their skills to selectors may be hindered by poorly performing team-mates.

704. Third, the NZRU anticipates that reduced spending on player salaries as a result of the cap would free up funds for increased spending on player development.
705. Fourth, the NZRU argues that the cap would force some unions to seek talent from overseas in order to remain competitive, which would help lift the standards of New Zealand rugby. This claim is based on the idea that in the long-run all provincial unions and the NZRU would be more prosperous under the Proposed Arrangements, which would lead to overall higher expenditure on players, and eventually, overseas talent flowing into New Zealand. However, counterbalancing this is the possibility that overseas talent may, in some instances, begin to displace local talent, yet may not be willing or eligible for selection to the All Blacks and other international representative sides. This would have the effect of at least partially offsetting the overall benefits generated by incoming foreign players.
706. In any event, it seems likely that any benefits from overseas talent migrating to New Zealand would only be felt in the long-run (i.e., more than five years hence), so the Commission did not give significant weight to this claimed benefit.

Conclusion on Nexus for ‘Indirect’ Public Benefits

707. The Commission accepts that the impact of the Proposed Arrangements could flow through to the performance of representative teams, and to enhanced financial performance of the provincial unions (and the NZRU). Given the offsetting factors assessed earlier, and the fact that these flows are only likely to give rise to ‘indirect’ public benefits, the Commission considers that these effects are likely to be weak.

Evaluation of Claimed Public Benefits

708. As noted above, the Commission considers that a public benefit is any gain to the public of New Zealand, with an emphasis on gains measured in terms of economic efficiency. Such benefits may arise in the market or markets where competition is lessened, or in any other market.

Direct Benefits

709. The direct public benefits claimed to flow from the Proposed Arrangements are the following:
- a more attractive domestic provincial competition for spectators and television viewers; and
 - enhanced domestic sponsorship and broadcasting interest and funding.

Indirect Benefits

710. The indirect public benefits claimed to flow from the Proposed Arrangements are the following:
- greater enjoyment for New Zealand spectators and television audiences of New Zealand international matches;
 - greater leverage for NZRU in its negotiations over (international) television rights, sponsorship, and revenue sharing arrangements;
 - greater sponsorship expenditure by New Zealand firms spent in New Zealand (with NZRU) instead of being spent overseas via other promotional avenues with no benefit to New Zealand entities;
 - improved international trading opportunities for New Zealand firms via the “association with success” factor;
 - increased tourism to New Zealand; and
 - a “feel good” factor for many New Zealanders.
711. The Applicant did not attempt to quantify any of the claimed indirect benefits.
712. The Commission is of the view that any impact of the Proposed Arrangements would be felt mostly on the domestic provincial competition, with more attenuated effects on the New Zealand Super 14 and All Black teams. Consequently, the claimed benefits may be arranged hierarchically, with the benefits from domestic sources potentially being more likely and more significant, and those deriving from overseas being smaller and less likely.
713. Each of the claimed benefits is now assessed in turn.

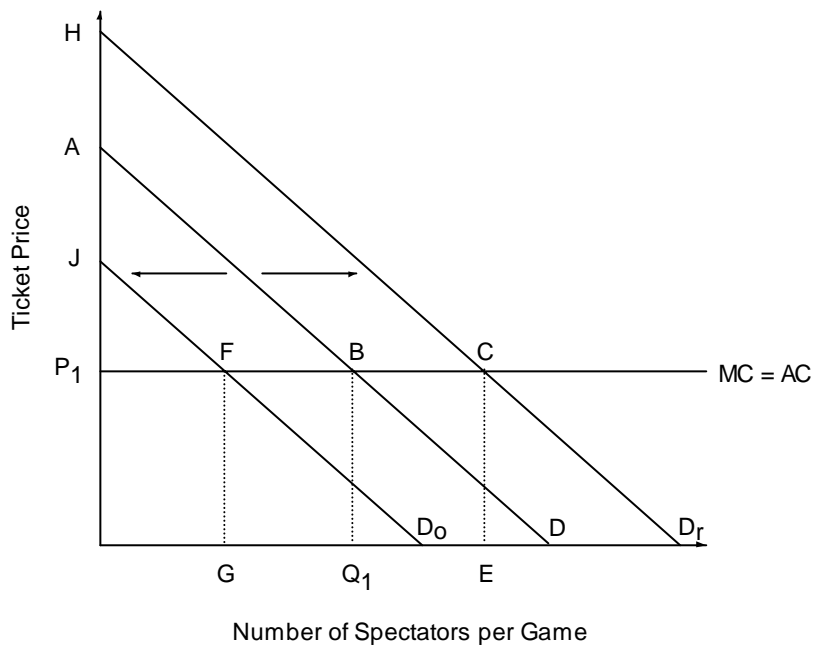
Spectator Enjoyment

714. Increasing the attractiveness of the game for spectators and television viewers, compared to the lesser attractiveness of a competition with declining balance in the counterfactual, would count as a benefit to the New Zealand public.
715. The intangible nature of this benefit makes it difficult to quantify, yet because of its potential significance, it is important that the effort be made. One measure might be the increase in the numbers of spectators and viewers, or the rise in gate takings, but this would be only a partial measure because it would not include the extra benefit enjoyed by existing spectators and viewers, nor would it incorporate off-setting losses in entertainment from which the increased spectators and viewers have shifted patronage.
716. In the context of considering Decision 281, the Commission developed a simple model of demand for rugby union and other forms of sports entertainment, which incorporated these factors. Mr. Copeland recalibrated this model using

more recent information in order to estimate the net public benefit to spectators flowing from the implementation of the proposed salary cap arrangements and amendments to the transfer regulations. He estimated these net public benefits to be between \$105,000 and \$420,000 per year (commensurate with a 10 to 20% increase in spectatorship).

717. In making its own assessment of the likely net benefits to spectators, the Commission utilised the same model, but also employed some simple econometric techniques in order to augment the analysis. First, a brief description of the model follows, after which the modelling results are presented.
718. Consider the market demand for two competing forms of entertainment: spectatorship at domestic provincial competition rugby games; and a composite of all other forms of sports entertainment. The representative demand curves for these two forms of entertainment are represented in Figure 5.

Figure 5: Stylised View of Demand for Rugby Spectatorship and All Other Forms of Sports Entertainment



719. The following assumptions are involved in constructing Figure 5:

- in initial equilibrium, the demand curve (D) represents both the demand to spectate at PD rugby game, and the demand for other sports, i.e., the demand for both is the ‘same’;¹⁶⁶
- the unit cost of each service is constant and equal to P_1 , as represented by the horizontal cost curves, $MC = AC$ (marginal cost = average cost);
- the number of buyers in the sports entertainment services market is fixed;
- the implications for television followers of rugby are ignored; and
- the pool of spectators in this market is fixed.

720. In competitive equilibrium both services reach equilibrium at point B with a price P_1 and quantity Q_1 . In the case of the rugby union entertainment services segment, P_1 is the ticket price and Q_1 is the number of spectators. In both, the consumers’ surplus, given by area ABP_1 , is maximised. The outcome is allocatively efficient.
721. Now suppose that as the consequence of the greater interest in the domestic provincial competition resulting from improved balance or quality, the demand for rugby tickets shifts rightwards (increases) to D_r , while simultaneously the demand for other entertainments shifts leftwards (decreases) *by the same horizontal distance* to D_o . Assuming also that prices remain at P_1 , the total expenditures of consumers on both rugby and other entertainments services will stay the same, i.e., the increased spending on the former of $BCEQ_1$ is balanced by the decreased spending on the latter of FBQ_1G . Nonetheless, the increase in the consumers’ surplus derived from buying more rugby union entertainment services, shown by the area $AHCB$, is greater than the loss of consumers’ surplus from buying fewer other sports entertainment services of $AJFB$.
722. In the scenario just described, there is a net gain in consumers’ surplus associated with the shift in consumer patronage from other sports entertainments to rugby union, even though total consumer outlay on the two combined remain the same. This net gain can be estimated by calculating the difference:

$$AHCB - AJFB, \quad (1)$$

$$\text{where } AHCB = (HCP_1 - ABP_1),$$

$$\text{and } AJFB = (ABP_1 - JFP_1).$$

723. The Commission employed some simple econometric techniques in order to calibrate this model and calculate the difference represented in equation (1). First, the simple linear demand function, D , was econometrically estimated

¹⁶⁶ It seems likely that there will considerable variations across the country, with plenty of other sports entertainment options in large centres like Auckland at one extreme, and rugby union being ‘the only game in town’ in small rural centres.

using average price and annual attendance data.¹⁶⁷ Second, assuming a range of possible shifts in demand (D_o and D_r), and using simple geometry, the areas under the demand curves depicted in Figure 5 were calculated in order to estimate the average net gain in consumers' surplus per provincial union, represented by equation (1). Total spectator benefits arising from a more attractive PD are calculated by multiplying the average net gain in consumers' surplus per provincial union by the total of 14 unions in the PD (see Appendix 7 for a more detailed description of the methodology employed).

724. Expected spectators' benefits were calculated by assuming, as outlined earlier in the section entitled "The Role of Proposed Arrangements", that:
- the benefits over years 1 to 5 flow according to the following time profile: 5% of total benefits in year 1, 10% of total benefits in year 2, 15% of total benefits in year 3, 25% of total benefits in year 4 and 40% of total benefits in year 5. Essentially, it is assumed by the Commission that the demand shifts depicted in Figure 5 would occur gradually, as the impact of the salary cap takes effect; and
 - the assumed real discount rate is 6.8%.
725. The estimated net public benefit from increased spectatorship of rugby union (in present value terms), over a range of assumed proportional increases in demand for PD rugby, resulting from the Proposed Arrangements, are reported below in Table 11.

Table 11 – Estimated Present Values of the Net Public Benefits Resulting from Increased Spectatorship for PD Rugby Union over a Five Year Period

Percentage Increase in Spectator Demand	Estimated Net Gain in Public Benefits
0	\$0
5	\$67,109
10	\$268,434
15	\$603,977
20	\$1,073,737

726. A few important caveats must be noted at this point. The benefits quantified above have been estimated using a rather crude demand model, which is built on a number of simplifying assumptions. (The Applicant has also used essentially the same model when quantifying the claimed public benefits.) These assumptions are necessary to ensure the manageability of the model, and

¹⁶⁷ See Appendix 3 for a summary of the estimation results.

because of some data limitations. It is likely that relaxing the various assumptions would alter the quantified benefits.

727. One major assumption made is that demand for all sports entertainment other than PD rugby could be ‘compressed’ into some single measure of demand, captured by a unique demand function. In reality though, various forms of sports entertainment are likely to be differentiated products, and so the concept of a composite demand for all sports entertainment (excluding PD rugby) is a fairly artificial one.
728. Another significant assumption is that demand for PD rugby and other sports entertainment is the ‘same’ in initial equilibrium (i.e., that the demand curves for the two forms of entertainment are identical to begin with). It seems unlikely that this would be the case in practice. Whilst some data on demand for 1st Division NPC rugby (a proxy for demand for PD rugby) is available, it would be a very difficult task to assemble similar data for all other forms of sports entertainment. Hence, it is difficult to assess demand for PD rugby in relation to demand for other sports entertainment.
729. This is significant because if, in initial equilibrium, demand for all other sports entertainment sufficiently exceeded demand for PD rugby (i.e., if the demand curve for other sports entertainment initially lay sufficiently to the right of the demand curve for PD rugby spectatorship), a modest increase in demand for rugby might lead to a *reduction* in total welfare, because the total loss in consumers’ surplus from other sports entertainment may be greater than the gain in welfare for PD rugby spectators. In other words, the area AJFB might turn out to be greater than AHCB.
730. A 2005 Colmar Brunton survey suggests that rugby union is by far the most popular sporting code in New Zealand, with approximately []% of respondents following rugby, in comparison to only []% for rugby league (rugby union’s nearest rival, according to the study). The study did not evaluate the popularity of 1st Division NPC rugby (which is only part of all rugby entertainment) in relation to other forms of sports entertainment. In the absence of detailed data, it is difficult to assess the demand for PD rugby relative to that for other forms of sports entertainment.
731. A further assumption is that demand functions in the analysis are linear, for the purpose of simplifying the analysis. If in fact the demand functions were non-linear, the magnitude of the predicted welfare changes might be quite different (and also be considerably more difficult to measure).
732. A related point is that the data used to estimate the demand function, D, only informs on the characteristics of demand near the point of equilibrium. Demand may behave quite differently when prices are very high or very low, but data on these scenarios are not available. The significance of this point relates to the assumption that any shifts in the demand curves occur in a parallel

fashion. In practice though, the slopes of the curves may change when demand shifts (indicating that demand may become either more or less sensitive to price). Slope changes would affect the size of the triangular areas under the demand curves that represent consumers' surplus, and would therefore influence the overall welfare effects.

733. Finally, the model assumes that the size of this sports entertainment market remains constant, notwithstanding changes in demand. However, it is likely that if PD rugby were to become more attractive (perhaps due to a more even competition), individuals who previously were not sports-watchers might begin to participate in the sports entertainment market by becoming spectators of rugby. Similarly, if interest in the competition declines, some individuals (who might find sports other than rugby union unappealing) might exit the market altogether. Allowing such possibilities in the model would likely alter the size of the estimated benefits.
734. In the absence of a better framework, the Commission gave consideration to the estimated public benefits predicted by the model. However, in doing so, the Commission recognised the limitations of the model, as discussed above, and evaluated the quantified benefits with due caution.
735. One criticism of the Commission's approach to estimating spectators' benefits, raised by Dr. Stroombergen in submissions on the Draft Determination, is that the market-clearing price in this model, P_1 , does not take into consideration the cost to spectators of attending matches (e.g., transport, parking, etc.). Dr. Stroombergen submitted that by failing to take into account these additional costs, the Commission had under-estimated the benefits that would flow to spectators.
736. The Commission makes two points in relation to Dr. Stroombergen's objection. Firstly, the value of P_1 adopted in the Commission's modelling, \$15, was initially suggested by the NZRU's own advisor, Mr. Copeland. Secondly, if applied correctly, estimates of public benefits generated by the model should be invariant to the assumed price. This is because, for the sake of consistency, if the market-clearing price P_1 is to be scaled up by a fixed amount (say, to reflect spectators' attendance costs), so should every other price on the demand schedule faced by spectators. That is, the entire demand curve should be shifted up at each price level by this fixed amount (unless there is good reason to expect that the cost of attendance varies along with the ticket price). Therefore, the area under the demand curve (but above the market clearing price), which represents consumers' surplus, would remain unchanged. Hence, there is no need for the Commission to adjust its estimates of spectators' benefits on the basis that attendance costs were excluded from the assumed market-clearing price.
737. Using the spectator demand model introduced above, the Commission estimates that the net public benefits from greater spectator interest in rugby union would

be between \$0 and approximately \$1,100,000 over five years (in present value terms).

Viewer Enjoyment

738. The Applicant also argued that the introduction of the Proposed Arrangements would generate additional benefits in the form of greater enjoyment for television viewers. In attempting to quantify these claimed benefits, Mr. Copeland took as a starting point the net benefits to television viewers that the Commission accepted in Decision 281 as arising from introducing the Transfer Regulations. He then made an adjustment for inflation and the possibility that the proposed salary cap would be more effective in achieving balance than the previous Transfer Regulations, and arrived at an estimate of additional net benefits in the range of between \$0.60 and \$1.20 per viewer. On this basis, Mr. Copeland estimated public benefits from increased television viewership for PD rugby, as a consequence of implementing the Proposed Arrangements, to be between \$6,000,000 and \$12,000,000 per annum.
739. The difficulty with this approach is that it is fairly ad hoc; no sound reasoning was provided by the Applicant as to why this was a sensible range for the net benefits that may accrue. The Commission sought to assess the claimed benefits to television viewers using a different approach. This approach involved adapting the spectator demand model developed above to model the benefits that may flow to television viewers, with the aid of insights provided by the econometric analysis conducted by the Commission.
740. In submissions, Professor Fort and Dr. Stroombergen both largely supported this approach, albeit with some reservations on the insights drawn from the Commission's econometric work (these issues were discussed in detail in the earlier section, "Evidence from New Zealand – Television Audience Demand").¹⁶⁸
741. The earlier discussion of the Commission's econometric investigation into the key drivers of demand for televised 1st Division NPC rugby matches found a lack of support for the Applicant's hypothesis that uncertainty of outcome is attractive to television audiences. Given the weight of this evidence, and the lack of empirical or convincing qualitative evidence to the contrary, the Commission is of the view that little or no public benefits are likely to flow from increased uncertainty of outcome of PD matches under the factual.
742. However, the empirical analysis did suggest that contest quality—as proxied by the number of international (Super) players involved in matches—matters to television viewers. As the Tables in Appendix 5 show, a 10% increase

¹⁶⁸ Rodney Fort (28 May 2006), Submission on the Commission's Alternative Approach to Modelling Quality as a Driver of Television Demand for NPC Matches; Adolph Stroombergen, Infometrics (29 May 2006), Submission on the Commission's Alternative Approach to Modelling Quality as a Driver of Television Demand for NPC Matches.

(reduction) in the total number of Super players involved in a contest would be expected to raise (reduce) match ratings by approximately 0.11 points. As discussed in the earlier section on “The Economics of Salary Caps”, the key outcome of an effective salary cap scheme is the redistribution of talent from strong to weak teams. The Commission is of the view that any benefits to television viewers that arise as a result of the Proposed Arrangements would flow from the more even distribution of Super players across teams.

743. In recent submissions (22 May 2006) the NZRU suggested that improved team quality would arise not simply through the redistribution of Super players, but also the redistribution of “fringe” Air New Zealand Cup players (i.e., those players who may not make the starting 22 in the major unions, or who play in B teams). Mr. Copeland submitted that 16 of last year’s Canterbury B squad have already transferred to some of the teams newly promoted to the PD, at least partially in anticipation of the salary cap, and that a “similar loss” of B team players has also occurred in Wellington.¹⁶⁹
744. Two points are noted in relation to Mr. Copeland’s comments. Firstly, it seems likely that majority of these players would have transferred to the four new unions regardless of whether the Proposed Arrangements are implemented or not, i.e., the change would occur under both the factual and counterfactual, so would be irrelevant to the matter at hand. Secondly, whilst it is possible that the redistribution of fringe players may enhance the performance of receiving unions, it is unlikely that these players have the same drawing power of Super players. Super players are those players who are selected to compete at the international level due to their rare talent and superior mental/physical capabilities. These qualities allow them to command viewer interest that ordinary players cannot. Hence, the Commission gave little weight to the Applicant’s argument that the redistribution of fringe players would have a significant impact on audiences.
745. The Commission’s econometric analysis also identified a number of other factors that explain the variation in televised demand for 1st Division NPC matches including:
- household income – a proxy for ability to pay SKY subscription charges (positive effect);
 - prime-time scheduling of broadcasts (positive effect);
 - ‘spectacle’ matches, such as Ranfurly Shield challenges (positive effect);
 - the number of other 1st Division matches broadcast on match day (negative effect); and
 - Sunday broadcasts (negative effect).

