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COMMENTS ON COMMERCE COMMISSION DRAFT DETERMINATION DATED 9 MARCH 2006 RE PROPOSED ARRANGEMENTS BETWEEN THE NEW ZEALAND RUGBY UNION AND PROVINCIAL UNIONS TO CREATE MORE COMPETITIVE DOMESTIC COMPETITIONS

M C Copeland

Brown, Copeland & Co Ltd

1. INTRODUCTION

1. This report comments on the analysis of detriments and public benefits contained in the Commerce Commission's draft determination of the proposed Premier Division salary cap and changes to the transfer regulations. The comments are grouped under the following headings:
   - General Comments;
   - Detriments;
   - Public Benefits;
   - Balancing.

2. GENERAL COMMENTS

The Nature of Detriments and Public Benefits

2. Paragraph 490 of the Commission's draft determination goes to the very heart of the reasons for the NZRU seeking to introduce a salary cap. In this paragraph the Commission questions whether the adverse externalities imposed on other teams in the league by individual teams seeking their own best interests exceed the benefits of allowing teams to pursue their own self-interest without restriction.

3. This is why, for example, the Wellington Rugby Union was supportive of the salary cap proposal. Taking a short-term, narrow perspective, Wellington as one of the financially stronger unions might have been better off opposing the salary cap so that it was free to use its relative financial strength to further its own interests at the expense of other provincial unions. However adopting a longer-term broader perspective, Wellington did not want to be one of only a few strong unions in a weak league. In the longer term even from its own self-interested viewpoint it considered that it would be better off being a member of a strong league even if that meant giving up some of its natural advantages over its competitors in the league.[1]

4. It is a moot point whether this construction of the problem implies zero allocative efficiency losses and positive allocative efficiency gains, which are additional to the other, identified public benefits. However the Commission's construction of the issue in paragraph 490 is consistent with the decision taken by the NZRU after extensive research and consultation with its provincial unions to propose the salary cap; it is consistent with the interventions by similar bodies in overseas leagues seeking greater competitive balance; and it is consistent with the view that player salaries under a salary cap will in the long run be higher than in an unbalanced league without a salary cap.

5. Whilst the decisions by the NZRU and overseas sports bodies may not be taken with explicit cognisance of concepts such as allocative efficiency gains and losses and externalities, the framework presented by the Commission in its paragraph 490 is an accurate portrayal of the position faced by the NZRU (and other sports bodies) in deliberating over measures such as a salary cap to achieve greater competitive balance.

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1 Similarly the NZRU in its decision-making within the International Rugby Board will on occasions vote in the interests of the international game rather than the immediate returns to NZRU. Strengthening the game internationally is likely to often be in NZRU's best interests in the longer term although it may sometimes impose a cost on the NZRU if it looks at only its narrow short-term interests

Five-Year Analysis Period

6. The Commission chooses a five-year analysis period[2] because of uncertainty. However shortening the analysis period does not remove or reduce uncertainty. By choosing only a five-year analysis period, it becomes necessary to consider the residual values of the detriments and the public benefits at the end of the five-year period since even with a discount rate of 10% the residual values may have a significant impact on the cost benefit analysis results.

7. The residual values in this case are the present values of the future detriment and public benefit streams after year 5. This highlights the inappropriateness of attempting to get rid of uncertainty by arbitrarily choosing a short analysis period.

8. In this particular instance, the choice of only a five-year analysis period biases the results against authorisation. Firstly the Commission has included significant initial set up costs for the NZRU and provincial unions under the heading of "productive inefficiency". Because these costs are non-recurring, extending the analysis period[3] will result in a higher net surplus of public benefits over detriments.

9. Secondly the Commission in its analysis of public benefits has assumed the full impacts of the salary cap on public benefits will take longer to occur than on detriments. I do not think such an assumption is appropriate, but even if it is, such an assumption has the effect in combination with the short five-year analysis period of biasing results against authorisation.

10. Thirdly the Commission have chosen to include only one year (year 5) of the benefits of the salary cap re NZRU broadcasting rights revenues. This is because

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2 Although the Commission says in paragraph 550: "As the Player Transfer Regulations have lasted about ten years, it seems appropriate to assume the same for the Salary Cap Regulations, with an interest rate of 10%." It is unclear exactly what the Commission is suggesting here but the length of life of the Player Transfer Regulations and the interest rate (or discount rate) have no bearing whatsoever on the length of life of the proposed Salary Cap Regulations.

3 or including appropriate residual values at the end of year 5.

the existing contract still has four years to run. Again the impact of this assumption together with selecting a short five-year analysis period is to understate public benefits.

11. Even if the Commission is unwilling to extend its analysis period for its quantitative analysis, it should at least give some consideration to these biases inherent in choosing such a short analysis period when considering the balancing of public benefits and detriments.

The Hardness of the Cap

12. In several places in its draft determination the Commission expresses doubts about how hard the cap will be and on the basis of these doubts reduces their estimates of public benefits. These concerns also influence how it balances the public benefits against the detriments.

13. However, if the cap is not hard then this will impact on detriments as well as public benefits. There will be fewer player "misallocations" (therefore allocative inefficiency will be lower); the cap's ineffectiveness will reflect inadequate resources committed to its establishment and operation (therefore productive inefficiency will be lower); there will be fewer players migrating abroad; and there will be less negative impact on player development.[4]

14. Also in paragraph 533 the Commission in summing up its discussion on the hardness of the cap says: "….. if the salary cap were ineffectual, 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." This is a non sequitur. Just because the absolute values of detriments and benefits are low does not mean an authorisation cannot be given. It is the relative values that are important. By way of example there is no reason,

4 Later in this report the Commission's claims about the salary cap on player development and the economic costs of player migration are disputed

other things being equal, why an arrangement affecting a small part of the New Zealand economy should be less likely to get an authorisation than an arrangement affecting a large part of the economy.

Revenue Sharing

15. In paragraph 518 and elsewhere the Commission suggest that since there are no provisions for revenue sharing the salary cap may not be effective in improving competitive balance. I understand the NZRU will be providing information to the Commission highlighting the extent of "revenue sharing" already in place. The soon to be released paper on NZRU funding assistance to provincial unions may also indicate additional steps to be taken.

Closing of the Gaps Between Unions Without a Salary Cap

16. In paragraph 519 the Commission refers to analysis they have done showing that the extent of disparity between unions has remained roughly stable and even improved since 2000. The NZRU in its authorisation application provided information showing the disparity of performance on the field in terms of the teams reaching NPC Division 1 finals. So far as off-field performance is concerned, the NZRU has recently distributed to provincial unions a group of charts in a booklet entitled "2004 Financial Provincial Union Benchmarking Booklet". The charts in the booklet provide a series of comparisons between the 10 NPC Division 1 unions for each of the five years 2000 to 2004 inclusive. Notwithstanding concerns about the accuracy[5] of the base data and that there are a number of caveats which need to be taken into account in interpreting the information, the charts are a very clear indication of the existing and growing inequalities between the respective unions.

17. By way of example, on page 19 of the booklet where the operating surpluses are recorded it shows in 2004 [ ]

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[5] In particular whether revenue and expense items are being coded consistently by the unions

18. Looking to the future, the addition of the four new teams to the Premier Division, and the increased difficulties in maintaining funding from gaming, licensing and community grants[6] will exacerbate the inequality between unions.

[ ] In 2005 the anti-smoking legislation reduced the total amount of funds available, whilst for a number of years there has been a general tightening in the controls over the distribution of funds from these sources.

3. DETRIMENTS

Productive Inefficiency

19. There are a number of reasons why the Commission has overstated its estimate for this detriment.

20. First given that a final decision will not now be released until well into 2006 and possibly as late as 1 June the set up costs will have been substantially incurred prior to the Commission releasing its decision – i.e. they will be incurred in both the factual and counterfactual. Since it is the difference in the costs between these scenarios looking forward that we need to identify they net out to zero.

21. Second this is also true for year one of at least say 50% of NZRU ongoing annual costs, the provincial union annual compliance costs and the first year operating premium. (The Commission are aware of this – see the final sentence of paragraph 330 of the draft determination.)[7]

22. Third the Commission assumes a cost per provincial union of $15,000. The figure of $10,000 put forward by NZRU in my previous report was based on an average of two inquiries per annum at a cost of $70,000 each. NZRU staff checked with

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6 [.]