¹⁶⁹ Michael Copeland, Brown Copeland (22 May 2006), Submission on “*What Drives Television Demand for NPC Rugby Matches?*”, para.8.

746. The spectator demand model outlined above was adapted for television viewers by making the following assumptions:

- the ‘marginal fee’ for viewing an additional televised match is zero. Since SKY viewers pay a bundled price (i.e., one price that covers all subscribed content, as opposed to paying for content on a pay-per-view basis) it seems reasonable to assume that the monetary cost to subscribers of watching an additional match is zero.¹⁷⁰ Delayed coverage on free-to-air channels, by definition, has a zero monetary marginal price;¹⁷¹
- the initial horizontal intercept of the demand curve equals the historical average number of television viewers of 1st Division matches (on SKY and TV3) over the age of five, per match. This equates to approximately [] viewers per match in 2005;¹⁷²
- the slope of the demand curve is arbitrarily set at – 4,500. The Commission had to make assumptions about the magnitude of the gradient because, unlike in the live spectatorship case considered earlier, there is no per-match price data with which to calibrate the demand function. The sensitivity of estimated benefits to this assumption was analysed by sensitivity testing alternative values. An assumed slope of – 4,500 implies a vertical intercept of \$33.33 (the price at which demand would be forced back to zero if broadcasters charged for matches on a pay-per-view basis);
- as in the spectators’ benefits case, the full effect of the cap is felt at some unspecified time in the distant future, but estimated benefits over years 1 to 5 are spread according to the same time profile: 5% of total benefits in year 1, 10% of total benefits in year 2, 15% of total benefits in year 3, 25% of total benefits in year 4 and 40% of total benefits in year 5; and
- the assumed real discount rate is 6.8%, as before.

747. On the very first assumption, Professor Fort argued in a recent submission that the Commission should consider the possibility of a positive marginal price for viewing when estimating viewers’ benefits.¹⁷³ (A positive marginal price could reflect both a higher monetary price per match as well as any non-pecuniary costs associated with viewing, such as time costs.) But this is simply the same as saying the corresponding demand for matches (assumed to be [] viewers) occurs at a higher point on a new, higher demand curve. Consumers’ surplus—

¹⁷⁰ It is difficult to see how the overall subscription charge paid by viewers could be allocated to individual television programmes, unless particular viewers only watch NPC rugby, which seems unlikely, even for the most enthusiastic of sports fans. Otherwise, it seems reasonable to assume that the marginal fee for additional viewing is zero.

¹⁷¹ At present, Prime Television is the only free-to-air channel in New Zealand that broadcasts NPC matches.

¹⁷² Television viewership data was supplied to the Commission by the Applicant.

¹⁷³ Rodney Fort (28 May 2006), Submission on the Commission’s Alternative Approach to Modelling Quality as a Driver of Television Demand for NPC Matches, paras 8-9.

measured as the area under the new demand curve, and above the marginal price—is the same as the area under the old demand curve at the zero marginal price. Hence, there is nothing to be gained in the modelling exercise by considering a marginal price for viewing greater than zero.

748. In order to provide some guidance on a sensible range for the possible increase in viewer demand, the Commission analysed the effect on expected demand on the assumption that in the long-run (i.e., at final equilibrium when the full effect of the salary cap is eventually felt at some terminal date), the salary cap would force the redistribution of 30% of the Super players from each of the five unions that currently have the *most* Super players in their squads (as at 2006) to the five unions that currently have the *fewest* Super players (as at 2006).¹⁷⁴ This represents a best-case scenario, since redistribution from the strongest to the weakest unions is likely to have the greatest impact on viewership.
749. This possible expansion in demand may occur both through new viewers (i.e., individuals who previously did not watch NPC rugby being induced to do so by the increased quality of matches), or through existing viewers watching more NPC matches. Both Dr. Stroombergen and Mr. Copeland suggested it is important to incorporate this feature in any assessment of viewers' benefits.¹⁷⁵
750. The five unions with the most Super players equate with [] – Canterbury, Wellington, Auckland, Waikato and Otago. The receiving unions are Manawatu, Hawke's Bay, Tasman, Northland and Counties-Manukau, four of whom are new to the PD. The 30% re-allocation is worked out union by union so, for example, one with 10 Super players would lose 3, and another with 20 would lose 6. The transferring players are allocated amongst receiving unions by assuming that each union secures one-fifth of the total number of players that are redistributed.
751. The Commission's econometric analysis predicted that such redistribution would have a net positive effect on demand; demand falls slightly when a 'strong' contest loses a Super player, but increases more than proportionally when a 'weak' contest gains a Super player.¹⁷⁶ The overall increase in demand derives from possible scale economies from redistributing talented players to weaker unions; an additional Super player in a weak contest significantly raises perceived the level of quality of a match, and therefore has a greater marginal

¹⁷⁴ The number of Super players in the NPC 1st Division has remained fairly stable over time. Over the period 1998 to 2004, the standard deviation of the total number of Super players per season is approximately 4 (relative to a mean of approximately 146 players); the coefficient of variation over the same period is just 0.03, indicating very low variance.

¹⁷⁵ Adolph Stroombergen (22 May 2006), op cit, para. 13; Brown Copeland, (22 May 2006), op cit, para. 16.

¹⁷⁶ Commerce Commission (15 May 2006), "*What Drives Television Demand for NPC Rugby Matches?*", pp.12-3.

impact on demand, whereas an additional Super player in a strong contest would have a smaller marginal effect on viewership.

752. The net gain in demand (on average, per match) was estimated by computing the expected post-redistribution change in demand (either increase or reduction) for every possible PD round-robin match (remembering that a 10% increase (reduction) in the total number of Super players involved in a contest would be expected to raise (reduce) match ratings by approximately 0.11 points (the average rating per 1st Division NPC match in 2005 was approximately [] points), and holding all other factors constant), and then averaging over all possible match combinations.
753. The Commission found that a 30% redistribution of Super players in the manner assumed leads to an eventual expected increase in television demand for matches of approximately 8% per match, when the proposed salary cap is fully functioning. This is taken to be the mid-point in the possible range of the ultimate increase in demand.
754. The Applicant generally contends that the redistribution of top players may lead to some transfer of skills to weaker players, via training sessions and in matches. Whilst this may be so, there may also be a dampening effect on demand from ‘excess’ quality. Presumably Super players exert drawing power on viewers because they display some rare talent or skill. If such skills become reasonably common (i.e., as non-Super players lift their respective games, relative to Super players), the novelty factor for viewers may wear off somewhat. There could also be a potentially offsetting loss of skills in the teams from which the players transfer. So, the Commission is cautious in how much weight is given to the ‘skills transfer’ argument. A further margin of 2% is allowed to accommodate this possible effect.
755. The total range for the possible ultimate increase in viewer demand is therefore estimated to be zero (i.e., if no improvement in contest quality occurs) to 18% (i.e., $2 \times 8\% + 2\% \text{ margin} = 18\%$).
756. The next step is to evaluate the net change in viewers’ surplus per match—the difference in surplus gained by increased demand for NPC rugby less the surplus lost by reduced demand for other forms of sporting entertainment—which is done by applying the possible range of demand shifts to equation (1) above. This number is then multiplied by the total number of matches in the new PD—70, including playoff and repechage matches—which gives the total expected (undiscounted) benefits likely to flow from the Proposed Arrangements in a future year with the full impact of the cap. Because this analysis considers the change in *total* consumers’ surplus, the estimated benefits take into account the gain (i.e., increased willingness to pay for match) not only to existing viewers, but also ‘new’ viewers.

757. These benefits are then scaled for each of years 1 to 5 according to the time profile specified above, and discounted back to their present values. The sum of these amounts gives the total benefits expected to accrue to television viewers under the Proposed Arrangements over years 1 to 5. Table 12 below shows these benefits over the full range of demand increases considered by the Commission, and for three different demand curve specifications.

Table 12: Estimated Present Value of Net Public Benefits Resulting from Increased Television Viewership for PD Rugby Union over a Five Year Period

		Assumed Slope of Demand Curve		
		-5,500	-4,500	-3,500
Increase in Viewership (%)	0	\$0	\$0	\$0
	10	\$2,112,661	\$2,582,142	\$3,319,896
	18	\$6,845,023	\$8,366,139	\$10,756,465

758. Given that the estimated benefits to viewers are derived using the spectator demand model presented above, the same caveats discussed in relation to that model apply to the quantified viewer benefits presented in Table 12.
759. The Commission estimates that the net public benefits from greater television viewer interest in rugby union, as a result of the Proposed Arrangements, would be between \$0 to \$10,800,000 over five years (in present value terms).

Increased Funding

760. The Applicant submitted that one of the direct benefits likely to flow from instituting the Proposed Arrangements is an increase in the level of broadcasting and sponsorship revenues to the NZRU and provincial unions. (In the Application, the NZRU also makes mention of merchandising and royalty income, and ground signage revenues, but focuses on the potential growth of (television) broadcasting and sponsorship earnings.) The basic proposition is that a more attractive domestic provincial competition is a more marketable product, from the perspective of broadcasters, and a more effective marketing vehicle for sponsors. Revenue contributions from broadcasting and sponsorship should therefore increase as a result.
761. The NZRU presently contracts directly with broadcasters (News Corp and The Radio Network) on behalf of the individual provincial unions. Broadcasting monies are therefore typically paid directly to the NZRU, and the individual

provincial unions receive contributions via the annual disbursements made by the NZRU.¹⁷⁷

762. Mr. Copeland argued in his submission that, since all television broadcasting revenues derive from the sale of rights to News Limited, a foreign company, any potential reduction of these revenues in the counterfactual would represent a net loss to the New Zealand public, as no other New Zealand entity would receive this income. Instead, News Limited would purchase alternative overseas sports or other entertainment for New Zealand audiences.¹⁷⁸ The Applicant therefore contends that any increase in overseas television broadcasting revenues would represent a public benefit to New Zealand.
763. However, the Commission notes that although broadcasting funding may derive from overseas, and so can be seen as an export-equivalent, it must be remembered that the service being ‘exported’ must be produced, incurring domestic costs. This funding largely underpins New Zealand rugby in the professional era, including player salaries, as well as the cost of other inputs used in the production of matches. As the NZRU and the individual unions are not profit-makers, any additional revenues will, in the end, go into ‘costs’.
764. The Commission’s usual approach in such circumstances is to value any additional exports as extra sales revenue less all the additional costs (including a normal return on capital) incurred in producing the product. However, it may be argued that the overall improvement to the competition would have resulted from the elimination of a detrimental externality, rather than from improved working on the part of players, and crucially it seems likely that players’ opportunity costs won’t have changed. It also seems possible that cost pressures may apply to other inputs into the production of NPC matches, such as support, coaching staff and facilities. However, these increases could be argued to be a by-product of the salary-cap-induced improvements. After considering these various arguments, the Commission concluded that costs are unlikely to increase as a direct result of the salary cap, at least in the short-run.
765. However, as noted in Decision 281 any broadcasting income derived from overseas should be balanced against the outlay by SKY in acquiring the New Zealand rights when estimating public benefit. John Fellet (CEO, SKY) advised the Commission that SKY pays an annual programming charge of approximately US\$[] to US\$[] to News Corp to acquire all rugby-related broadcasting rights. According to Mr. Fellet approximately []% of the programming charge, NZ\$[], relates to NPC content.¹⁷⁹ These costs

¹⁷⁷ The exception to this is when some individual provincial unions sell broadcasting rights to local radio stations. In such cases, all broadcasting revenues are paid directly to the contracted provincial union. The Commission understands that this is a rare occurrence, and in any case, the sums of money involved are likely to be relatively small.

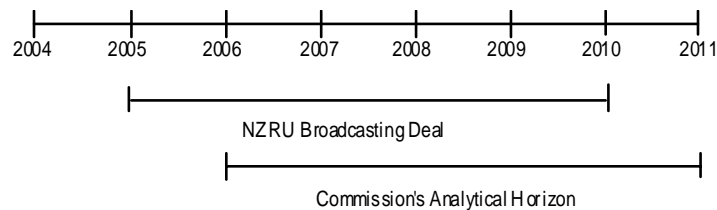
¹⁷⁸ The Application, Schedule J: Brown Copeland Report, para 51.

¹⁷⁹ This currency conversion was performed using an exchange rate of NZ\$1 = US\$0.69, which is the same exchange rate assumed by the NZRU in its Application when estimating the value of its annual SANZAR

need to be netted off the NZRU's television broadcasting revenues when calculating net public benefits, as such payments would reflect transfers of funds to an overseas entity.

766. The NZRU submitted that total television broadcasting revenues (in 2005 dollar terms) amount to approximately [] per annum (taking into account revenue-sharing arrangements with SANZAR). These revenues flow from a five year broadcasting contract with News Corp and South Africa's Supersport International (Pty) Ltd, which expires in December 2009.
767. The Applicant suggests that it would, in future contracting rounds, have the ability to negotiate a more favourable broadcasting deal on the basis of a more attractive PD competition. On this basis, the NZRU assumes that the broadcasting revenues mentioned above could rise by between 10 to 20% per annum. By virtue of the recently settled broadcasting contract, the NZRU cannot expect any annual increases in these revenues until at least the beginning of 2010. As noted earlier, the Commission has, for the purposes of the present Application, assessed benefits and detriments over a five year horizon. Hence, any potential broadcasting revenue increases would only be captured in the final year of the Commission's analysis (i.e., 2010 to 2011). The preceding discussion is set out diagrammatically in Figure 6.

Figure 6: NZRU's Broadcasting Contract and Commission's Analytical Horizon



768. The expected increase in broadcasting revenues in 2010, net of expected programming charges, is estimated to be \$26,377. The benefits scaling factor for the fifth year (i.e., 40% of the benefits ultimately anticipated to arise) is then applied to this amount to calculate the expected benefits in Table 13.
769. Another claim made by the Applicant is that a more attractive PD competition will attract more sponsorship, and that this would produce public benefits. However, an important question to ask when assessing this claim is to what extent would additional sponsorship actually be socially optimal? From the private point of view of sponsors, it may be argued that since these firms willingly allocate spending towards sponsorship of sport, and given that these firms are likely to be rational profit-maximisers, sponsorship must be a profit-enhancing activity from their perspective. In his submission, Mr. Copeland

seems to infer that this private benefit equates with a social benefit.¹⁸⁰ Presumably, this could occur if sponsorship were a cost-effective means of firms achieving socially desirable outcomes, such as by informing consumers more effectively.

770. However, the welfare effects for consumers are less clear cut. Ultimately, firms aim to alter the tastes and preferences of consumers in favour of their products and services through advertising and sponsorship. Any such altered consumption behaviour could be either efficient or inefficient from a welfare point of view; on the one hand, consumers switching to new products and services as a result of greater exposure to advertising could genuinely increase their overall utility of spending (and/or incur lower search costs), yet on the other, overall utility may be unchanged or even diminished as a result (at least in the short-run, until consumers recognise the fact and alter their purchasing habits accordingly). At the same time, other firms, some perhaps with superior products, might lose sales. Moreover, some economists have argued that advertising expenditure, when carried to excess, can be socially harmful as it can distort otherwise optimal consumption behaviour.¹⁸¹ Hence, the impact on consumers' surplus of increased sponsorship to the provincial unions is virtually impossible to judge.
771. From the perspective of the provincial unions, additional sponsorship revenues is a gain as this income can be fed into development activities, match and training facilities, coaching and medical services, etc. There may be some flow-on benefits to demanders of NPC rugby as a result.
772. Another important consideration is that any increase in sponsorship expenditure means a diversion of funding from other recipients, such as other sports or the arts. This effect needs to be factored in when assessing the overall gain from any potential increase in sponsorship funding.
773. Standing back and looking at sponsorship in the round, the Commission is sceptical that any increase in sponsorship revenues to the provincial unions is likely to lead to more than a small overall welfare gain to society. Consequently, the Commission has assumed arbitrarily that only 10% of any increase in sponsorship revenues as a result of implementing the Proposed Arrangements can be counted as a benefit to the public of New Zealand.
774. Another important consideration is that any increase in sponsorship expenditure means a diversion of funding from other recipients, such as other sports or the

¹⁸⁰ The Application, Schedule J: Brown Copeland Report, para 52.

¹⁸¹ See, for example, Telser, L. G., (1962), "Advertising and Cigarettes", *Journal of Political Economy*, 70(5), pp. 471-99; Dixit, A., Norman, V., (1978), "Advertising and Welfare", *Bell Journal of Economics*, 9(1), pp. 1-17; Netter, J. M., (1982), "Excessive Advertising: An Empirical Analysis", *Journal of Industrial Organization*, 30(4), pp. 361-73; or Becker, G. S., Murphy, K. M., (1993), "A Simple Theory of Advertising as a Good or Bad", *Quarterly Journal of Economics*, 108(4), pp. 941-64.

arts. This effect needs to be factored in when assessing the overall gain from any potential increase in sponsorship funding.

775. Mr. Copeland concedes that it is difficult to assess the extent to which the Proposed Arrangements would enhance, or at least stabilise or avoid a reduction in, the current level of domestic provincial competition broadcasting and sponsorship. However, he estimates that, assuming that the Proposed Arrangements were to lead to the retention or enhancement of 10 to 20% of this income, the public benefits would be in the range \$406,000 to \$810,000 per annum. This calculation also assumes that 100% of the expected increase in television broadcasting revenues, and 10% of the increase in expected sponsorship revenues, represent a gain to the public of New Zealand.¹⁸²
776. Mr. Copeland's submission also provided actual 2004 revenues (i.e., merchandising and royalties; NPC round robin match income; NPC round robin ground signage revenues; cash and in-kind sponsorship) for the ten teams currently competing in the NPC 1st Division.
777. Adjusting these amounts to 2005-equivalent dollar values (i.e., scaling up for inflation at the rate of 3% per annum) provides the following totals:
- merchandising and royalties, \$[];
 - signage and advertising revenues, \$[]; and
 - sponsorship (cash and in-kind), \$[].¹⁸³
778. In its Draft Determination the Commission ignored any impact on gate revenues on the basis of a preliminary assessment that any such gains would have already been captured in the evaluation of public benefits arising from increased spectator demand. Mr. Copeland argued in submissions that the evaluation of spectator benefits only captured gains to consumers' surplus (i.e., the increase in benefits to consumers over and above the price they pay for tickets); it does not capture the effect on the surplus to producers of NPC matches.
779. However, Mr. Copeland's submission did not consider the impact on the surplus faced by other suppliers into the sports entertainment market. In assessing public benefits, the Commission needs to consider the *net* impact on producers' surplus.
780. From Figure 5, it is clear that any surplus gained by provincial unions from an expansion in demand for NPC matches would be balanced by the surplus lost by producers of other sports entertainment, assuming the two marginal costs are

¹⁸² The remaining 90% of sponsorship revenue gains are assumed to be private gains that represent a transfer from one sector of the New Zealand economy to the NZRU, and therefore ought not to be counted as a public benefit.

¹⁸³ 'Sponsorship' includes all major and minor team cash sponsorship, and major and minor team in-kind sponsorship, but excludes Air New Zealand in-kind travel sponsorship.

equivalent (and the ‘market price’ equals marginal cost). In practice, it seems highly unlikely that marginal costs would be equivalent across all producers in the sports entertainment market, but it is unclear in which direction marginal costs would vary.

781. It can be inferred from Figure 5 that if the marginal costs to suppliers of NPC rugby union matches exceeds the marginal costs faced by all other suppliers to the sports entertainment market, any increase in demand for NPC matches would result in a net gain in surplus. In this circumstance it would be appropriate to make some allowance for increases in producers’ surplus as Mr. Copeland suggests. However, the opposite is true if the marginal cost of other producers exceeds the marginal costs faced by suppliers of NPC matches – any increase in demand for NPC matches would result in a net reduction producers’ surplus.
782. In practice, it is very difficult to observe producers’ marginal costs, and therefore, the likely impact on overall producers’ surplus is ambiguous. However, it seems plausible that some suppliers into the sports entertainment market would face gains in surplus and others would face losses. In the absence of clear evidence to indicate to net outcome, the Commission considers that it reasonable to assume that net effect is neutral (i.e., that the gains and losses cancel out), and therefore, there is no need to make allowance for changes in producers’ surplus in this case.
783. In addition, the NZRU submitted that total sponsorship revenues directly attributable to the domestic provincial competition, accruing to the NZRU, amount to approximately \$[] per annum.
784. Summing across all these income streams (both NZRU and provincial union) provides a total revenue figure (in 2005-dollar terms, and excluding annual broadcasting income) of \$[]. This total is taken to be the base year value, upon which any future increases (under the factual) would be counted.
785. The Applicant argued that since provincial unions’ costs are relatively fixed across moderate changes in merchandise sales, match income, signage, and sponsorship, any extra revenues would be mostly additional profit. However, in discussions with the Commission, the Applicant advised that so-called “sponsorship servicing costs” (i.e., expenses incurred in the course of discharging responsibilities to sponsors) do tend to increase as sponsorship revenues increase (i.e., as sponsorship deals become larger, the associated duties also increase). This suggests that it would be inappropriate to treat all incremental sponsorship revenues as pure profit.
786. A simple correlation analysis to investigate the relationship between sponsorship and sponsorship servicing costs revealed that a []% increase in sponsorship would be expected to result in a []% increase in sponsorship

servicing costs.¹⁸⁴ 2005-equivalent provincial union sponsorship servicing costs (found by adjusting the 2004 GARAP total for inflation at a rate of 3% per annum) totalled \$[]. No NZRU-specific sponsorship servicing cost data was made available to the Commission.

787. In response to the Draft Determination, Mr. Copeland disputed that such a relationship between sponsorship servicing costs and sponsorship revenues exists (at least across the range of a 0 to 20% movement in sponsorship revenues). In particular, Mr. Copeland contends that "... a significant drop in income from any source could not be mitigated to any significant extent by corresponding reductions in the costs associated with earning that income".¹⁸⁵ In several other places in his submission Mr. Copeland discusses the difficulty faced by provincial unions in lowering sponsorship servicing costs in response to a reduction in sponsorship revenues. However, nowhere did he address the Commission's assessment that sponsorship servicing costs may *rise* along with sponsorship revenues.
788. Mr. Copeland seems to assume that, by symmetry, if a reduction in sponsorship revenues cannot accompany a reduction in sponsorship servicing costs, then it must be true that an increase in sponsorship revenues would not be followed by an increase in sponsorship servicing costs. There is no reason that this should be true; sponsors may be reluctant to scale back their expectations of unions when in the event they reduce sponsorship support, but, intuitively, it seems likely that sponsors would seek to impose greater obligations on the NZRU and provincial unions in exchange for greater funding. As noted earlier, the data provided by the NZRU indicates that a relationship between revenues and costs does exist.¹⁸⁶ The Commission therefore considers that it is reasonable to adjust rising sponsorship revenues for increases in sponsorship servicing costs.
789. In quantifying the claimed public benefits, Mr. Copeland assumed that the Proposed Arrangements would lead to an increase in NZRU and provincial union revenues (in relation to the PD) competition, of between 10 to 20% per annum. However, the Commission is of the view that a minimum 10% increase in annual revenues is too optimistic, given the likely weak link between the Proposed Arrangements and a more attractive PD competition.

¹⁸⁴ The correlation analysis was performed by regressing individual union sponsorship servicing costs against individual union sponsorship. Annual cost and revenue data was drawn from the NZRU's GARAP information (which covers the years 2001 to 2004), across all unions in all Divisions. The regression model was specified in log-linear form. The estimated correlation coefficient, 1.080984, was found to be statistically significant even at the 1% level (t statistic = 10.85; p-value = 0.000). The regression R² was 0.6045; 79 observations were included in the sample.

¹⁸⁵ NZRU/CC Questions 1 and 2 re: Variable Cost Savings, Brown Copeland, para. 6.

¹⁸⁶ In submissions, Mr. Copeland raised concerns about the reliability of the data used to econometrically assess the relationship between sponsorship revenues and sponsorship servicing costs (i.e., the consistency in approach across different unions in categorising revenues and costs). Yet, Mr. Copeland relies on the very same data to inform his own estimate of public benefits.

790. In the Draft Determination the Commission assumed a zero to 10% annual increase in revenues, and applied a relatively high nominal discount rate (20%) when calculating the expected present value of benefits in recognition of the likelihood that benefits arising under the factual will flow only gradually over time. In submissions on the Draft Determination, Mr. Copeland considered that a more appropriate approach would be to utilise a build-up profile for benefits, and a lower nominal discount rate of 10%, in order to be consistent with the approach used when estimating benefits to spectators and television viewers. He suggested that a suitable build-up profile might be 10% in year one, 25% in year two, 50% in year three, 80% in year four and 100% in year 5.
791. The Commission accepted Mr. Copeland's suggestion of applying a build-up profile for benefits, without accepting the specific profile he proposed. In line with its approach taken to assess spectator and television viewer benefits, the Commission assumed that a fully effective cap (achieved at an unspecified terminal date in the distant future) would generate a maximum increase in NZRU and provincial union revenues of 20%. Public benefits in years one to five were estimated by assuming the following build-up profile:
- 5% of the terminal date gains realised in year one;
 - 10% of the terminal date gains realised in year two;
 - 15% of the terminal date gains realised in year three;
 - 25% of the terminal date gains realised in year four; and
 - 40% of the terminal date gains realised in year five.
792. The present value of the expected public benefits were estimated by making the following additional assumptions:
- a real discount rate of 6.8%;
 - 10% of the total expected annual increase in domestic revenues represent true gains to the New Zealand public (as opposed to transfers of wealth), as assumed by the Applicant; and
 - the programming charges faced by SKY rise proportionally with increases in broadcasting revenues derived from abroad (NZRU broadcasting).
793. Table 13 presents the results of the quantification exercise for the expected upper-end of the benefits range (i.e., assuming a revenue growth rate of 20% per annum by the terminal date).

Table 13: Estimated Net Public Benefit Arising from Increased PD Revenues over a Five Year Period

Year	Net Domestic PD Revenues	Annual Increase in Revenues	Net Annual Increase in Broadcasting Revs.	Realised Public Benefit	Present Value
0	\$14,379,683				
1	\$17,197,203	\$2,817,520	\$0	\$14,088	\$13,191
2	\$20,565,375	\$3,368,172	\$0	\$33,682	\$29,531
3	\$24,591,501	\$4,026,127	\$0	\$60,392	\$49,581
4	\$29,403,725	\$4,812,224	\$0	\$120,306	\$92,483
5	\$35,155,056	\$5,751,331	\$26,377	\$240,604	\$173,191
Net Present Value					\$357,978

Notes: Net Provincial PD-related Revenues for each year were estimated by subtracting from total expected revenues expected sponsorship servicing costs; hence, net revenues in year 0 equal []. It was assumed that 10% of the total expected increases in domestic revenues represent true gains to the New Zealand public, and that a 1% increase in sponsorship revenues would lead to a 1.1% increase in sponsorship servicing costs. Present values were calculated using a real discount rate of 6.8% per annum. Realised public benefits were estimated using a benefits build-up profile of 5%, 10%, 15%, 25% and 40% of the terminal date benefits in years 1, 2, 3, 4 and 5, respectively.

794. In summary, the Applicant has suggested that the Proposed Arrangements would lead to a more balanced, and therefore, a more attractive PD competition. The Applicant further contends that a more appealing competition would attract higher revenues, and a proportion of these increases would represent an overall welfare gain.

795. The Commission concludes that the net public benefits (in present value terms) attributable to increased funding to the NZRU and PD provincial unions under the factual would be between \$0 and \$360,000 over five years.

Assessment of Indirect Benefits

796. The Applicant argued that the Proposed Arrangements would lead to the improved performance of New Zealand's international teams (e.g., the Super 14 teams and the All Blacks), since a more competitive PD will result in the enhancement of player skills and the eventual inward migration of overseas talent (or the retaining of domestic talent). The NZRU argues that this would produce a number of indirect benefits.

797. First, there would be greater enjoyment for New Zealand audiences watching international matches featuring New Zealand teams. While the Commission accepts that an increase in the present level of enjoyment attributable to better performances by international New Zealand squads would count as a public benefit, it nevertheless considers (as discussed earlier) that the link between the Proposed Arrangements and those teams is likely to be weak, and therefore, the benefits that might flow as a result are likely to be very small.
798. Second, enhanced performances by New Zealand international teams would allow the NZRU greater leverage when negotiating international television rights, sponsorship, and revenue sharing arrangements. Once again, the Commission agrees that this would represent a public benefit, to the extent that these revenue flows derive from foreign sources, and after netting off any additional costs incurred. However, this bargaining advantage is only relevant insofar as improved international performances are related to the introduction of the Proposed Arrangements. As discussed earlier, the Commission considers that this nexus is a weak one for these indirect benefits, and therefore, that the resulting benefits are likely to be relatively minor.
799. Third, some marketing expenditures by New Zealand companies, which would otherwise be channelled overseas, are likely to be diverted to domestic sponsorship (especially the All Blacks and Super 14 teams). Whilst it may be true that some New Zealand firms do draw on the success of New Zealand international rugby teams to market themselves, the number of such firms is likely to be relatively small in the overall scheme. Furthermore, it is unclear that these companies would not divert their sponsorship monies to other successful New Zealand entities, thereby preventing a transfer of these funds overseas. Also, this benefit claimed by the Applicant rests on there being a reasonably strong link between the Proposed Arrangements and the performance of New Zealand international rugby teams. However, the Commission is of the view that this link is likely to be quite weak.
800. Fourth, New Zealand companies may improve their trading opportunities through an “association with success” factor. In particular, it is claimed that the All Blacks and Super Rugby teams raise New Zealand’s profile overseas, thereby aiding New Zealand exporters. If these benefits arise through the direct marketing of All Black or Super 14 franchise brands, then the royalties paid by these firms to the NZRU must also be accounted for when assessing the size of the claimed benefits; doing so would probably offset any benefits from this source to a large extent. It is possible that some firms may enjoy indirect gains through association (i.e., the fact they originate from New Zealand). Although the Commission cannot rule out this possibility, it seems likely that any such spin-offs would be minor in the overall scheme, and only weakly linked to the implementation of the Proposed Arrangements.
801. Fifth, implementation of the Proposed Arrangements is likely to benefit the New Zealand tourism industry through an increase in overseas visitors, both on

rugby and non-rugby tours. The NZRU cites the case of the recent (2005) British and Irish Lions tour of New Zealand, which is reported to have attracted over 20,000 foreign tourists, and generated a total GDP impact of NZ\$135.2 million, in support of its claim. The potential economic benefits include an increased inflow of foreign exchange receipts, and greater tax revenues for the government. The Applicant did not, however, attempt to quantify the expected impact of improved performances of New Zealand international teams on tourism, nor to net off the additional costs incurred in servicing additional tourist numbers.

802. The Commission accepts that earnings from tourist inflows (net of any costs associated with catering for these tourists) could be categorised as a public benefit. However, it concludes that any benefits from this source are likely to be relatively small given the weak and indirect linkage between the Proposed Arrangements and tourism flows.
803. Finally, the Applicant argues that stronger performances by New Zealand international squads will lead to a general “feel-good” factor. While this may be so, the Commission is disinclined to place any real weight on this claimed benefit, given its tenuous nature, and the seeming weak and indirect linkage with the Proposed Arrangements.
804. Overall, the Commission is of the view that the expected indirect benefits likely to flow from the implementation of the Proposed Arrangements would be small.

Conclusion on Benefits

805. The Commission’s assessment is that the following benefits are likely to flow as a result of the Proposed Arrangements, measured over five years and expressed in present value terms is summarised in Table 14.

Table 14: Aggregation of Benefits Estimates

Arrangement	Type of Benefit	Estimated Size
Proposed Arrangements	Direct Benefits	
	Spectator’ Benefits	\$0 to \$1,100,000
	Television Viewers’ Benefits	\$0 to \$10,800,000
	Increased PD Revenues	\$0 to \$360,000
	Indirect Benefits	Small
	Total (rounded)	\$0 to \$12,260,000

BALANCING

806. The determination of the Application involves the Commission considering and balancing the benefits to the public that will in the circumstances result, or would be likely to result, against the lessening in competition that would result or be likely to result or is deemed to result. Only where, on the balance of probabilities, the detriments from the lessening in competition are clearly outweighed by public benefits, so there is a net public benefit, would the Commission be able to be satisfied that the Application should be authorised.
807. The available evidence and analysis on the basis of which the Commission may be satisfied that authorisation should be granted includes quantitative data and analysis. The Court of Appeal has previously referred to "the desirability of quantifying benefits and detriments where and to the extent it is feasible to do so".¹⁸⁷ Such analysis is desirable rather than indispensable, and extensive analysis may not be feasible in every case. Quantitative analysis, to the extent it is feasible, can serve to inform the Commission's deliberations, and to assist it in the exercise of its judgement, as to whether authorisation should be granted.¹⁸⁸
808. In its *Air New Zealand/Qantas* Decision, the Commission said this of modelling:¹⁸⁹

With respect to the use of models, the Commission considers that these are useful to the degree that they focus the parties' attentions on key assumptions regarding characteristics of the market. The Commission's view is that the value of a model is in its ability not . . . to supplant the Commission's exercise of judgement, but rather in providing support to the Commission's deliberations by:

- focusing parties' attention on verifiable economic arguments;
- making transparent the values of the key parameters and assumptions in the analysis; and
- producing quantitative estimates of the results of a given transaction or arrangement.

809. The identification and quantification of the benefits and detriments likely to result from the implementation of arrangements consistent with the proposed Proposed Arrangements as compared to the counterfactual, has been previously discussed extensively. A summary of the benefits and detriments from implementation of the Salary Cap Arrangement and the Player Movement Regulations is given in Table 15. These aggregate benefit and detriment figures have been estimated over a five year period ahead, and then have been discounted to their present values, as described earlier. Foremost amongst the detriments are the costs of implementing, monitoring and enforcing the salary

¹⁸⁷ *Telecom v Commerce Commission* (1992) 3 NZLR 429 (CA) at 447, per Richardson J.

¹⁸⁸ *Commerce Commission, Decision 511* at {909}, quoted in *Air New Zealand v Commerce Commission (No 3)* (unrep, HC Auckland, Rodney Hansen J, 20 May 2004, CIV 2003-404-6590 para 5.)

¹⁸⁹ *Commerce Commission, Air New Zealand/Qantas*, 23 October 2003, para 909, pp. 206-07.

cap, together with the loss of player talent overseas. The principal benefit is the greater enjoyment of television viewers from watching higher quality games. Although the Commission recognises that benefits and detriments may extend beyond a five year period, it considers that this further period is too distant, and the possible outcomes are too uncertain, to allow reasonable projections to be made. It could be that this might lead to an understatement of net benefits.

810. A qualitative assessment of other elements of detriments and benefits not capable of quantification, with some assessment of their relative magnitudes, has also been included in Table 15. However, the impact of both categories is considered to be small, and hence the two are largely off-setting.

Table 15: Balancing of Benefits and Detriments

Benefit/Detriment	Estimated Size (rounded)
Overall Quantified Detriments	\$3,200,000 to \$4,500,000
Overall Quantified Benefits	\$0 to \$12,300,000
Overall Unquantified Detriments	Small*
Overall Unquantified Benefits	Small*
Net Public Benefit/(Detriment)	\$(4,500,000) to \$9,100,000

* Relative to the sizes of the quantified detriments and benefits.

811. Overall, the Commission's findings on quantified and non-quantified benefits and detriments shows that the Proposed Arrangements would be likely to have an impact within a range from a net public detriment of around \$4.5 million, to a net public benefit of about \$9.1 million. This establishes the range within which the actual outcome is likely to fall.