7 In the case of the Wellington Union and I suspect the other major unions facing a binding salary cap in year 1 or shortly afterwards, work in response to the proposed salary cap by the board, management and coaches commenced in 2005.

provincial unions and none was intending to engage additional staff. The NZRU's estimate should be accepted over the Commission's hypothetical figure not based on concrete factual inquiries. Further the Commission's figure of $15,000 per union is too high because:

- It is an average figure across all 14 unions in the Premier Division and is applied from year 1 through to year 5 for each provincial union, even though most of the provincial unions will not face salary cap issues in the first few years of the cap;
- The unions will not take on extra staff or contract out additional work[8] as a consequence of the salary cap. Existing staff resources will be used more efficiently. In economic parlance this is a reduction in "underemployment" of resources, which has zero economic cost from the national viewpoint, since no alternative output is being forgone;[9]
- Even without the salary cap provincial unions must work within an effective salary cap. They have to consider what their budgets will allow. Relativity between players is an important issue even without a cap; and
- The Commission has included an additional cost per annum of $100,000 to cover provincial union costs for an average of two breaches per year.

23. Excluding the one-off set up costs, excluding 50% of first year NZRU and provincial union first year premium and annual costs, excluding the Commission's $100,000 per annum breach costs and using an average of $10,000 per annum per provincial union instead of $15,000 gives first year total costs of between $193,750 and $248,750 and costs for years 2 to 5 of between $320,000 and $400,000 per annum. The present value of these costs using a 10% discount rate is $1,098,000 to $1,379,000.[10]

8 Perhaps with the exception that they will incur a slight increase in external auditor fees

9 In the case of the Wellington union the proposed salary cap has involved inputs from the board, management and the coaches, already. However there has been no additional staff employed for this purpose by the union and nor is it proposed to do so in the future. NZRU has informed me that this is also the situation at the Canterbury and Auckland unions.

10 The Commission appear to have adopted the convention of fully discounting costs in year 1, even though year 1 corresponds to 2006 assuming the salary cap is introduced this year. For consistency this same convention is adopted in this report.

Loss of Player Talent

24. The Commission shows no calculations for its estimate of this detriment. However by deducting the Commission's estimates for allocative and productive inefficiency from its total detriments estimate it appears that this detriment has been valued by the Commission at $1.2 million in present value terms.

25. This estimate can be questioned on two grounds. Firstly it is debatable whether the cap will in fact lead to the level of migration out of New Zealand rugby assumed by the Commission especially given the much greater importance of All Black and Super 14 contract payments for the elite players; the Commission imposed timeframe of only the next 5 years; and the introduction of four new teams into the Premier Division for 2006. In the short to medium term (say the next five years) the major issue for these four new unions will not be lack of money but lack of available talent to purchase.[11]

26. However a more fundamental flaw in the Commission's analysis of loss of playing talent is its use of migrating players' salaries as a measure of economic cost to New Zealand. The Commission calls this the lost "productivity" (see paragraph 568). However this is not a measure of lost "productivity" and is not an efficiency loss. Whilst the players concerned lose these salaries, the provincial unions no longer need to pay these salaries. So from "NZ Inc.'s" point of view there is no net loss at all – just a transfer. What then occurs is other players step up to take these players places and the provincial unions pay the salaries to them.

27. We could surmise about whether the replacement players who step up "produce" as much as the migrating players previously did but presumably to the extent they do not their salaries may be correspondingly lower. Only to the extent that there is

[11] Also for those unions hard up against the salary cap a key response will be innovative lending of players. This will not only help them to keep within the cap but provide maximum flexibility to fill gaps in future years to cover retirements, injuries, loss of form by incumbents, improvements in form and development by loan players and players away with All Black teams

a net loss in producers' surplus would there be an efficiency loss from the perspective of "NZ Inc." In the overall scheme of things this will be insignificant if it exists at all.

28. In fact from the perspective of the total national economy any effect the migration of players overseas as a consequence of the salary cap may be positive. There are many examples of NPC first division players (and even some with lesser skills and experience) who have travelled overseas to play (and coach) and as a consequence have been much better able to pay off student loans and invest in property, businesses and other assets from the proceeds earned abroad. A net inflow of capital to New Zealand is created without subsequent out-flows as is the case with foreign investment. During their time away they will not have consumed any government provided services but depending upon their length of time away may still have been required to pay tax. The export of services by New Zealand residents working abroad temporarily is better seen as giving rise to public benefits, rather than detriments.