Balancing Public Benefits Resulting from the Proposed Arrangements

812. The quantification of benefits and detriments is a process designed to inform the Commission about the possible magnitudes of the various elements, and hence to assist the Commission in the balancing of the public benefits against the detriments. In this case the ranges of benefits and detriments are such as to give rise to the possibility that the Proposed Arrangements could result in either a net benefit or a net detriment, as shown in Table 15. The determination whether to grant an authorisation involves the exercise of the Commission's judgement as to where in the range the outcome is likely to be. The Commission's decision is a finely balanced one. In exercising its judgement, it has taken into account all of the available evidence and analysis put before it, and outlined and discussed above. On this basis, the Commission is satisfied that the midpoint of the range of the likely net public benefit is appropriate. This indicates a net public benefit of the order of \$2.3 million.

CONCLUSION

813. In arriving at its conclusion, the Commission has assessed the extent of the impact of the Proposed Arrangements on competition in the relevant markets, and considered the benefits and detriments described above, on the basis of both a quantitative and qualitative assessment. In addition, the Commission has had regard to the cumulative effect of all relevant considerations, in order to ensure that it has, in all the circumstances, properly taken account of the matters set out in s 61(6) of the Act.
814. The Commission concludes, on the balance of probabilities that the Salary Cap Arrangement and the Player Movement Regulations, which together comprise the Proposed Arrangements, would each result or be likely to result in a lessening of competition, or would be deemed to result in a lessening of competition, in respect of the premier player services market.
815. Countering this lessening of competition, the Commission acknowledges that the Proposed Arrangements have the potential to deliver the benefits outlined in this Determination. However, the Commission shall not make a determination granting an authorisation unless it is satisfied in all the circumstances that the Salary Cap Arrangement and the Player Movement Regulations would result, or be likely to result, in a benefit to the public that would outweigh the lessening in competition that would result or be likely to result or is deemed to result. The Commission considers that, in the present situation, limiting the period of authorisation and imposing certain conditions is likely to increase the probability that the potential benefits will eventuate, such that the Commission can then be satisfied that it is appropriate to authorise the Proposed Arrangements.
816. The imposition of conditions and limiting the period of authorisation are discussed separately below.

CONDITIONS

Introduction

817. Section 61(2) of the Act states:

“Any authorisation granted pursuant to section 58 of this Act may be granted subject to such conditions not inconsistent with this Act and for such period as the Commission thinks fit.”

818. In the Draft Determination the Commission signalled that it was considering whether, if it chose to authorise the Proposed Arrangements, it might impose conditions on the authorisation which would address concerns about the uncertainty of the assessment of the benefits of implementing the Salary Cap Framework. The Commission sought submissions from the parties on suitable

conditions to provide sufficient certainty that the cap would be hard, and as to the scope of the exclusions and other exceptions in the Salary Cap Framework.

819. On 19 May 2006, the Commission also wrote to interested parties outlining a further condition the Commission was considering, namely requiring the NZRU to commission an independent review on the operation of the salary cap and Player Transfer Regulations to be completed by the fourth anniversary of the date of the granting of any authorisation, together with a proposal to grant an authorisation for a limited period of time. The Commission sought comment from the NZRU and interested parties.
820. The Commission received a submission from the NZRU on the conditions contained in the Draft Determination, and a response to the specifications contained in the Commission's letter of 19 May 2006. The Commission has taken these into account in this Determination.
821. In considering whether it is satisfied that the benefits of the Proposed Arrangements as they stand outweigh the lessening of competition likely to result from the Arrangements, the Commission has identified three areas where it remains concerned that potential benefits could be placed at risk. The areas for concern are that:
- the Salary Cap Arrangement creates incentives for Provincial Unions to evade or avoid the cap;
 - draft Salary Cap Regulations are intended to include certain financial and non-financial benefits whilst excluding certain other financial and non-financial benefits, but these have not yet been finalised or agreed; and
 - the proposed Salary Cap Arrangement creates a new and untested regime for which quantification of benefits is difficult to assess.

Conditions

Condition One – Compliance and Monitoring

822. The Commission remains concerned that the Proposed Arrangements create incentives for Provincial Unions to evade and/or avoid the salary cap. Notably, the RPC submitted that there may be scope for wealthy unions to increase legitimate payments to players outside the cap, or to use non-pecuniary benefits (e.g., better coaches, medical specialists and facilities) to undermine the cap. As discussed in the Draft Determination, even well-established salary caps seem difficult to manage and monitor, as indicated by the recent experience in Australia with NRL salary cap breaches.
823. The Commission remains of the view that if the audit, monitoring and compliance mechanisms contained in the final form of salary cap regulations

were not effective, the intended benefits of the Proposed Arrangements might not be realised.

824. The NZRU has advised that it continues to negotiate the final form of the salary cap regulations, and that currently they are not in final form. The Commission accepts that the intention of the NZRU is to provide for audit, monitoring and compliance mechanisms within the salary cap regulations. However, in order for the anticipated benefits from the Salary Cap Arrangement to flow, it is imperative that the NZRU ensures its salary cap regulations provide for the effective audit, monitoring and compliance of the salary cap.
825. As with the other conditions discussed below, the first condition adopted by the Commission is expressed in general terms. The Commission is not pre-determining the matters that should be covered by the salary cap regulations. It remains for the NZRU and the parties with whom it contracts to determine the wording of the salary cap regulations to ensure that they give effect to this condition, and for the NZRU to determine the appropriate processes to be used.
826. The Commission will impose the following condition to address this concern:

The NZRU shall implement and give effect to regulations that provide for the effective audit, monitoring and enforcement of compliance with the Salary Cap Arrangement.

Conditions Two, Three and Four – Scope of Inclusions, Exclusions and Exceptions

827. The Commission considers that certainty as to exactly what is included and, equally, the scope of all exclusions and other exceptions in the Salary Cap Arrangement, is necessary, as otherwise the potential benefits of the Proposed Arrangements could be placed at risk. The Commission considers that unless there is clarity about how to determine whether a particular form of remuneration or benefit is to be included or excluded from the salary cap, there will remain opportunities for Provincial Unions to defeat it.
828. The Salary Cap Arrangement sets out the fundamental parameters of the salary cap to be reflected in the salary cap regulations. The Commission has reviewed draft salary cap regulations, but notes that they are still in a relatively unfinished draft state, and that various terms remain undefined. Therefore, it is not possible for the Commission to review and authorise the particular regulations, nor has this been sought. In light of this, the Commission sought confirmation from the NZRU that all the key elements of the proposed salary cap are included in Clauses 53 to 59 of the CEA.
829. The NZRU has confirmed that, subject to the inclusion of team quarter final bonuses, all elements of the salary cap are covered in clauses 53 to 59 of the CEA. Quarter finals bonuses were incorporated as one of the finals bonuses particularised in the Table provided at paragraph 2.3 of the Application as excluded revenue, and a maximum amount is specified for the quarter finals

matches (\$15,000 for an away quarter final match and \$20,000 for a home quarter final match). Clause 46.8 of the CEA, which sets out the team finals bonuses, does not include quarter finals bonuses.

830. The Commission will impose the following three conditions to address these concerns:

Except as expressly provided for in clauses 54.2 and 54.3 of the CEA, and including the provision for team quarter final bonuses, all remuneration or other financial or non-financial benefits that are received by or on behalf of or paid for a player for or in connection with the provision of playing services to a Provincial Union, irrespective of the source of the remuneration or other financial or non-financial benefit, is included for the purposes of determining compliance with the salary cap for that Provincial Union.

Except as expressly provided for in clauses 54.2 and 54.3 of the CEA, and including the provision for team quarter final bonuses, remuneration or other financial or non-financial benefits received by a player that are unrelated to the provision of playing services to a Provincial Union are excluded for the purposes of determining compliance with the salary cap for that Provincial Union. In this regard, the onus shall be on the Provincial Union to demonstrate that such other remuneration or other financial or non-financial benefit is unrelated to the provision of playing services.

All non-financial benefits shall be accorded a financial value that reflects the fair market value of the non-financial benefit.

Condition Five – Review of Regime

831. The Commission recognises that the Proposed Arrangements are intended to:
- ensure that New Zealand rugby lives within its means and is financially stable; and
 - create more competitive domestic rugby competitions thereby, among other things contributing to more attractive games, greater revenues, increased performance of New Zealand representative teams and better cost management within New Zealand rugby.
832. The Commission has identified some uncertainty around the quantification of the public benefits. The Commission also recognises that the Proposed Arrangements are new and therefore untested in practice. There is a risk that the anticipated benefits (which the NZRU identified) of attracting more television viewers, and providing them with greater enjoyment due to a greater spread of quality players throughout the premier division teams, may not materialise as anticipated following implementation. Further to this, there may be unanticipated negative effects resulting from the implementation of the Proposed

Arrangements, and/or the identified detriments may be of a magnitude greater than anticipated.

833. The NZRU itself noted that it had an interest in ensuring that the cap was effective, and therefore that it would be consistently monitoring whether or not the cap is delivering the benefits that have been identified. The Commission considers that, while the NZRU may have an incentive to monitor this itself, the Commission considers that it is not appropriate to allow an open-ended authorisation where the Applicant acknowledges concerns as to the long-term benefit of the Salary Cap Arrangement.
834. The Commission considers that the risk that anticipated benefits from the Salary Cap Arrangement do not outweigh the identified detriments is likely to be ameliorated if the effectiveness of the regime is subject to a review aimed at identifying any deficiencies. The Commission recognises that renewal of contractual arrangements between the NZRU and players within the framework of a newly introduced salary cap may be slow to have an effect, and short-term reviews may not always identify long-term effects. The Commission considers that any review within the three year period of the current CEA may not allow adequate time for the processes to have had an effect. Extending that review period so that it may be considered by the NZRU (and may be taken into account by the Commission in the event of any subsequent Application for authorisation of the Proposed Arrangements) prior to the expiry of an anticipated additional three year period for a renewed CEA, appears to be an appropriate balancing of these respective considerations.
835. In addition, the Commission considers that it is appropriate for any review to be conducted with some proximity to the expiry of the authorisation and the renewal of a subsequent CEA (assuming, as the NZRU did in its submission on this point, a further three year CEA). This would enable the NZRU to assess whether the anticipated benefits of the Proposed Arrangements had materialised, and to make any amendments or proposals for further authorisations that are considered appropriate in the context of that additional information. While the Commission initially considered that a review after five years would be desirable, and would be likely to be able to identify any deficiencies and assess any positive effects, it has taken into account the NZRU submissions that any authorisation process would commence approximately 18 months prior to the expiry of the CEA.
836. In the event that the NZRU does seek authorisation of a further salary cap from the expiration of the current authorisation, this review could be one of the sources of information and evidence that the Commission may have regard to in considering that Application. For that reason, the Commission considers it is important that the review be genuinely independent and that it be undertaken by a person or body with the relevant expertise.

837. The Commission expects that any review would rigorously consider the available evidence over the first five years of the operation of the Proposed Arrangements, and would consider in particular:
- whether the Salary Cap Arrangement has operated as expected;
 - whether there is evidence of non-compliance with the salary cap and evidence as to compliance costs;
 - whether the Salary Cap Arrangement has had the anticipated effects, including:
 - better cost management within New Zealand rugby;
 - constraining payments to players made by wealthier Provincial Unions;
 - facilitating the more even spread of talented and skilled players across the Provincial Unions; and
 - creating a more competitive domestic competition;
 - whether the anticipated effects have resulted in the anticipated benefits; and
 - whether the assumptions on which the salary cap are based are supported by the evidence.
838. In considering whether the salary cap has resulted in the anticipated benefits, the Commission would expect the reviewer to consider whether there is evidence that the salary cap had:
- contributed to more attractive games;
 - increased crowd attendance and viewership of games;
 - increased revenues; and
 - improved performance of New Zealand Super Rugby and All Black teams.
839. In addition, the Commission considers the reviewer should also consider what costs or other detriments may have arisen in relation to the Salary Cap Arrangement, including for example:
- the costs of monitoring and compliance by the NZRU and the Provincial Unions;
 - loss of player talent;
 - reduction in player skill levels;
 - circumvention or weakening of the Salary Cap Arrangement.

840. For the review to be effective the Commission considers that it will be necessary that the NZRU fully cooperates with the review, including providing all information and other material assistance requested by the independent reviewer, and procuring the cooperation of the Provincial Unions and the RPC in such a review.
841. The points outlined in the previous seven paragraphs provide an indication of the broad considerations that the Commission anticipates should be addressed in a review of the effectiveness of the Proposed Arrangements. It is acknowledged, however, that it is difficult to identify how the effectiveness of the Proposed Arrangements might be tested at a future date, particularly when the counterfactual at that future date is difficult to define. The Commission specifically notes that the terms of reference for any review that the NZRU later undertakes, and the selection of an appropriate reviewer, is at the discretion of the NZRU. In the event that the Commission is later required to consider an Application from the NZRU for authorisation, and that Application presents the findings of this review, the Commission will, as always, independently assess the evidence put before it by the applicant.
842. The Commission will impose the following condition to address this concern:

The NZRU shall commission and meet the costs of an independent review on the operation of the salary cap and Player Transfer Regulations to be commenced not before the fourth anniversary of the date of the granting of the authorisation and to be completed at least six months prior to the expiry of the authorisation.

Limited Period of Authorisation

843. The Commission considers that the uncertainty over important elements of the Proposed Arrangements increases the risk that net benefits may not eventuate. Similarly, the nature of indirect benefits, such as spectator and viewer enjoyment, and the likelihood of increased funding when New Zealand teams are successful, are such that they are difficult to predict. The Commission has recognised these risks in its assessment of public benefits and detriments.
844. Should anticipated benefits not eventuate, or are less than anticipated, the extent of the ensuing net detriment can be limited by the Commission placing a finite period on the authorisation. For the Proposed Arrangements to continue beyond that limited time period, the Commission will need to be satisfied on a future Application that the benefit to the public from the continuation of such arrangements would outweigh the detriments. When it considers such a future Application, the Commission will have the benefit of evidence as to the operation and effect of the Proposed Arrangements in practice.
845. The Commission recognises that if the period of authorisation is too long, there is a possibility that the ongoing costs arising from inefficiencies (particularly productive inefficiencies associated with administering the salary cap and the

loss of players to overseas markets) would create a situation where New Zealand rugby did not create a more competitive domestic rugby competition, nor live within its means. On the other hand, too short a period could give rise to uncertainty, and could invite strategic gaming as parties seek to obtain their preferred outcome following the Commission's consideration of a new Application. Both could lessen efficiency and decrease the benefit to consumers.

846. Submissions received from the NZRU note that in the event that the Commission considers that a limited time period is appropriate, a five year expiry date is undesirable as it would coincide approximately with the time that the NZRU is hosting the Rugby World Cup. In addition, the NZRU submitted that it is desirable to synchronise any expiry with the anticipated timeframes of the current model of the Proposed Arrangements and the CEA. Accordingly, if there is to be an expiry date, the NZRU would prefer, for operational, resourcing and practical reasons, for it to be six years out from the anniversary on which any authorisation is granted.
847. Having considered the NZRU submissions, the Commission considers that limiting the period of authorisation, in combination with the conditions discussed above, assists in providing greater certainty that anticipated benefits are seen to flow through from the granting of any authorisation. Therefore, this authorisation will expire on the sixth anniversary of the date of the granting of such authorisation.

Conclusion on Impact of Conditions and Time Period

848. The Commission acknowledges that the Proposed Arrangements have the potential to deliver the benefits outlined in this Determination. However, the Commission shall not make a determination granting an authorisation unless it is satisfied in all the circumstances that the Salary Cap Arrangement and the Player Movement Regulations, would result, or be likely to result, in a benefit to the public that would outweigh the lessening in competition that would result or be likely to result or is deemed to result.
849. The Commission considers that, in the present situation, the potential benefits outweigh the detriments, although:
- there remains a lack of certainty that the benefits will in fact flow through; and
 - if the benefits do not flow through, the extent of the ensuing net detriment should be limited.
850. Imposition of the conditions discussed above and placing a finite period on the authorisation satisfies the Commission that the Proposed Arrangements will in all the circumstances result, or be likely to result, in a benefit to the public that would outweigh the lessening in competition that would result or be likely to result, or is deemed to result.

DETERMINATION

851. Pursuant to s 61(1)(a) of the Act the Commission grants authorisation to the NZRU, subject to the conditions and for the period set out below, to:
- a. enter into the Salary Cap Arrangement in accordance with clauses 50, and 53 to 59 of the CEA; and
 - b. enter into an arrangement consistent with the Player Movement Regulations; and
 - c. give effect to that Salary Cap Arrangement by implementing and giving effect to salary cap regulations, such authorisation to apply only insofar as the salary cap regulations implement and give effect to clauses 53 to 59 of the CEA; and
 - d. give effect to the Player Movement Regulations.
852. This authorisation extends to the NZRU, Provincial Unions, any current and future rugby players who are or may in future be playing rugby in a Provincial Union that has a team competing in any competition covered by the Salary Cap and the RPC, and is subject to the following five conditions imposed under s 61(2) of the Act:

Condition 1

The NZRU shall implement and give effect to regulations that provide for the effective audit, monitoring and enforcement of compliance with the salary cap regulations.

Condition 2

Except as expressly provided for in clauses 54.2 and 54.3 of the CEA and including the provision for team quarter final bonuses, all remuneration or other financial or non-financial benefits that are received by or on behalf of or paid for a player for or in connection with the provision of playing services to a Provincial Union, irrespective of the source of the remuneration or other financial or non-financial benefit, is included for the purposes of determining compliance with the salary cap for that Provincial Union.

Condition 3

Except as expressly provided for in clauses 54.2 and 54.3 of the CEA and including the provision for team quarter final bonuses, remuneration or other financial or non-financial benefits received by a player that are unrelated to the provision of playing services to a Provincial Union are excluded for the purposes of determining compliance with the salary cap for that Provincial Union. In this regard, the onus shall be on the Provincial Union to

demonstrate that such other remuneration or other financial or non-financial benefit is unrelated to the provision of playing services

Condition 4

All non-financial benefits shall be accorded a financial value that reflects the fair market value of the non-financial benefit.

Condition 5

The NZRU shall commission and meet the costs of an independent review on the operation of the salary cap and Player Transfer Regulations to be commenced not before the fourth anniversary of the date of the granting of the authorisation and to be completed at least six months prior to the expiry of the authorisation.

- 2 Pursuant to s 61(2) of the Act, this Authorisation expires on the sixth anniversary of the date of the granting of the authorisation.