29. Also a number of returning New Zealand players will have acquired coaching skills whilst abroad (they are frequently engaged as "player-coaches") and their services are much in demand upon their return. Just some examples include Warren Gatland, Jamie Joseph, Ross Nesdale, Shane Howarth, Frank Bunce, John Leslie, Martin Leslie and Tim Mannix.

Reduction in Player Skill Levels

30. Although the Commission did not quantify this detriment they listed it as "significant". [12] It is difficult to determine how the Commission reached this conclusion but it appears to be based on a belief that player development efforts under the proposed salary cap regime and the replacement of the existing Player

[12] In paragraphs 578 and 582 the Commission says that this detriment "could be significant" but in Table 20 of paragraph 812 this detriment is recorded as "significant"

Transfer Regulations with the new Player Movement Regulations will result in reduced player development efforts.

31. I doubt that the removal of development compensation fees will lessen efforts regarding player development. I suspect most unions would describe the payments as a welcome bonus but not a motivational factor. However more importantly the response of Premier Unions to the salary cap will be the complete opposite to that assumed by the Commission. Faced with the salary cap unions will devote more, not less resources to player development. The salary cap will prevent the "filling of holes" with star players already developed by other unions. Much greater attention will need to be focussed on identifying and developing new talent in each union's own "nursery" – i.e. their academies.

32. [ ]

Summary of Salary Cap Detriments

33. The Commission's quantitative analysis estimated a present value for detriments in the range of $3,500,000 to $4,000,000.

34. Removing the loss (migration) of playing talent component and adjusting the productive inefficiency losses figure as described above[13] reduces the range for the present value of detriments to between $1.4 million and $1.7 million ($293,000 for allocative inefficiency, the same as assumed by the Commission, plus $1,098,000 to $1,379,000 for productive inefficiency).

35. There are no "significant" unquantified detriments in the form of a reduced effort to develop players. In fact the impending salary cap is already leading to greater efforts to develop players.

[13] I.e. to account for start up and year 1 costs already spent (and therefore common to both the counterfactual and the factual.), resetting the average cost per provincial union at $10,000 instead of $15,000 per annum and removing the additional $100,000 per annum cost for breaches.

4. PUBLIC BENEFITS

Impacts of the Salary Cap

36. The Commission in paragraphs 612 to 630 and elsewhere in its analysis of public benefits downplays the effectiveness of the salary cap in achieving the claimed public benefits. Part of this discussion refers to econometric work done by Owen and Weatherston and the Commission itself analysing historic data to determine the importance of particular variables on Super 12 and NPC match attendances. Reports by Brown, Copeland & Co Ltd and Professor R. Fort on the limitations of this sort of analysis to predict the impacts of the salary cap have already been forwarded to the Commission, apparently not in time for consideration by the Commission prior to the publication of the draft determination.[14]

37. Further the Commission assumes a gradual build up in public benefits over their 5-year time horizon with full benefits not achieved until year 5. Even then the Commission has halved the assumed range of increased crowds and increased revenues previously suggested of a 10 to 20% increase down to a 0 to 10% increase.

38. The 10 to 20% impacts were based on much larger increases experienced in the Australian NRL and the Australian Football League competitions. This information was forwarded to the Commission with the original authorisation application.

39. Given the greater unevenness in the Premier Division with the addition of four new teams, salary cap impacts on crowd attendances, TV viewers and NZRU and provincial union revenues in the range of 10 to 20% by year 5 are reasonable. This is especially so given the salary cap impacts in the new Premier Division are

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[14] See: NZRU Application to the Commerce Commission – Notes on Owen and Weatherston Papers regarding the Determinants of Match Attendance; Mike Copeland, Brown, Copeland & Co Ltd; 21 February 2006; and Comments on Owen and Weatherston; Rodney Fort; February 17, 2006.

as much about retaining existing crowd numbers and revenues as they are about increasing crowd numbers and revenues from current levels.

40. For example, against a typical average NPC Division 1 crowd of around 25,000 in 2005, the Wellington Union may be fortunate to achieve a crowd greater than 20,000 for its fixture against newly promoted Tasman in the 2006 first year of the Premier Division. If in five years the salary cap results in Tasman developing a side with the playing ability of say Southland in 2005, there is no reason why a Wellington –Tasman clash could not attract a crowd above 25,000 as was achieved in 2005 for the Wellington – Southland match.