**APPENDIX 1 – ELEMENTS OF PROPOSED SALARY CAP
(PROVIDED BY NZRU)**

Level of Cap
<ul style="list-style-type: none"> ▪ \$2.0m in 2006. ▪ \$2.0m plus CPI in 2007. ▪ Subsequently, the previous years Cap plus annual CPI adjustment.
Remuneration Included in Salary Cap
<ul style="list-style-type: none"> ▪ All Salary Cap Remuneration Payments Paid by a Provincial Union (including those paid by third parties) to a Player (or to a third party on behalf of a player) are included. ▪ Non-financial benefits are included. Policies re valuation will be developed and applied via the Salary Cap Regulations.
Provincial Union Salary Cap
<ul style="list-style-type: none"> ▪ If a Player is Paid Salary Cap Remuneration Payments of less than or equal to \$7,500 no amounts are included. ▪ If a Player is Paid Salary Cap Remuneration Payments of more than \$7,500 the total amount of that remuneration (and not just the amount above \$7,500) is included.
Excluded Remuneration
<p>The following forms of Remuneration are excluded:</p> <ul style="list-style-type: none"> ▪ Remuneration Paid pursuant to a Genuine Employment or Player Agreement; ▪ Finals Bonuses; (As set out on next page) ▪ Player Apparel; ▪ Relocation expenses for Loan Players; ▪ Financial Loans and interest (provided interest is paid at or above the “Interest Rate”); ▪ Remuneration Paid in settlement of an Employment Relationship Problem; ▪ Meals and match tickets; ▪ Travel assistance; and ▪ Educational Fees waived.
Notional Values
Notional Values (i.e. the value to be included in a Provincial Union’s Salary Cap

Payments in respect of NZRU salaried players):

- 10+ capped (tests) All Black and has played a test in the last three years = \$50,000.
- 3+ years Super Rugby = \$35,000.
- Less than 3 years Super Rugby = \$20,000.
- Party to NZRU Contract but not selected in Super Rugby = \$10,000.
- Party to a Wider Training Group Contract = \$10,000.

Discounts

- 60% discount on Salary Cap Remuneration Payments for Current All Blacks.
- 40% discount on Salary Cap Remuneration Payments for Former All Blacks.
- 40% discount on Salary Cap Remuneration Payments for Veteran Players.
- Current All Black discount applies regardless of availability and is not pro-rated per game.

Injured Player Payments

Where a Player is injured for three or more games a pro-rata amount of that Player's Salary Cap Remuneration Payments is excluded.

Provincial Union Performance/Win Bonuses

Discretionary payments contingent on teams making the playoffs are excluded to a maximum (payable to all Players in total) of:

- \$15,000 for playing an away Match in the quarter finals of the Premier Competition in a Contract Year.
- \$20,000 for playing a home Match in the quarter finals of the Premier Competition in a Contract Year.
- \$25,000 for playing an away Match in the semi-finals of the Premier Competition in a Contract.
- \$50,000 for playing a home Match in the semi-finals of the Premier Competition in a Contract Year.
- \$50,000 for playing an away Match in the final of the Premier Competition in a Contract Year.
- \$75,000 for playing a home Match in the final of the Premier Competition in a Contract Year.
- \$25,000 for winning the final of the Premier Competition in a Contract Year (irrespective of whether the Match is a home or away Match).

Relocation Allowances for Premier Division Loan Players excluded

- Up to \$1,500 for reasonable relocation and travel (including 3 return trips home); and

- Up to \$250 per week for costs for rental accommodation and associated utilities (excluding telephone and food),
are excluded.

Liability for Borrowed Player Payments

- Borrowing Provincial Union attributed with full value of Salary Cap Remuneration Payments and Notional Value if Loan is for entire Season.
- Apportionment of value of Salary Cap Remuneration Payments and Notional Value between Borrowing and Lending Unions if Loan for Part-Season.

Penalties

- Penalties for breach to be provided for in Regulations.

APPENDIX 2 – DISCUSSION OF FORT-STROOMBERGEN CRITIQUES OF OWEN & WEATHERSTON UOH STUDIES

853. Professor Fort and Dr. Stroombergen raised a number of methodological concerns about the Owen and Weatherston studies, which they claim invalidate (or at least significantly weaken) the findings therein. In assessing these critiques, the Commission conducted its own analysis and invited Professor Owen and Mr. Weatherston to provide responses to the concerns raised by Professor Fort and Dr. Stroombergen. Each of the critiques is discussed in turn below.
854. First, Owen and Weatherston do not address the effects of inter-seasonal uncertainty (i.e., the uncertainty surrounding competition outcomes over successive seasons). The Commission accepted in its Draft Determination that this is a limitation of the Owen and Weatherston studies, and noted that it undertook its own econometric analysis of inter-seasonal uncertainty and attendance to overcome this shortcoming. The results of this empirical work were discussed earlier in the section called “Evidence from New Zealand – Live Spectator Demand”.
855. Second, Professor Fort and Dr. Stroombergen argued that both studies use TAB betting odds as the only measure of match uncertainty when a number of other measures could have been utilised, possibly leading to different conclusions about the importance of the UOH.^{190, 191} In response to this criticism, Owen and Weatherston advised the Commission that they had selected TAB odds over alternative measures for several reasons:
- odds-based probabilities are based on an ex ante notion of outcome uncertainty that take into account a broader range of information than measures of differences in ranking, or competition points before the match under consideration, would provide. Other measures are backward-looking and based on only partial information;

¹⁹⁰ Alternative measures of match uncertainty include: the ratio of actual standard deviation of winning percentage to the standard deviation in a hypothetically balanced league; the likelihood that the winning percents of the top and bottom 20% of teams occur in the “idealised” normal distribution; concentration indices of winning percent of the teams at the top or bottom of the standings; league-wide Gini coefficient of winning percents; and the relative quality of the home team, by winning percent or league standing at the time of the game. For a more detailed survey of these alternative measures, see Fort (2006, op cit).

¹⁹¹ Indeed, there is some debate in the literature about the suitability of odds-based proxies as measures of uncertainty on the grounds that betting markets may not be efficient. Betting odds reflect the expectations of bettors rather than sports fans in general. Kuypers (2000) and Levitt (2004) demonstrate using theoretical models that it is profit-maximising for book-makers to distort odds away from those implied by ‘true’ probabilities to take account of bettor preferences. (See Kuypers, T., (2000), “Information Efficiency: An Empirical Study of a Fixed Odds Betting Market”, *Applied Economics*, 32, pp. 1353-63; and Levitt, S., (2004), “Why Are Gambling Markets Organised So Differently from Financial Markets?”, *Economic Journal*, 114, pp.223-46.)

- the TAB has a significant public profile in New Zealand and its predictions would reasonably proxy/influence public perceptions; and
 - background work for Owen and Weatherston (2004a) suggested that opening TAB odds were unbiased and efficient in predicting ex post match outcomes (as measured by actual points differences).
856. It is possible that if one of the alternative, backward-looking, match uncertainty measures had been employed in the model, the coefficient of that variable might have turned out to be statistically significant. However, one interpretation of such a result would be that the latter could just be representing past performance rather than uncertainty of outcome. Owen and Weatherston argue that what is required is really an ex ante measure. Overall, Owen and Weatherston concluded that odds-based proxies, of the sort used in their model, appeared to be the best available measures on the grounds of both a priori arguments and available evidence.
857. Third, Professor Fort considered that the measures of seasonal uncertainty, based on team standings and depth into the season, are inadequate. Owen and Weatherston disagreed, arguing that the variables provide information about the dominance of teams and, hence, an aspect of uncertainty about the overall championship winner. They also contend that alternative measures are backward-looking and therefore are unsuitable as ex ante uncertainty measures.
858. Fourth, Owen and Weatherston used lagged attendance measures as a rough proxy for spectator habit. Professor Fort considered this an over-simplistic modelling of habitual behaviour, and both he and Dr. Stroombergen argued that possible autocorrelation problems may arise through the inclusion of time-lagged variables,¹⁹² which in turn may lower the precision of the uncertainty estimates. Owen and Weatherston responded by re-estimating their model without the lagged attendance term and found that their results did not change; the other variables automatically selected by the model remained the same, and the coefficients of the uncertainty terms remained statistically insignificant.
859. Fifth, Professor Fort argued that certain dummy variables in the Owen and Weatherston models (designed to capture rivalry effects between unions, the drawing power of matched unions in adjacent geographic regions, and to control for the drawing power of superior facilities, such as Wellington stadium) also capture some of the uncertainty effects that should exclusively be explained by the uncertainty variables. This could possibly dilute the power of the uncertainty estimates. Both Dr. Stroombergen and Professor Fort also

¹⁹² Autocorrelation is a statistical problem where the error terms associated with two random variables (most commonly, a variable and its lag) are correlated with one another. Ordinary least squares (OLS) coefficient estimates under autocorrelation are unbiased and consistent, but are inefficient. This is problematic for forming inferences over the statistical precision of estimates. For more details, see Gujarati, D. N., (1995), *Basic Econometrics*, 3rd ed. (international), McGraw-Hill: U.S., Chapter 12.

pointed out the possibility for collinearity problems in the models through the inclusion of some dummy variables.¹⁹³

860. To address these issues, Owen and Weatherston re-estimated their models by omitting the variables suggested by Professor Fort. However, the new model form showed evidence of misspecification (meaning that resulting estimates may be biased and inconsistent). Therefore, they concluded that their original model specification was appropriate.
861. Sixth, Professor Fort argued that the “general to specific” (GETS) model selection approach used by Owen and Weatherston may simply build a model that fits the data well, but that has little reliability or true explanatory power. He proposed an alternative technique for model selection, the RETINA model developed by Perez-Amaral et al,¹⁹⁴ as an improvement on GETS.
862. However, Owen and Weatherston argued that RETINA is useful for a different purpose (out-of-sample forecasting) from what they sought to achieve (locating the local data-generating process, which GETS is suited to). They also pointed out that there is evidence that RETINA’s emphasis on achieving a parsimonious model can lead to a failure to retain highly significant variables.¹⁹⁵
863. Finally, Professor Fort and Dr. Stroombergen argued that the dataset used by Owen and Weatherston in their studies includes many matches, but over a very compressed time dimension (1999 to 2001 in the Super 12 study, and 2000 to 2003 in the NPC study). This makes it impossible to statistically test for cointegration amongst variables (unrelated trends moving in a similar direction),¹⁹⁶ which can produce spurious correlations between the dependent and independent variables. Spurious correlations may force out explanatory variables with greater theoretical relevance. Owen and Weatherston acknowledged the unsuitability of their data for cointegration testing as a shortcoming.

¹⁹³ Collinearity arises when two or more regressors can be written as a linear combination of one another. As long as perfect collinearity does not exist, estimation of regression coefficients is possible (and estimates will be unbiased and consistent), but estimates will be inefficient, making statistical inferences unreliable. Omitting highly collinear variables from the model is one possible remedy. For a more detailed discussion see Gujarati, op cit., Chapter 10.

¹⁹⁴ Perez-Amaral, T., Gallo, G. M., White, H., (2003), “A Flexible Tool for Model Building: The Relevant Transformation of the Inputs Network Approach (RETINA)”, *Oxford Bulletin of Economics and Statistics*, 65, pp.821-38; and Perez-Amaral, T., Gallo, G. M., White, H., (2005), “A Comparison of Complementary Automatic Modelling Methods: RETINA and PCGets”, *Econometric Theory*, 21, pp.262-77.

¹⁹⁵ See Castle, J. L., (2005), “Evaluating PcGets and RETINA as Automatic Model Selection Algorithms”, *Oxford Bulletin of Economics and Statistics*, 67, pp. 837-80.

¹⁹⁶ In fact, both Professor Fort and Dr. Stroombergen refer to the problem of non-stationarity, rather than cointegration, when speaking about the possibility of spurious correlations produced by variables with common trend. Strictly speaking, the co-movement of two or more time series is described by the statistical phenomenon of cointegration. A stochastic process is said to be non-stationary if its mean, variance and correlations change over time, so non-stationarity refers to the properties of a single time series. See Gujarati, op. cit., Part V.

864. The Commission considers that the Owen and Weatherston models, like all models, have a number of limitations. However, on balance, the Commission is of the view that the findings of those studies are useful in helping to inform its decision on the matter at hand.

**APPENDIX 3 – ECONOMETRIC ESTIMATION RESULTS – LIVE
SPECTATOR DEMAND MODEL**

1st Division Crowd Attendance and Uncertainty of Outcome

	1		2		3		4	
lnatt	Coef.	P \geq t	Coef.	P \geq t	Coef.	P \geq t	Coef.	P \geq t
lnprice	-0.539***	0.000	-0.527***	0.000	-0.527***	0.000	-0.477***	0.000
cert	-2.151	0.330	-2.033	0.340	-2.022	0.330	-2.100	0.310
uncert	-2.100	0.130	-2.130	0.120	-2.136	0.110	-2.287*	0.080
semip	0.290**	0.020	0.294**	0.020	0.294**	0.020	0.280**	0.020
lnpop	-0.220	0.850	-0.020	0.980				
lnreginc	0.694	0.580	0.695	0.570	0.669	0.380		
lnmarket	0.005	0.820						
cons	8.706	0.220	7.601	0.140	7.655*	0.100	11.654***	0.000
R^2	0.354		0.353		0.353		0.338	
N	48		48		48		48	

Notes: The panel data model was run under four different specifications. The coefficients for the uncertainty variable (*CERT*) and the uncertainty variable (*UNCERT*) have the expected signs suggesting that a balanced competition and an unpredictable competition tend to attract a higher crowd attendance. However, the coefficients for *CERT* are not statistically significant, and the coefficients for *UNCERT* are only marginally significant in the fourth specification of the model. However, ticket prices are significant (a 10% increase in prices tends to drive attendance down by 5%) as is the past history of union playing in a semi-final (a 10% increase in the probability that a union will play be a semi-finalist increases demand by 30%).

**Pairwise Correlation Matrix for Regression Variables
in Spectator Demand Model**

	lnprice	cert	uncert	semip	lnpop	lnreginc	lnmarket
lnprice	1.00						
cert	-0.14	1.00					
uncert	0.06	0.15	1.00				
semip	0.57	-0.01	0.19	1.00			
lnpop	0.76	-0.11	-0.01	0.50	1.00		
lnreginc	0.34	-0.03	-0.04	0.05	0.54	1.00	
lnmarket	0.49	0.05	0.30	0.39	0.74	0.43	1.00

APPENDIX 4 – DISCUSSION OF FORT-STROOMBERGEN CRITIQUES OF COMMISSION’S SPECTATOR DEMAND STUDY

865. First, Professor Fort argued that the Commission’s modelling work concern the old NPC competition, and so the estimation results of that model may be suggestive at best for the new PD competition. The same criticism was raised in relation to the Owen and Weatherston studies, and the Commission considers that the same arguments discussed in relation to those concerns apply here. Given that the old NPC is the closest available structure to the new NPC, the findings of the model are helpful in informing the matter at hand.
866. Second, Professor Fort surmised that when estimating its model, the Commission used ordinary least squares (OLS), a technique that accounts only poorly for the fact that both fan and union decisions simultaneously determine match attendance. He suggested that a simultaneous equations approach would significantly improve the precision of coefficient estimates.
867. In fact, the Commission used generalised least squares (GLS), not OLS, when estimating its model. The OLS method effectively pools data and treats all observations as independent from one another. However, this is not sensible because such an approach ignores the team-specific effects captured in the time series dimension of the data, and these effects ought to be captured. The GLS approach accommodates this.
868. As for the suggestion of utilising a simultaneous equations approach, this would only be appropriate if there were a sound theoretical basis upon which to suppose the behaviour of unions influenced match attendance. Professor Fort was not clear in his comments as to how this might occur in practice. It seems highly unlikely that unions attempt to influence match attendance by manipulating winning probabilities (there are presumably league rules that prohibit match-rigging and other such collusive behaviour); the Commission assumed in its analysis that each union has every incentive to perform to the best of its ability, and this seems to be a reasonable assumption to make. It might be hypothesised that unions influence attendance via their marketing efforts, but this effect has already been modelled through the inclusion of unions’ marketing expenditure as a regressor.
869. Third, Professor Fort argued that the Commission’s model examines inter-seasonal uncertainty but ignores match and within-season uncertainty, and such omissions render coefficient estimates imprecise. However, when using aggregated, end-of-season league standing data (as in the Commission’s model) it is not sensible to specify variables that capture the uncertainty over individual match results. A competitive balance variable could have been included in the model as an intended proxy for within-season uncertainty, but it is highly likely that such variable would have strongly picked up time effects as well (in much the same way a yearly dummy variable would).