41. Under the salary cap, Tasman is likely to be a major beneficiary of Canterbury loaning or selling players as it seeks to remain under the cap but wishes to retain talent within the Crusader Super 14 franchise area. This together with astute recruitment of players from elsewhere could realistically see Tasman's playing strength to be comparable to a number of 2005 NPC Division 1 sides within a few years under the salary cap.

Spectator Enjoyment

42. Comment on the Commission's econometric analysis of spectator enjoyment is to be provided separately by Dr Adolf Stroombergen of Infometrics. However I wish to consider an intuitive interpretation of the Commission's end result. The Commission's analysis concludes that the salary cap will result in benefits to spectators having a present value of $0 to $42,000. The upper limit of this range is equivalent to a uniform average annual amount of $11,000.

43. On the basis of 48 games per annum and an average crowd size of 12,470 for NPC Division 1 over the period 2002 to 2004 inclusive, the Commission's result suggests the proposed salary cap will produce a net benefit per spectator per game

of only between 0 and 1.8 cents[15]. For the net gain to spectators at games to be so insignificant seems counter-intuitive against a background of the PricewarehouseCoopers' Competitions Review report, the decisions of the NZRU Board in response to the Competitions Review, the adoption of salary caps in many overseas sports leagues and the claimed benefits of salary caps in terms of match attendances in the Australian NRL and AFL.

TV Viewer Enjoyment

44. The Commission in its draft determination describes my use of 60 cents to $1.20 as the additional benefits per viewer per game from a more even competition as "fairly ad hoc". The Commission in 1996 accepted the additional value of more even games would lie at the low end of the range 50 cents to $10. The 60 cents is the bottom of this range adjusted for inflation. The $1.20 at the top end of the range was to reflect the greater link between the salary cap and a more even competition than the link present between the Player Transfer Regulations and a more even competition accepted by the Commission in 1996.

45. In my opinion, an amount per viewing is a more easily understood and reliable approach than applying econometric and geometric analysis reliant on simplifying assumptions[16]. For example, the reasonableness of 60 cents to $1.20 per viewing might be "calibrated" by considering the charge out rates for new release versus dated videos (or dvds). The charge out rate for a new release video is typically[17] $8 for overnight hire compared to $4 for an eight-day hire of dated videos. In

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15 If instead of converting the present value of $0 to $42,000 to an equivalent uniform annual range of $0 to $11,000, the Commission's build up profile for spectator benefits of 0% in year 1, 10% in year 2, 50% in year 3, 80% in year 4 and 100% in year 5 is used, the Commission's estimated benefit per spectator per game reaches a maximum of 4.3 cents in year 5. In year 1 the maximum value it is zero, in year 2 it is 0.4 cents, in year 3 it is 2.2 cents and in year 4 it is 3.4 cents per spectator per game. In other words even adopting this approach produces figures, which are counter-intuitive

16 E.g. that the gain in consumer surplus per viewer is the same as for a spectator at the game, and that the relationships between price and quantity demanded for rugby and displaced leisure activities can be represented by straight lines having the same gradient.

17 I.e. ignoring various concessions available, which affect the price of both new releases and other videos.

other words there is at least[18] a $4 premium for new release videos. Assuming an average audience of 2 implies a premium of at least $2 per viewing. In this context, a 60 cents to $1.20 price premium for watching a more even game of rugby seems reasonable.

46. Assuming a build up in benefits of 10% in year1, 25% in year 2[19], 50% in year 3, 80% in year 4 and 100% in year 5 gives a range for the present value of additional benefits of $11.0 million to $22.0 million against the Commission's range of $0 to $9 million.

47. Even accepting the Commission's approach of using its ground spectator increase in average net benefit, it seems logical that the additional enjoyment for TV viewers from watching a more even contest is vastly greater than for at ground spectators.

48. Spectators at the ground will be predominantly supporters of one or other of the two teams playing. TV viewers on the other hand, given the national audience will predominantly not be fans of one team or another. In such circumstances they are more likely to watch a game from beginning to end where there is evenness of competition. In uneven contests they are much more likely to not watch at all, switch channels or go and do something else during the game as the result becomes predictable.

49. Therefore I would suggest a doubling or even some multiple of the estimated improvement in welfare for game spectators is appropriate.

Increased Funding

50. NZRU Broadcasting Rights. The allowing of only one year of the broadcasting rights highlights the shortcoming of assuming a 5-year analysis period and

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18 Since no account is taken of different length of time each can be hired for at these rates.

19 The Commission assume 0% in year 1 and 10% in year 2. However since there is evidence that the salary cap will bite on some teams in year 1 this is too conservative.

ignoring impacts beyond this time period. In addition the Commission is wrong to discount 50% of the overseas broadcasting revenue on the grounds there are costs associated with it. The cost structure is fixed and no material additional costs will be incurred to obtain the additional revenues, which will be earned as a result of the salary cap.

51. NZRU and Provincial Union Sponsorships The Commission in its Draft Determination have conducted some regression analysis to determine a relationship between sponsorship income and the costs of sponsorship servicing. Apart from concerns about the reliability of the data base[20] used for this regression analysis, across the range of a 10 to 20% increase or decrease in sponsorship (or 0 to 10% assumed by the Commission) sponsorship servicing costs will be largely fixed – that is as sponsorship rises or falls across this range, sponsorship servicing costs remain unchanged. NZRU's Premier Division sponsors total only 3 and the bulk of sponsorship income for each of the provincial unions will come from a handful of sponsors[21]. The salary cap will most importantly impact on how much income is generated from these key sponsorships, not from an extension or contraction in the number of sponsorships. Sponsorship servicing costs will therefore remain relatively constant with marginal changes in sponsorship income.

52. Match Income The Commission in its Draft Determination gave no weight in terms of public benefits to increased gate revenue for provincial unions because "any gains would have been captured in the evaluation of public benefits arising from increased spectator demand. "

53. However the gains to spectators are measured in terms of increased consumer surplus – i.e. the increase in benefits to consumers over and above the price they pay for their tickets. In addition to this benefit to consumers, if the salary cap has

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20 I have concerns about the consistency of allocating revenues and costs by the different unions.

21 For example, Wellington talks about its "family of five" who are its frontline sponsors.

the effect of enhancing or maintaining provincial union gate revenue and subsequently surpluses of revenues over costs[22] we will have a situation of both consumers being happier (as measured under 'Spectator Enjoyment') and provincial unions with greater surpluses to

- Reduce financial losses;
- Pay off debt;
- Distribute to their clubs to help foster club rugby; and/or
- Spend on rugby related facilities and development programs in their areas.

The increase in producers' surplus is not captured in the calculation of the increased consumers' surplus arising from the increased spectator demand.

54. This benefit needs to be incorporated somewhere in the assessment of public benefits.

55. In any event only 10% of the additional revenue (and surpluses) gained or retained by provincial unions was included in my previous report's assessment of this component of public benefits. This estimate is conservative given the largely fixed costs of providing the product.

56. 20% Discount Rate The Commission applied a 20% discount rate in present valuing the benefits from additional NZRU and provincial union revenues. This was because the Commission assumed that it would take 5 years before the full impacts of the salary cap would be seen. Elsewhere in its analysis the Commission has used a 10% discount rate and instead used an assumed build-up profile for the particular benefits over the 5-year period. For example in relation to spectator enjoyment, the Commission assumed 0% benefits in year 1, 10% in year 2, 50% in year 3, 80% in year 4 and 100% in year 5.

22 Because costs of supply are substantially fixed across a range of 10 to 20% increase in spectator numbers.

57. Quite apart from the inconsistent approach by the Commission and general concerns about using different discount rates within the same analysis, the arbitrary doubling of the discount rate here does not do what the Commission is endeavouring to achieve. It weights future benefits (say in year 5) downwards relative to benefits in the early years (say in years 1 or 2) when in fact the Commission is wishing to do the reverse.

58. A more appropriate approach would be for the Commission to adopt the same approach as it did with respect to the build up profile for spectator enjoyment. However given that some effects of the salary cap will be felt as early as this year (2006)[23] I believe a more realistic build-up in benefits might be 10% in year 1, 25% in year 2, 50% in year 3, 80% in year 4 and 100% in year 5.

59. Applying this build-up to these public benefits, gives a net present value for these benefits of between $702,300 and $1,405,000.[24] This excludes any adjustment for the additional teams and the additional games as a consequence of the 14-team Premier Division competition compared to the 10-team NPC Division 1 competition.