870. Both Professor Fort and Dr. Stroombergen contend that the Commission's model may suffer from multicollinearity. For example, they argue that the two variables used to capture inter-seasonal uncertainty appear to be inversely related, and so it would be difficult to discern independent effects of either variable. However, an examination of the pairwise correlations between these two variables does not support this criticism (see Appendix 3).
871. Dr. Stroombergen argued that the variable that measures the probability of reaching a semi-final would also capture uncertainty if semi-finals are between relatively evenly-matched unions. However, this appears to be a misinterpretation of this regressor. This variable is a team-specific measure; it does not compare the probabilities of two distinct teams reaching the playoffs as a true uncertainty variable would do. The semi-finals variable is more likely capturing team quality effects than uncertainty effects.
872. Finally, Dr. Stroombergen suggests that the variable capturing the probability of a union reaching the semi-finals is likely correlated with market size. However, the correlation matrix reported in Appendix 3 shows that the pairwise correlation between these two regressors is relatively low, and therefore collinearity is unlikely to be an issue in this case. (As a rule of thumb, multicollinearity is considered a serious problem if pairwise correlations between regressors exceed 0.8; the pairwise correlation between the semi-finals variable and market size is only 0.05)

**APPENDIX 5 – ECONOMETRIC ESTIMATION RESULTS – TELEVISION
VIEWER DEMAND MODEL**

Sky TV Rating and Difference in NPC Standings						
	Without Super 12 Players		With Super 12 Players		With Super 12 Players and Quadratic Standing Difference	
	Coef.	P>=z	Coef.	P>=z	Coef.	P>=z
<i>POP</i>	0.27	0.33	-0.11	0.69	-0.11	0.69
<i>PLAY</i>	-0.11	0.52	-0.17	0.31	-0.17	0.32
<i>RELEG</i>	-0.07	0.45	-0.05	0.64	-0.05	0.64
<i>RS</i>	0.55*	0.08	0.45	0.14	0.44	0.15
<i>INC</i>	3.32**	0.04	3.95***	0.01	3.96***	0.01
<i>TV3</i>	0.10	0.69	0.04	0.86	0.04	0.86
<i>SAT</i>	-0.15	0.79	0.19	0.73	0.19	0.73
<i>SUN</i>	-1.11***	0.01	-1.02**	0.02	-1.02**	0.02
<i>4PM</i>	0.13	0.66	0.19	0.51	0.20	0.51
<i>7PM</i>	0.98***	0.00	1.04***	0.00	1.04***	0.00
<i>NOGAMES</i>	-0.50*	0.06	-0.66***	0.01	-0.66***	0.01
<i>GAMES</i>	-0.29	0.37	-0.33	0.29	-0.33	0.29
<i>CRICK</i>	-0.07	0.71	-0.19	0.34	-0.19	0.34
<i>LEAG</i>	-0.38	0.17	-0.29	0.29	-0.28	0.30
<i>UNION</i>	-0.13	0.71	-0.09	0.80	-0.09	0.81
<i>TENNIS</i>	-0.26	0.18	-0.25	0.20	-0.25	0.20
<i>SUPER</i>			1.07***	0.00	1.08***	0.00
<i>STAND</i>	-0.10	0.20	-0.02	0.85	-0.01	0.85
<i>CBALW</i>	-0.54	0.29	-0.31	0.53	-0.31	0.54
<i>HMWPS</i>	-2.00	0.26	-0.17	0.93	-0.15	0.94
<i>AWSWS</i>	-1.95	0.25	-0.42	0.80	-0.43	0.80
<i>STDDIST</i>	-0.02	0.58	-0.04	0.32	-0.06	0.75
<i>STDDIST^2</i>					0.00	0.93
<i>CONST</i>	-16.18*	0.09	-22.36**	0.02	-22.42**	0.02
OBS.	172		172		172	
R² (OVERALL)	0.5615		0.5910		0.5910	
WALD CHI2	173.48		215.17		213.84	

Note: *** indicates significant at 1% level;

 ** indicates significant at 5% level;

 * indicates significant at 1% level

Sky TV Rating and Difference in Winning Percentage

	Without Quadratic form of Uncertainty Measure		With Quadratic form of Uncertainty Measures	
	Coef.	P \geq z	Coef.	P \geq z
<i>POP</i>	-0.13	0.63	-0.11	0.71
<i>PLAY</i>	-0.16	0.35	-0.15	0.36
<i>RELEG</i>	-0.05	0.59	-0.04	0.67
<i>RS</i>	0.49*	0.10	0.48	0.11
<i>INC</i>	4.20***	0.01	4.14***	0.01
<i>TV3</i>	0.03	0.92	0.03	0.89
<i>SAT</i>	0.21	0.71	0.13	0.81
<i>SUN</i>	-1.05***	0.01	-1.08***	0.01
<i>4PM</i>	0.17	0.56	0.15	0.60
<i>7PM</i>	1.04***	0.00	1.02***	0.00
<i>NOGAMES</i>	-0.68***	0.01	-0.65***	0.01
<i>GAMES</i>	-0.33	0.29	-0.33	0.30
<i>CRICK</i>	-0.17	0.40	-0.15	0.45
<i>LEAG</i>	-0.32	0.24	-0.30	0.26
<i>UNION</i>	-0.12	0.73	-0.17	0.64
<i>TENNIS</i>	-0.24	0.22	-0.23	0.24
<i>SUPER</i>	1.02***	0.00	1.01***	0.00
<i>STAND</i>	-0.03	0.73	-0.03	0.67
<i>CBALW</i>	-0.28	0.58	-0.31	0.54
<i>HMWPS</i>	-0.27	0.89	-0.23	0.90
<i>AWWPS</i>	-0.72	0.68	-0.50	0.78
<i>DHMWP</i>	0.10	0.84	1.35	0.42
<i>DHMWP^2</i>			-1.95	0.43
<i>CONST</i>	-23.64***	0.01	-23.49***	0.01
Obs.		172		172
R² (overall)		0.5883		0.5900
Wald Chi2		211.83		209.57

Note: *** indicates significant at 1% level;
 ** indicates significant at 5% level;
 * indicates significant at 10% level

**Sky TV Rating and the Difference in Winning Probability
(For and Against Scores)**

	Without Quadratic form of Uncertainty Measure		With Quadratic form of Uncertainty Measures	
	Coef.	P \geq z	Coef.	P \geq z
POP	-0.18	0.59	-0.18	0.61
PLAY	-0.15	0.36	-0.15	0.35
RELEG	-0.06	0.51	-0.06	0.55
RS	0.53*	0.08	0.52*	0.09
INC	4.76***	0.01	4.82***	0.01
TV3	0.03	0.91	0.03	0.90
SAT	0.33	0.55	0.28	0.61
SUN	-1.00***	0.02	-0.99**	0.02
4PM	0.25	0.40	0.25	0.41
7PM	1.06***	0.00	1.06***	0.00
NOGAMES	-0.72***	0.01	-0.70***	0.01
GAMES	-0.44	0.16	-0.44	0.17
CRICKET	-0.19	0.31	-0.19	0.32
LEAG	-0.27	0.31	-0.27	0.31
UNION	-0.14	0.70	-0.13	0.71
TENNIS	-0.26	0.17	-0.27	0.16
SUPER	1.11***	0.00	1.09***	0.00
STAND	-0.04	0.59	-0.04	0.57
CBALW	-0.05	0.93	-0.04	0.93
HMWPS	2.72	0.26	2.71	0.27
AWWPS	0.31	0.89	0.38	0.87
DHMWPS	-1.10	0.37	0.77	0.85
DHMWPS^2			-5.99	0.63
CONST	-27.52***	0.01	-27.96***	0.01
Obs		172		172
R² (Overall)		0.5937		0.5944
Wald Chi2		201.29		198.16

Note: *** indicates significant at 1% level;

 ** indicates significant at 5% level;

 * indicates significant at 1% level

**TV Spectatorship and Difference in Wining Probability
(Past Contest History)**

	Without Quadratic form of Uncertainty Measure		With Quadratic form of Uncertainty Measure		Coef.	P \geq z
	Coef.	P \geq z	Coef.	P \geq z		
<i>POP</i>	-0.15	0.65	-0.07	0.84	-0.12	0.74
<i>PLAY</i>	-0.17	0.29	-0.16	0.32	-0.16	0.34
<i>RELEG</i>	-0.07	0.50	-0.07	0.48	-0.07	0.46
<i>RS</i>	0.55*	0.07	0.52*	0.09	0.54*	0.08
<i>INC</i>	4.31**	0.02	4.02**	0.03	4.19**	0.03
<i>TV3</i>	0.03	0.91	0.03	0.91	0.03	0.89
<i>SAT</i>	0.31	0.57	0.33	0.55	0.32	0.55
<i>SUN</i>	-0.90**	0.04	-0.87**	0.04	-0.91**	0.03
<i>4PM</i>	0.24	0.42	0.24	0.41	0.25	0.39
<i>7PM</i>	1.09***	0.00	1.11***	0.00	1.08***	0.00
<i>NOGAMES</i>	-0.70***	0.01	-0.70***	0.01	-0.70***	0.01
<i>GAMES</i>	-0.40	0.21	-0.40	0.21	-0.43	0.18
<i>CRICK</i>	-0.21	0.27	-0.21	0.26	-0.20	0.28
<i>LEAG</i>	-0.30	0.26	-0.26	0.34	-0.29	0.28
<i>UNION</i>	-0.18	0.61	-0.17	0.63	-0.17	0.64
<i>TENNIS</i>	-0.25	0.19	-0.26	0.18	-0.25	0.19
<i>SUPER</i>	1.04***	0.00	0.95***	0.01	1.03***	0.00
<i>STAND</i>	-0.05	0.50	-0.06	0.42	-0.04	0.58
<i>CBALW</i>	-0.16	0.75	-0.15	0.77	-0.13	0.80
<i>HMWPS</i>	2.24	0.37	1.88	0.46	2.27	0.36
<i>AWWPS</i>	-0.10	0.97	-0.56	0.82	-0.02	0.99
<i>DHMWPG</i>	-0.59	0.28	0.61	0.68	-0.51	0.38
<i>DHMWPG^2</i>			-1.66	0.37		
<i>DHMWPS</i>					-0.78	0.54
<i>CONST</i>	-24.40**	0.03	-22.94**	0.04	-23.93**	0.03
Obs	172		172		172	
R² (overall)	0.5941		0.5961		0.5951	
Wald Chi2	202.30		200.33		198.54	

Note: *** indicates significant at 1% level;

 ** indicates significant at 5% level;

 * indicates significant at 1% level

**Pooled Summary Statistics of Independent Variables in
Television Viewer Demand Model**

Variable	Mean	Std. Dev.	Min	Max	Coef. Of Variation
<i>RATING</i>	3.53	1.57	0.10	8.00	0.44
<i>POP</i>	6.41	0.49	5.29	7.30	0.08
<i>INC</i>	6.22	0.09	6.00	6.44	0.01
<i>SUPER</i>	3.25	0.48	1.79	4.03	0.15
<i>STAND</i>	5.53	1.87	1.70	9.95	0.34
<i>RELEG</i>	0.87	1.31	0.00	5.69	1.51
<i>PLAY</i>	0.42	0.76	0.00	5.20	1.81
<i>STDDIST</i>	3.53	1.86	1.00	9.00	0.53
<i>DHMWP</i>	0.25	0.18	0.00	0.78	0.72
<i>DHMWPS</i>	0.13	0.08	0.01	0.38	0.62
<i>DHMWPG</i>	0.29	0.20	0.00	0.92	0.69
<i>CBALW</i>	0.76	0.23	0.37	1.23	0.30
<i>HMWPS</i>	0.19	0.07	0.11	0.36	0.37
<i>AWWPS</i>	0.19	0.07	0.11	0.36	0.37
<i>NOGAMES</i>	1.22	0.98	0.00	3.00	0.80

**Reduced Television Demand Model (Parsimonious Specification)
Estimated Using GEE Approach**

	Coef.	P \geq z	Coef.	P \geq z	Coef.	P \geq z	Coef.	P \geq z	Coef.	P \geq z
<i>INC</i>	3.65	0.00	3.67	0.00	3.56	0.00	3.67	0.00	3.56	0.00
<i>SUPER</i>	1.00	0.00	0.97	0.00	1.00	0.00	0.95	0.00	1.00	0.00
<i>STAND</i>	-0.06	0.35	-0.06	0.35	-0.05	0.46	-0.06	0.27	-0.05	0.47
<i>RS</i>	0.42	0.06	0.45	0.05	0.46	0.04	0.45	0.05	0.46	0.05
<i>STDDIST</i>	-0.06	0.14								
<i>DHMWP</i>			-0.30	0.51						
<i>DHMWPS</i>					-1.25	0.25			-1.25	0.26
<i>DHMWPG</i>							-0.18	0.68	0.00	1.00
<i>CBALW</i>	-0.57	0.19	-0.56	0.20	-0.51	0.24	-0.58	0.18	-0.51	0.25
<i>NOGAMES</i>	-0.60	0.07	-0.63	0.06	-0.65	0.04	-0.63	0.05	-0.65	0.04
<i>SAT</i>	-0.01	0.99	0.01	0.99	0.08	0.91	0.02	0.97	0.08	0.91
<i>SUN</i>	-1.04	0.00	-1.08	0.00	-1.07	0.00	-1.05	0.00	-1.07	0.00
<i>7PM</i>	1.07	0.00	1.07	0.00	1.07	0.00	1.09	0.00	1.07	0.00
<i>CONST</i>	-21.13	0.00	-21.32	0.00	-20.72	0.00	-21.26	0.01	-20.72	0.01
Wald Chi ²	229.94		214.03		217.2		201.46		219.43	
Obs.	180		180		180		180		180	

Pairwise Correlation Matrix for Regression Variables in Television Viewer Demand Model

	RATING	POP	INC	SUPER	STAND	RELEG	PLAY	RS	STDDIST	DHMWP	DHMWPS	DHMWPG	CBALW	HMWPS	AWWPS	NOGAMES	TV3	SAT	SUN	4PM	7PM	GAMES	CRICK	LEAG	UNION	TENNIS	
RATING	1.00																										
POP	0.38	1.00																									
INC	0.25	0.50	1.00																								
SUPER	0.48	0.65	0.21	1.00																							
STAND	-0.41	-0.51	-0.08	-0.71	1.00																						
RELEG	0.07	0.06	0.06	0.09	-0.12	1.00																					
PLAY	-0.16	-0.16	-0.10	-0.18	0.28	0.59	1.00																				
RS	0.15	0.19	-0.03	0.25	-0.24	0.15	0.07	1.00																			
STDDIST	-0.18	-0.07	-0.13	-0.03	0.13	-0.05	-0.02	-0.10	1.00																		
DHMWP	-0.27	-0.17	-0.18	-0.21	0.26	0.03	0.22	-0.01	0.50	1.00																	
DHMWPS	-0.21	-0.01	-0.23	-0.13	0.22	-0.07	0.16	0.01	0.54	0.73	1.00																
DHMWPG	-0.24	-0.16	-0.38	-0.19	0.13	-0.14	-0.02	0.09	0.27	0.17	0.38	1.00															
CBALW	-0.01	-0.02	-0.45	-0.01	-0.08	-0.04	0.03	0.00	0.00	0.02	0.15	0.12	1.00														
HMWPS	-0.33	-0.36	-0.22	-0.48	0.51	-0.08	0.18	-0.14	0.05	0.20	0.16	0.06	-0.10	1.00													
AWWPS	-0.28	-0.34	-0.17	-0.44	0.40	-0.04	0.18	0.04	0.13	0.29	0.19	0.03	-0.01	-0.09	1.00												
NOGAMES	-0.28	0.02	-0.01	0.02	-0.05	0.00	0.03	-0.03	0.07	0.12	0.06	-0.05	-0.06	0.00	0.12	1.00											
TV3	-0.09	0.04	0.08	0.07	-0.02	0.03	-0.10	0.05	0.08	0.06	-0.01	0.16	-0.03	0.01	-0.18	-0.14	1.00										
SAT	-0.23	0.04	0.05	0.00	-0.05	0.03	0.03	-0.01	0.03	0.08	0.06	-0.08	-0.13	-0.02	0.13	0.94	-0.14	1.00									
SUN	-0.25	-0.19	-0.07	-0.19	0.25	-0.02	0.07	0.06	0.09	0.10	0.07	0.29	0.04	0.18	-0.07	-0.55	0.53	-0.59	1.00								
4PM	-0.26	-0.12	-0.02	-0.17	0.10	-0.02	0.07	-0.10	0.08	0.16	0.08	-0.05	-0.12	0.04	0.23	0.36	-0.27	0.38	-0.22	1.00							
7PM	0.47	0.02	-0.20	0.10	-0.16	-0.01	-0.08	-0.02	-0.09	-0.21	-0.05	0.02	0.36	-0.09	-0.16	-0.18	-0.11	-0.21	-0.28	-0.45	1.00						
GAMES	-0.05	0.00	0.09	-0.02	0.03	-0.19	-0.14	0.01	0.01	0.00	-0.11	-0.08	0.08	0.08	0.04	-0.05	0.06	-0.02	-0.03	0.02	-0.03	1.00					
CRICK	-0.05	0.00	0.08	0.03	0.00	-0.28	-0.25	-0.05	-0.08	-0.03	-0.04	-0.12	-0.05	0.19	-0.12	-0.09	0.02	-0.03	0.06	0.01	-0.09	0.16	1.00				
LEAG	-0.29	-0.10	-0.04	-0.11	0.10	-0.52	-0.31	-0.10	0.14	0.09	0.07	0.10	-0.02	0.11	-0.03	0.08	0.14	0.01	0.23	0.06	-0.23	0.17	0.22	1.00			
UNION	0.00	0.10	0.06	0.02	-0.05	0.03	-0.10	0.05	0.03	0.01	-0.02	-0.12	0.04	0.04	0.01	-0.12	-0.06	-0.06	0.02	0.00	-0.04	0.27	0.26	-0.02	1.00		
TENNIS	-0.14	0.02	0.11	-0.05	0.04	-0.31	-0.27	-0.02	-0.02	0.05	0.02	0.05	-0.13	0.04	0.14	0.27	0.01	0.25	-0.14	0.11	-0.08	0.08	0.08	0.23	0.06	1.00	

APPENDIX 6 – DISCUSSION OF FORT-STROOMBERGEN CRITIQUES OF COMMISSION’S TELEVISION VIEWER DEMAND STUDY

873. Both Professor Fort and Dr. Stroombergen argued that since the Commission’s study uses only four years of data, there are only four observations on the same set of teams. They argued that such low degrees of freedom mean standard statistical tests of individual coefficients would not have much power. It is true that the time series element of the Commission’s model is fairly short, but no more so than is the case for several published empirical studies that examine demand for sport. For example, the study by Baimbridge et al (1995) on rugby league in the UK only covered the 1993-1994 season; Baimbridge et al (1996) looked at demand for English Premier League football, but only over the 1993-1994 season; Borland and Lye (1992) studied Australian rules over a lengthier period, 1981-1986, yet have only 182 observations in their study (the Commission’s model covers four years and contains 172 observations in total). More recent works, such as Butler’s (2002) study of US Major League baseball covered only the 1999 season; and Forest and Simmons (2002) examined English football, but only over the 1997-1998 season.¹⁹⁷ There are many more such examples. Hence, the Commission’s analysis does not seem out of line with published empirical studies.
874. A related concern voiced by Professor Fort is that there may not be much variation in the data used by the Commission; outcomes may be similar game by game, and the end result may be similar across teams in each of the years, possibly leading to weak significance outcomes. This criticism may be valid if the Commission had simply examined a binary win/loss relationship between teams over time. However, the Commission used several alternative measures of uncertainty of outcome, one of which was the difference in winning probability based on unions’ historical for and against scores. This winning probability is calculated for each team as “the total points scored by the team in the season, divided by the sum of all points scored by the team and all points scored against it by opponents, in the same season”.¹⁹⁸ Defining winning probabilities based on match scores ensures cross-sectional (inter-match) and time-series variation.

¹⁹⁷ See Baimbridge, M., S. Cameron, et al. (1995). "Satellite Broadcasting and Match Attendance: The Case of Rugby League." *Applied Economics Letters* 2(10): 343-46; Baimbridge, M., S. Cameron, et al. (1996). "Satellite television and the demand for football: A whole new ball game?" *Scottish Journal of Political Economy* 43(1): 317-333; Borland, J. and J. Lye (1992). "Attendance at Australian Rules football: a panel study." *Applied Economics* 24(9): 1053-1058; Butler, M. R. (2002). "Interleague Play and Baseball Attendance." *Journal of Sports Economics* 3(4): 320-334; and Forrest, D. and R. Simmons (2002). "Outcome uncertainty and attendance demand in sport: the case of English soccer." *Journal of the Royal Statistical Society* 51(2): 229-241.

¹⁹⁸ Commerce Commission (15 May 2006), "What Drives Television Demand for NPC Rugby Matches?", p.9.

875. Another uncertainty of outcome measure used by the Commission was the spread in to-date winning probabilities between competing unions, which was constructed using win/loss data on all matches in which the unions have faced each other since 1997. Similarly, the team-specific uncertainty variables were constructed using match data for the period 1997-2004. Hence, the criticism of too short a time-series element in the model should be less acute, at least in relation to model specifications that included these variables.
876. Professor Fort's criticism above ignored the cross-sectional variation present in the data. In fact, a random effects rather than fixed effects approach to estimation was used, precisely to exploit this cross-sectional variation. As noted earlier, in each cross-section there are 45 round-robin matches, and the effective dataset used in the estimation contained 172 observations. In the most complete specification of the model, there are a total of 23 independent restrictions imposed, which provides 149 degrees of freedom. This is reasonable for a panel model.
877. Appendix 5 presents pooled summary statistics on all the non-dummy variables specified in the Commission's econometric model. The statistics show that there is a significant range (spread between the largest and smallest observation) in virtually all of the variables, and the coefficient of variation (ratio of the standard deviation to the mean) associated with all variables (except the relegation and playoff variables) is very small (<1), indicating that there is significant variation in the data.
878. Mr. Copeland submitted that one problem with the Commission's study is that there might be a sample selection bias in that it excluded non-subscribers of SKY. Mr. Copeland argued that this exclusion may be significant because "these persons are not the classic "couch potato" and their decisions to view or not view may be much more sensitive to competitive unevenness".¹⁹⁹ However, it seems tenuous to suggest that the viewing preferences of non-subscribers (in particular, their sensitivity to outcome uncertainty) vary systematically from those of subscribers.
879. Professor Fort argued that the Commission did not provide an adequate treatment of the time series element of the data, and that any non-stationarity in the dependent variable can generate spurious regression results. As Professor Fort pointed out, with only four years of data it is impossible to perform standard stationarity tests. However, the problem of spurious correlations generated by cointegrated series arises through the presence of a systematically common trend. When the series are truncated, their trend are unlikely to be sufficiently developed to have systematically common components; the

¹⁹⁹ Michael Copeland, Brown Copeland, (22 May 2006), Submission on "What Drives Television Demand for NPC Rugby Matches?", para. 23.

problem of spurious correlations is likely to be most acute with longer time series.

880. Also, as noted earlier, most of the published empirical studies that examine match attendance use panel models with smaller time dimensions than four years. According to Professor Fort's argument, those studies should be even more prone to the non-stationarity critique than the Commission's model.
881. It is argued by Professor Fort that the Commission's model ignores a consumption selection issue. Viewers must decide whether to pay a monthly fee to gain access to live matches on SKY, or not pay the fee and watch free-to-air television delayed coverage. In fact, this selection issue was identified by the Commission, and an attempt, albeit simplistic, was made to model it through the inclusion of a free-to-air dummy variable. This should at least partially control for this problem.
882. As Professor Fort submitted, a more extensive treatment is difficult. However, one point worth noting is that free-to-air coverage is generally considerably more limited in scope than subscription-based coverage, since free-to-air viewers have access to only a small number of broadcast matches. There may also be significant utility value associated with live versus delayed coverage. These arguments suggest that free-to-air matches may not be an effective substitute for SKY-broadcast matches (the statistical insignificance of the free-to-air dummy variable supports this), meaning that failing to fully model this consumption selection problem is unlikely to be fatal to the findings of the Commission's model, as suggested by Professor Fort.
883. Professor Fort submitted that any demand function for television viewership should reflect the willingness to pay to watch games on television, and argued that the Commission's inclusion of regional income as a regressor does not achieve this. However, the inclusion of this variable was not intended to capture *willingness* to pay, but rather *ability* to pay. Professor Fort is correct in asserting that, ideally, willingness to pay should be modelled. But in his submission he acknowledged the difficulties involved in doing so. SKY viewers pay a 'bundled' subscription charge for a range of content rather than a pay-per-view price for matches, so it is very challenging to untangle the per match price, let alone value the non-pecuniary (e.g., time) costs of viewing.
884. In the absence of data with which to model willingness to pay, it seems reasonable to at least account for ability to pay for viewership. It is also worth noting that the only published study on the effect of uncertainty of outcome on television demand for sport, Forrest et al (op cit), does not address this issue at all.
885. Professor Fort criticised the use of variables (regional population and income) relative to the geographical location of the two unions involved in any given match in the sample on the basis that it omits all of the rest of the viewing

audience for no sound reason. In response, the first thing to note is that the dependent variable, viewer ratings, is measured on a national basis so the participation of a national audience is accounted for through this variable. Second, regional population was included not spuriously, but rather to test a plausible hypothesis, namely, that those viewers who are most likely to be attracted by the match are those drawn from the competing provinces. This could have been a potentially important element in the demand for matches and it seems reasonable to at least investigate the possibility. Finally, the objection over the use of regional income is perhaps more justified, but the alternative (i.e., a measure of national income) would involve no cross-sectional variation and would likely have been met with even harsher criticism.

886. Professor Fort identified the desirability of incorporating match, seasonal and consecutive-season uncertainty, and argued that the Commission's analysis narrowly defines UOH to cover only match uncertainty. However, subsequent points in his submission essentially argued that proxies for all three aspects of uncertainty *were* actually included in the Commission's study. For example, he correctly identified that the competitive balance variable may be interpreted as a measure of seasonal uncertainty. However, this variable proves to be statistically insignificant under all specifications of the model. The same is true for the relegation and playoffs variables.
887. Professor Fort incorrectly interpreted the league standings variable (which the Commission used as a measure of contest quality) as capturing consecutive-season uncertainty. In submissions, Professor Fort interpreted this variable as the "previous season standing in past seasons *versus* current pre-match standing" (emphasis added).²⁰⁰ However, the correct definition of this variable is "a *weighted average* of competing unions' standings in the previous season and their current pre-match standings" (emphasis added).²⁰¹ Clearly, comparison of performance in one season relative to the next (Professor Fort's interpretation) is not the same as taking the weighted average of the two (the actual definition of the variable employed by the Commission).
888. A measure of inter-seasonal uncertainty must have two characteristics. First, it must capture the performance of one union relative to the performance of others, and secondly, it must allow comparison of this relativity over successive seasons. Professor Fort's interpretation of the league standings variable used by the Commission permits the latter but not the former, so would not be an effective measure in any case.
889. Professor Fort argued that the measures of the historical volatility of unions' performance included in the Commission's model are actually measures of match uncertainty. Once again, this is an incorrect interpretation of the

²⁰⁰ Professor Rodney Fort, (22 May 2006), Submission on "*What Drives Television Demand for NPC Rugby Matches?*", para.10.

²⁰¹ Commerce Commission, *ibid*, p.7.

variables used. These variables essentially compare the recent performance of a union (either home team or away team) against its *own* historical performance. They are therefore designed to capture the effect on demand of ‘wild-card’ teams, i.e., those teams whose future performance cannot readily be predicted from past results. They do *not* compare the performance of one union relative to the performance of other unions, which a measure of match uncertainty should do.

890. Professor Fort also considered that the time-of-day and day-of-week variables are actually picking up uncertainty of outcome effects because better balanced matches will be aired on “prime days” in “prime time”. However, a more likely explanation is that these variables may be capturing contest quality effects. It is likely that fewer close matches between weak unions feature at prime times than matches involving at least one team of big-name players. Also, it is likely that games including at least one ‘big market’ union are scheduled during prime times. So, when statistically significant, these variables may indeed be picking up more than just time-slot effects, but it is also likely that the effects being captured are something other than match uncertainty effects.
891. In addition, as discussed shortly, these timing variables are not particularly correlated with any of the uncertainty measures specified (the highest pair-wise correlation was 0.29). Hence, there is no reason why, if relevant, these variables should be precluded from adding to the explanation of television viewership. It is also interesting that Professor Fort apparently accepts the statistical significance of these timing variables, and interprets these as supportive of the UOH, while at the same time expressing scepticism over the soundness of the data and methodology employed in the Commission’s empirical study. This seems internally inconsistent. The results cannot sensibly be simultaneously completely unreliable and, at the same time, supportive.
892. When claiming, as discussed above, that multiple variables specified in the Commission’s model are picking up the same effects, Professor Fort is essentially arguing that the model suffers from the statistical problem of multicollinearity, i.e., when two or more regressors can be written as a linear combination of one another. When multicollinearity exists estimated coefficients will be inefficient making statistical inferences unreliable. Therefore, standard tests may wrongly reject a variable as statistically insignificant.
893. For example, Professor Fort submitted that playoff and relegation variables are constructed in nearly perfect negative relation to one another, and this is a sure prescription for multicollinearity. Dr. Stroombergen also raises concerns that:
- the match standings quality variable, competitive balance variable and team uncertainty variables may all be picking up elements of both match quality and uncertainty;

- the variable measuring the number of Super 12 players involved in a contest is likely to be correlated to the regional population (larger provinces tend to have more international players); and
 - the regional income variable may be capturing uncertainty of outcome, since the closest contests tend to be between unions that originate from the wealthiest provinces (this ignores the fact that close contests can arise between weak unions, who tend to draw from the least wealthy provinces, and also the possibility that the high average income regions correspond to the large urban centres for which there could be a ‘big market’ effect on ratings).
894. The claim that multiple variables in the model are capturing common effects has led to the criticism from Professor Fort that the Commission’s model is “over-specified”.
895. There is no sure way to rule out the presence of multicollinearity in a model, but one very useful starting point is to examine the pairwise correlations between individual regressors. As a general rule of thumb, multicollinearity is thought to be a serious problem if pairwise correlations exceed 0.8.²⁰² Appendix 5 reports the pairwise correlation matrix for all variables used in the Commission’s econometric models. It is clear from this matrix that none of the pairwise correlations between the variables said to be contributing to collinearity or picking up common effects exceed 0.65 (in fact, most do not exceed 0.29), so the correlations reported lie well within what is generally regarded as a reasonable bound.²⁰³
896. High pairwise correlations are a sufficient but not necessary condition for a high degree of multicollinearity since near-perfect linear combinations of the variables can involve more than two regressors with relatively low pairwise correlations. Therefore, the Commission also examined the variance inflation factors (VIF) associated with the auxiliary regressions of each regressor on all the remaining regressors included in the model. The VIF shows how the variance of an estimator is inflated by the presence of multicollinearity; generally, the larger the VIF values, the more troublesome the collinearity problem. The VIF tests performed by the Commission rejected the presence of multicollinearity.²⁰⁴

²⁰² See Gujarati, op cit, p.335; Griffiths, W. E., Hill, R. C., Judge, G. G. (1993), *Learning and Practicing Econometrics*, Wiley: U.S.A., p.435.

²⁰³ Some of the competing match uncertainty measures specified by the Commission do appear to be reasonably highly correlated, but no two match uncertainty variables were ever included together in the same estimation, so the apparent high correlations are no cause for concern. In fact, these high correlations may be considered a strength rather than a weakness of the model as it suggests that all the alternative measures of match uncertainty are picking up similar rather than disparate effects, which is what one would hope for.

²⁰⁴ The results of this testing are available on the Commission’s official file.

897. The preceding analyses find no evidence of multicollinearity in the model, suggesting that Professor Fort's criticism of the Commission's model being over-specified seems to be unfounded.
898. Dr. Stroombergen argued that concepts such as uncertainty of outcome and quality are inherently subjective, and quality and uncertainty tend to overlap. Therefore, any measurable proxy for these is likely to be subject to measurement error, which would lead to under-estimates of the effects of those variables. (Dr. Stroombergen ignored the possibility that such overlaps may also over-state the effects of such variables.) Whilst it is true that 'quality' can be a nebulous, hard-to-pin-down concept, uncertainty of outcome can be well specified and there is an extensive literature on this issue. The Commission's study specifies some new measures of uncertainty, which Dr. Stroombergen describes as innovative, but also builds on ideas in the extant literature.
899. Furthermore, the apparent vagueness surrounding the notion of team quality can, to some extent, be overcome by exercising care and precision when defining the contest quality variables, and interpreting the estimation outputs in a manner consistent with those definitions. The Commission's analysis is very clear what aspects of quality are being measured, and care was taken to limit to the extent possible any overlap with the uncertainty measures. To this end, comparison of pairwise correlations are very useful, and the correlation matrix included in Appendix 5 shows only a very weak relationship exists between the quality and uncertainty variables specified. This suggests that, all else constant, these two classes of regressors are capturing different effects, so it is not inappropriate to include them in the same estimation.
900. Dr. Stroombergen argued that it is unclear whether the data used by the Commission has been checked for the statistical problem of autocorrelation, and suggests that not correcting for this problem "could bias the coefficients and hence lead to incorrect interpretation of the impact of the explanatory variables". The first point on this issue is that the problem of autocorrelation does not lead to biased estimates. It is well-recognised in the econometrics literature that under autocorrelation, estimates remain unbiased and consistent (i.e., have nice large-sample properties), but are inefficient, which makes hypothesis testing problematic.²⁰⁵ Second, it is meaningless to perform standard autocorrelation tests on time series' covering only four observations; the results of such tests would not be reliable given the small sample size. Third, there are estimation techniques, such as the Generalised Estimating Equations (GEE) method, which allow robust estimation under alternative variance-covariance structures.²⁰⁶ The Commission re-estimated its viewer

²⁰⁵ See, for instance, Gujarati, op cit, Chapter 12.

²⁰⁶ See Liang, K.-Y., Zeger, S. L. (1986), "Longitudinal Data Analysis Using Generalized Linear Models", *Biometrika*, 73, pp.13-22; Zeger, S. L., Liang, K.-Y. (1986), "Longitudinal Data Analysis for Discrete and Continuous Outcomes", *Biometrics*, 42, 121-30.

demand model using this approach and found that the results (estimated coefficient and inference statistics) did not change significantly at all.²⁰⁷

901. Dr. Stroombergen also submitted that the Commission should test for possible heteroskedasticity, which, if present and uncorrected, could weaken the measured significance of the explanatory variables. The Commission tested for this problem and found that two variables—the home team uncertainty measure, and a prime-time variable—exhibited evidence of heteroskedasticity. The model was then re-estimated with a robust variance matrix, which produced White-corrected standard errors that can safely be used for inference testing. The statistical significance of the affected variables did not change, even after correcting for the apparent heteroskedasticity.²⁰⁸
902. Another concern voiced by Dr. Stroombergen is that there are too many insignificant variables in the Commission’s model, and that a more parsimonious specification, which reflected careful application of a general-to-specific methodology, would be preferable. It is true that a more parsimonious specification may allow more efficient estimation and inference. However, general-to-specific reduction is a non-trivial exercise when estimating random effects models. Nevertheless, the Commission re-estimated its model after removing from the full specification those regressors found to be least significant (but leaving in the uncertainty variables), and found the results remained stable; the uncertainty variables remained statistically insignificant, and contest quality remained significant. The regression results of the reduced model are presented in Appendix 5.
903. In summary, Professor Fort and Dr. Stroombergen each focused their critiques of the Commission’s econometric study on possible data limitations, claimed deficiencies in the modelling techniques used, and potential misinterpretations of certain variables, which they suggest actually provide support for the UOH. In reviewing their comments, the Commission conducted further diagnostic work on the data and model and found that most of the criticisms raised were either very weak or unfounded. The Commission acknowledges that all economic models are imperfect to some degree, but this should not preclude their usefulness in informing key decisions. On balance, the Commission considers that the findings of its econometric study provide useful insights on the benefits likely effects of the Proposed Arrangements.

²⁰⁷ The results of this re-estimation are available on the Commission’s official file.

²⁰⁸ The results of this re-estimation are available on the Commission’s official file.

APPENDIX 7 – METHODOLOGY FOR ESTIMATING SPECTATOR BENEFITS

904. Figure 5 depicts a simple linear demand model for rugby spectatorship and all other forms of sports entertainment. For simplicity, it is assumed that in initial equilibrium the demand for both competing forms of entertainment are the ‘same’ (i.e., the two market demand curves overlap one another). An increase in demand for rugby spectatorship, following an increase in attractiveness of the game as a result of improved competitive balance, results in a corresponding fall in demand for other sports entertainment.
905. Each demand curve is assumed to face an equal and parallel shift, but in opposite directions, such that the increase in total spending on rugby union spectatorship exactly offsets the reduction in spending on other forms of sports entertainment.
906. By Figure 5, the net gain in total social welfare can be estimated by calculating the difference:

$$\text{AHCB} - \text{AJFB}, \quad (1)$$

$$\text{where AHCB} = (\text{HCP}_1 - \text{ABP}_1),$$

$$\text{and AJFB} = (\text{ABP}_1 - \text{JFP}_1).$$

907. The Commission employed some simple econometric techniques in order to calibrate this model, and to calculate the difference represented in equation (1). Firstly, the simple linear demand function, D , was econometrically estimated using average price and attendance data provided by the NZRU:

$$Q(P) = a + bP + u \quad (2)$$

where Q denotes match attendance, P is the average price per ticket, a is the intercept along the horizontal axis, b is the slope of the demand curve, and u is an error term (assumed to be independent and identically distributed).

908. A summary of the regression analysis for equation (2) is reported in the Table below.

Demand for NPC 1st Division Rugby

attendance	Coefficient	t	Prob> t
price (\hat{b})	-2,418.492	-2.33	0.025
constant (\hat{a})	74,724.82	7.68	0.000
R^2	0.3692		
Number of obs.	51		

Notes: All estimated coefficients were found to be statistically significant at the 5% level. Per-union annual attendance data utilised for this regression analysis spanned the period 1999 to 2004; annual average ticket prices (over the same period) were calculated by dividing total gate revenues by total attendance. All data were provided by the NZRU.