Indirect Benefits

60. The Commission's unwillingness to place much weight on the indirect benefits flowing via a more even competition and improved performances by NZ national teams is based on its view that there is only a weak link between the proposed salary cap and improved performances of New Zealand national teams. The link between the salary cap and national team performance rests on three propositions:

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23 See Commission's draft determination paragraph 330

24 Assumes salary cap impact of 10% to 20% revenue increase or retention; NZRU additional overseas broadcasting revenue only year 5; no deduction of NZRU broadcasting costs; 10% of 2004 provincial revenues including gate income a national economic benefit; no adjustment for sponsorship servicing costs; 3% increase in 2004 figures for CPI adjustment; build-up profile of 10%, 25%, 50%, 80% and 100% for years 1,2,3,4 and 5 respectively; and 10% discount rate.

- That the salary cap will lead to increased emphasis on player development not less – this has been addressed above under 'Reduction in Player Skill Levels' in the Detriments section of this report above;
- That the salary cap will lead to a more even competition, thereby improving the skills of players through playing in more "pressure" games; and
- That the salary cap will lead to increased game time for the most talented players in the Premier Division and therefore will increase the skill and experience of the player base from which national teams are selected.

61. The veracity of the second and third of these three propositions is perhaps best argued by respected rugby coaches, as Sir Brian Lachore did before the Commission in relation to the Player Transfer Regulations back in 1996.

Summary of Public Benefits

62. Adding together the public benefits estimated above under the headings of TV viewing and increased funding for NZRU and premier division provincial unions gives a present value for public benefits of between $11.7 million and $23.4 million. This excludes any allowance for increased spectator enjoyment. The Commission's estimate of $0 to $42,000 gets lost in the rounding. Allowing a benefit ranging between 30 cents to 60 cents per spectator per game (i.e. half the benefit assumed in this report for TV viewers increased enjoyment) and the number of spectators per season the same as for the average of NPC Division 1 during 2002 to 2004 (i.e. no adjustment to the increase in number of games from 48 to 70 per season in the new Premier Division competition) gives a more realistic present value for game spectator benefits ranging between $0.3 million and $0.7 million.

63. In addition to these quantified public benefits are the so-called indirect public benefits. The Commission labels these as "insignificant" but presumably would accord them some significance if convinced of the link between the player salary cap and improved national team performances.

5. BALANCING

64. Comparing this report's present value of detriments ($1.4 million to $1.7 million) and public benefits ($11.7 million to $23.4 million) gives a net public benefit surplus ranging between $10.0 million and $22.0 million. To this needs to be added unquantified benefits to spectators at games and indirect public benefits. There are no significant unquantified detriments.

65. By adopting only a 5-year analysis period, the quantitative analysis has understated the range for the net public benefit surplus.

66. The Commission's Draft Determination balancing of public benefits versus detriments identified quantified benefits of $0 to $10 million and quantified detriments of $3.5 million and $4 million in present value terms. The Commission elects "to take no more than the midpoint of the range as being a reasonable estimate of the likely public benefit (i.e. $5 million) " and compares this with the maximum quantified detriments (i.e. $4 million)" to conclude the net public benefits are $1 million.

67. Taking the mid-point of the range it has estimated for public benefits but the upper end of the range it has estimated for detriments effectively double-counts the Commission's discounting of public benefits relative to detriments in that it has already reduced public benefit estimates due to concerns about the cap not being effectively applied but failed to similarly reduce detriments, which must also be a function of the cap's effectiveness. Further the Commission takes no account of the effects of using only a 5-year analysis period.

68. However even adopting all the Commission's analysis and its approach to balancing public benefits and detriments, the quantified public benefits are $1 million, or 25% in excess of the quantified detriments. Contrary to the

Commission's statement in paragraph 817, a $1 million or 25% net surplus is significant relative to the size of the quantified detriments and public benefits, especially given the conservatism built into the Commission's analysis.

69. This report identifies a number of areas where the Commission has overstated detriments and understated public benefits. Adjusting the analysis to account for this results in the net public benefits surplus increasing to between $10.0 million to $22.0 million. There are no significant unquantified detriments since under the cap there will be a greater rather than lesser concentration on talent identification and development. There are unquantified benefits to the extent that the salary cap will improve national team performances and increase the indirect benefits that would flow from this.