909. Rearranging equation (2) in terms of P (and dropping the error term) gives what is known as the *inverse demand function*:

$$P(Q) = \frac{Q - a}{b} \quad (3)$$

910. Evaluating equation (3) by setting $Q = 0$ permits calculation of the intercept along the vertical axis, $P(0) = -a/b$.
911. Given the assumption that the new demand curves, D_r and D_o , lie exactly parallel to the initial demand curve, D , it is possible to estimate the position of the new demand curves as follows:

$$D_r: Q(P) = a(1 + \Delta) + bP,$$

and $D_o: Q(P) = a(1 - \Delta) + bP$.

where Δ is an assumed percentage change in spectator demand for rugby union for a given improvement in competitive demand.

912. Finally, in his analysis, Mr. Copeland assumes an average match ticket price of \$15. The Commission therefore adopts, as a working assumption, that $P_1 = \$15$.
913. This provides all the information required to calculate the triangular areas under the demand curves represented in Figure 5. For instance, simple geometry provides that the area $ABP_1 = \frac{1}{2} (A - P_1) Q_1$. Evaluating $Q(15) = \hat{a} + \hat{b}15$ (i.e. equation (2)) gives the value of Q_1 , and $P(0) = -\hat{a}/\hat{b}$ gives the value of A . Now, area ABP_1 can readily be calculated.

914. Similarly, the area of $JFP_1 = \frac{1}{2} (J - P_1)G$. Evaluating $Q(15) = \hat{a}(1 - \Delta) + \hat{b}15$ gives the value of G, and $P(0) = -\hat{a}(1 - \Delta)/\hat{b}$ gives the value of J. This information can be used to calculate JFP_1 .
915. Finally, the area of $HCP_1 = \frac{1}{2} (H - P_1)E$. Evaluating $Q(15) = \hat{a}(1 + \Delta) + \hat{b}15$ gives the value of E, and $P(0) = -\hat{a}(1 + \Delta)/\hat{b}$ gives the value of H. This information can be used to calculate HCP_1 .
916. Combining ABP_1 , JFP_1 , and HCP_1 , the net gain in consumers' surplus, represented by equation (1), can be evaluated. Total spectator benefits arising from a more attractive PD may be found by multiplying (1) by the total number of 14 teams in the PD.
917. In this model, producers' surplus is ignored by the assumption that all suppliers to the market face the same marginal costs, and that the market-clearing price equals each supplier's marginal cost. Therefore, the net gain in consumers' surplus corresponds to a true gain in public benefits (as opposed to a transfer from producers to consumers).

APPENDIX 8 – NZRU PLAYER MOVEMENT REGULATIONS

NEW ZEALAND RUGBY UNION Player Movement Regulations



Contents

Part 1 • Definitions	2
1 Definitions	2
Part 2 • Player Movement	4
2 Introduction	4
3 Transfer Period	4
4 Captured Union	4
5 Transfer of Air New Zealand Cup Captured Players	4
6 Transfer of Division One Captured Players	5
7 Notification of Transfer.....	6
Part 3 • General	7
8 Changes to Regulations.....	7
9 Breach of Regulations.....	7
Schedules	8
Player Movement Form – Air New Zealand Cup Captured Player	8
Player Movement Form – Division One Captured Player	9

DRAFT



Part 1 • Definitions

1 DEFINITIONS

In these Regulations, unless the context requires or indicates otherwise, the following definitions shall apply:

“Air New Zealand Cup Captured Player” has the meaning set out in clause 5.1;

“Air New Zealand Cup Competition” means the Air New Zealand Cup Competition as provided for under the *NZRU Domestic Competition Regulations*. Any reference to “Air New Zealand Cup” has the same meaning as “Premier Competition” in the Collective Agreement;

“Air New Zealand Cup Union” means a Provincial Union competing in the Air New Zealand Cup of the domestic provincial rugby competition conducted by the NZRU from the 2006 season;

“Captured Union” has the meaning set out in clause 4.1;

“Collective Agreement” means the Collective Agreement entered into by the NZRU and the RPC which comes into effect from 1 January 2006;

“Contract Year” means the calendar year (commencing on 1 January and concluding on 31 December) and may be defined with reference to a particular year (eg Contract Year 2006);

“Development Compensation Fee” means the payment a Transferring Union is required to make to a Player’s Captured Union pursuant to these Regulations;

“Division One Captured Player” has the meaning set out in clause 6.1;

“Division One Competition” means the Division One Competition as provided for under the *NZRU Domestic Competition Regulations*;

“Division One Union” means a Provincial Union competing in Division One of the domestic provincial rugby competition conducted by the NZRU from the 2006 season;

“Home Super Rugby Franchise” has the meaning set out in clause 43.1 of the Collective Agreement;

“NZRU” means the New Zealand Rugby Football Union Incorporated;

“Player” means a rugby union player who is an Air New Zealand Cup Captured Player or a Division One Captured Player;

“Playing 22” means the fifteen selected players plus seven reserves as recorded on the team sheet provided to the NZRU for any Air New Zealand Cup or Division One Competition match;

“Provincial Union” means an Affiliated Union as defined in the *NZRU Constitution*;

“Provincial Union Contract” means the contract set out in Appendix 9 of the Collective Agreement;

“Provincial Union Development Contract” means the contract set out in Appendix 10 of the Collective Agreement;

“Provincial Union Term” has the meaning set out in clause 46.4 of the Collective Agreement;

“Provincial Union Development Term” has the meaning set out in clause 47.3 of the Collective Agreement;

“Registered” means a player who has completed the *NZRU Senior Player Registration Form* for that Contract Year;

“RPC” means the Rugby Players Collective Inc;

“Super Rugby Competition” has the meaning set out in clause 38.1 of the Collective Agreement;

“Super Rugby Eligibility Date” is a date specified by the NZRU in agreement with the RPC (with such agreement to be reached no later than the end of August in each Contract Year);

“Transfer” is the process by which a Player alters his Provincial Union by moving from his Captured Union to the Transferring Union pursuant to these Regulations;

“Transfer Period” has the meaning set out in clause 3.1;

“Transferring Union” in relation to a particular Player means the Provincial Union to which that Player wishes to transfer;

DRAFT

Part 2 • Player Movement

2 INTRODUCTION

- 2.1 These Regulations govern the process by which a Player alters their Provincial Union.
- 2.2 The Transfer of any Player wishing to be eligible to play for a Provincial Union other than the Player's Captured Union must take place in accordance with these Regulations.
- 2.3 There is no restriction upon the number of Players that may Transfer from, or to, any Provincial Union.

3 TRANSFER PERIOD

- 3.1 The Transfer of a Player may only occur during the period 1 October in one Contract Year to the Friday following the Super Rugby Competition final in the immediately following Contract Year. This period is the **Transfer Period**.
- 3.2 If the Transfer of a Player is agreed in writing and notified to the NZRU prior to the Super Rugby Eligibility Date (even if it is to take effect at a later date in that Transfer Period) the Player's Transferring Union will be taken into account for the purpose of determining his Home Franchise for the following Super Rugby Competition.
- 3.3 A Player may transfer only once in each Transfer Period.

4 CAPTURED UNION

- 4.1 An Air New Zealand Cup Captured Player or a Division One Captured Player shall be deemed to be captured by the Provincial Union in which he is currently Registered. This Provincial Union will be the Player's **Captured Union** until otherwise determined pursuant to these Regulations.
- 4.2 A Player is not eligible to be selected for the Playing 22 of a Provincial Union, other than his Captured Union, for the Air New Zealand Cup or Division One Competitions immediately following the Transfer Period during which the Player becomes a Air New Zealand Cup Captured Player or Division One Captured Player unless the Player has transferred in accordance with these Regulations, or has been loaned in accordance with the *NZRU Player Eligibility Regulations*.

5 TRANSFER OF AIR NEW ZEALAND CUP CAPTURED PLAYERS

- 5.1 An **Air New Zealand Cup Captured Player** is a player who is:
- (a) party to a Provincial Union Contract or a Provincial Union Development Contract at any time during the Transfer Period; or
 - (b) enrolled in one of the 14 Regional Rugby Academies and Registered with a club affiliated to an Air New Zealand Cup Union during the Contract Year in which the Transfer Period commences; or
 - (c) Registered with a club affiliated to an Air New Zealand Cup Union and is either:
 - (i) named in any New Zealand Under 21 representative squad announced during the Contract Year in which the Transfer Period commences; or
 - (ii) named in any New Zealand Under 21 representative squad announced during the Transfer Period; or
 - (d) Registered with a club affiliated to an Air New Zealand Cup Union and is either:
 - (i) named in the New Zealand Under 19 representative squad announced during the Contract Year in which the Transfer Period commences; or
 - (ii) named in any New Zealand Under 19 representative squad announced during the Transfer Period.
- 5.2 A Player who is a party to a Provincial Union Contract (or Provincial Union Development Contract) may only Transfer following the expiry of that Player's Provincial Union Term (or Provincial Union Development Term, as the case may be) or earlier termination of these contracts. For the avoidance of doubt, a Player is not in breach of any employment

obligation by entering into discussions during his Provincial Union Term or Provincial Union Development Term concerning employment arrangements which are proposed for a period after the expiry of that Term.

- 5.3 A Player who is not a party to a Provincial Union Contract or Provincial Union Development Contract may enter into a Provincial Union Contract or Provincial Union Development Contract at any time.
- 5.4 An Air New Zealand Cup Captured Player may Transfer to another Air New Zealand Cup Union or a Division One Union during the Transfer Period using the Player Movement Form attached as Schedule 1.
- 5.5 No Development Compensation Fee is payable where an Air New Zealand Cup Captured Player Transfers.

6 TRANSFER OF DIVISION ONE CAPTURED PLAYERS

6.1 A **Division One Captured Player** is a player who is:

- (a) Registered with a club affiliated to a Division One Union and is selected in the Playing 22 of that Division One Union on one or more occasions during the Division One Competition taking place at the time the Transfer Period commences (or for the Transfer Period ending 2 June 2006, a Provincial Union from Division 2 or 3 of the 2005 National Provincial Championship other than a Provincial Union that will participate in the Air New Zealand Cup Competition from 2006 onwards); or
- (b) Registered with a club affiliated to a Division One Union and is either:
- (i) named in any New Zealand Under 21 representative squad announced during the Contract Year in which the Transfer Period commences; or
- (ii) named in any New Zealand Under 21 representative squad announced during the Transfer Period; or
- (c) Registered with a club affiliated to a Division One Union and is either:
- (i) named in the New Zealand Under 19 representative squad announced during the Contract Year in which the Transfer Period commences; or
- (ii) named in any New Zealand Under 19 representative squad announced during the Transfer Period; or
- (d) Registered with a club affiliated to a Division One Union and is either:
- (i) named in the New Zealand Secondary Schools representative squad announced during the Contract Year in which the Transfer Period commences; or
- (ii) named in any New Zealand Secondary Schools representative squad announced during the Transfer Period.

6.2 A Division One Captured Player may Transfer to an Air New Zealand Cup Union during the Transfer Period using the Player Movement Form attached as Schedule 2. For the avoidance of doubt, no Transfer is required where a Division One Captured Player moves to another Division One Union and clause 4.2 will not apply.

6.3 A Player who is a party to an agreement with a Division One Union may only Transfer following the expiry of that agreement.

6.4 A Development Compensation Fee may be payable where a Division One Captured Player Transfers to an Air New Zealand Cup Union. The maximum Development Compensation Fee in these circumstances is as follows:

Category of Player	Maximum Development Compensation Fee
"Division One" as defined in 6.1(a)	\$15,000
"New Zealand Under 21" as defined in 6.1 (b)	\$20,000
"New Zealand Under 19" as defined in 6.1 (c)	\$15,000
"New Zealand Secondary Schools" as defined in 6.1 (d)	\$10,000



- 6.5 Where a Division One Captured Player wishes to Transfer to an Air New Zealand Cup Union there are two alternatives available to the Transferring Union:
- (a) The Transferring Union may agree a Development Compensation Fee with the Captured Union to be paid at the time the Transfer takes place during the Transfer Period; or
 - (b) The Transferring Union may agree at the time of the Transfer to pay the Captured Union a Development Compensation Fee for that Division One Captured Player in the event that the Transferring Union contracts that Player on a Provincial Union Contract or Provincial Union Development Contract during the Contract Year in which the Transfer Period finishes. For the avoidance of doubt:
 - i. the amount of such Development Compensation Fee need not be determined at the time of the Transfer; and
 - ii. the Development Compensation Fee will be payable at the time the Player enters into a Provincial Union Contract or Provincial Union Development Contract.

In the event the Transferring Union cannot agree the amount of the Development Compensation Fee with the Captured Union the maximum Development Compensation Fee will be payable.

- 6.6 In the event a Development Compensation Fee is payable by a Transferring Union, whether at the time of the Transfer or at the time the Player is contracted by the Transferring Union, the Transferring Union shall deposit the agreed Development Compensation Fee (plus GST) in the NZRU Transfer Account by no later than 10 working days after the Transfer or 10 working days after the Player is contracted by the Transferring Union.
- 6.7 In the event a Transferring Union fails to pay to the NZRU any agreed Development Compensation Fee the NZRU may deduct the amount from the next NZRU grant due to be paid to the Transferring Union.
- 6.8 The NZRU shall within 10 working days of receiving any Development Compensation Fee, or deducting it from any NZRU grant, pay the full amount to the Captured Union.

7 NOTIFICATION OF TRANSFER

- 7.1 No Transfer of a Player will be recognised by the NZRU unless a Player Movement Form as set out in Schedule 1 or 2 has been submitted to the NZRU.
- 7.2 All Player Movement Forms must be submitted to the NZRU prior to the end of the Transfer Period.
- 7.3 At the end of the Transfer Period the NZRU shall notify all Provincial Unions of all Transfers that occurred during that Transfer Period whereupon any Player will no longer be captured by his Captured Union and shall be entitled to be selected and play for the Playing 22 of the Transferring Union from the date of such notification.

Part 3 • General

8 CHANGES TO REGULATIONS

- 8.1 These Regulations have been developed pursuant to the Collective Agreement.
- 8.2 In the event the NZRU wishes to make amendments to these Regulations it must comply with the following process:
- (a) in the first instance, the NZRU must meet with the RPC and attempt to obtain its agreement to any amendment;
 - (b) if the RPC withholds agreement, the NZRU may proceed to make the amendment (provided that, in that event the RPC may seek to rely upon the problem resolution provisions of the Collective Agreement).

9 BREACH OF REGULATIONS

- 9.1 Any breach of these Regulations by a Provincial Union will be dealt with by the NZRU in accordance with clause 14 of the *NZRU Domestic Competition Regulations*.
- 9.2 Prior to reaching a conclusion that there has been a breach of these Regulations, the NZRU will notify the RPC of the nature of the alleged breach and provide the RPC with access to any information and an opportunity to have input into the investigation of any alleged breach, including any submissions RPC wish to make about penalty.

DRAFT

**PLAYER MOVEMENT FORM
AIR NEW ZEALAND CUP CAPTURED PLAYER**

1. Player Details *(Player to complete)*

Name:
(First name/s) *(Surname)*

(a) Captured Union:

(b) Transferring Union:

Status during the Transfer Period (tick relevant option/s):

-
- | | |
|---|--------------------------|
| Provincial Union or Provincial Union Development Contract | <input type="checkbox"/> |
| Rugby Academy Member | <input type="checkbox"/> |
| New Zealand Under 21 Representative | <input type="checkbox"/> |
| New Zealand Under 19 Representative | <input type="checkbox"/> |
-

This Transfer will take effect from:
(Transfer Date)

.....
(Signature of Player) *(Date)*

2. Details of Transfer *(Provincial Unions to complete)*

We, the Provincial Unions specified below, agree that the above named Player will Transfer in accordance with the NZRU Player Movement Regulations. From the Transfer Date the Player will be eligible to play for the Transferring Union in the Air New Zealand Cup or Division One Competition. If this form is agreed by all parties and notified to the NZRU before the Super Rugby Eligibility Date this Transfer will be taken into account for the Super Rugby Selection Process, regardless of the Transfer Date.

Name of Captured Union:

.....
(Signature of Authorised Person from the Captured Union)

Name: Position: Date:

Name of Transferring Union:

.....
(Signature of Authorised Person from the Transferring Union)

Name: Position: Date:

For Office use only:

1. *Date Form received:*
2. *Agreed Transferring Union:*

PLAYER MOVEMENT FORM • DIVISION ONE CAPTURED PLAYER

1. Player Details (Player to complete)

Name: (First name/s) (Surname)

(a) Captured Union:

(b) Transferring Union:

Status during the Transfer Period (tick relevant option/s):

Table with 3 columns: Representation Category, Maximum Development Compensation Fee, and checkbox. Rows include Division One Provincial Union Representative (\$15,000), New Zealand Under 21 Representative (\$20,000), New Zealand Under 19 Representative (\$15,000), and New Zealand Secondary Schools Representative (\$10,000).

This Transfer will take effect from: (Transfer Date)

..... (Signature of Player) (Date)

2. Details of Transfer (Provincial Unions to complete)

We, the Provincial Unions specified below, agree that the above named Player will Transfer in accordance with the NZRU Player Movement Regulations. From the Transfer Date the Player will be eligible to play for the Transferring Union in the Air New Zealand Cup. If this form is agreed by all parties and notified to the NZRU before the Super Rugby Eligibility Date this Transfer will be taken into account for the Super Rugby Selection Process, regardless of the Transfer Date.

Name of Captured Union:

..... (Signature of Authorised Person from the Captured Union)

Name: Position: Date:

Name of Transferring Union:

Either: (Delete if not applicable)

In accordance with clause 6.5(a), the Transferring Union agrees to pay by way of a Development Compensation Fee at the time of the Transfer of this Player.

Or:

In accordance with clause 6.5(b), the Transferring Union agrees to pay a Development Compensation Fee in the event that the Transferring Union contracts that Player on a Provincial Union Contract or Provincial Union Development Contract during the Contract Year in which the Transfer Period finishes.

..... (Signature of Authorised Person from the Transferring Union)

Name: Position: Date:

For Office use only:

- 1. Date Form received:
2. Agreed Development Compensation Fee:
3. Agreed Transferring Union: