

NEW ZEALAND RUGBY FOOTBALL UNION SUBMISSIONS IN RESPONSE TO DRAFT DETERMINATION – PART 1

INTRODUCTION

The primary focus of this part of the NZRU's submissions is on the legal issues and quantifiable benefits/detriments referred to by the Commerce Commission in its Draft Determination. Part 2 focuses more on the non-quantifiable benefits.

Jurisdiction Issues

- 1 The NZRU has by separate letter withdrawn that part of the application that relates to the Modified Division One regulations (in particular the non payment of players in Modified Division One and prohibition of player loans in Modified Division One). Accordingly the NZRU does not address in this submission issues only relevant to Modified Division One and should not be taken to agree with the Commission's position on any such issues. In particular this submission does not deal with:
 - a. Whether the playing of rugby as a volunteer amounts to services under the Act as suggested by the Commission at para 180; and
 - b. Issues relating to the market for non premium rugby players.

Paragraphs 151-152 and 197-198

- 2 The Commission in its draft determination has not accepted the NZRU's argument that the salary cap is exempt from the Act. The NZRU had argued that the salary cap is exempt on the grounds that
 - a. There is no realistic likelihood of players being engaged by the NZRU other than as employees, and accordingly there is no "market" for the purpose of the Commerce Act.
 - b. The salary cap is exempt from the Act under section 44(1)(f) of the Act.
- 3 For the reasons set out in the NZRU's original application, the NZRU is strongly of the view that the salary cap is exempt from the Act. The NZRU refers to the submissions already made by it in its original application, and reserves its position in respect of this issue.

Paragraphs 323-354, 391-394 and 452-460

- 4 The Commission in its draft determination has concluded that the salary cap would or would be likely to breach one or more of sections 27, 29 and 30 of the Act. The NZRU reserves its position on this point and should not be taken to have accepted that there would be any such breach in the absence of authorisation by the Commission. In particular the NZRU notes the points in Schedule 1 Part 1 of to this submission (some of which repeat points already made in the NZRU's application).
- 5 The NZRU does accept, however, that if the Commission concludes that there is an issue under section 27, 29 and/or 30 then the Commission's general approach to the calculation of benefits and detriments is appropriate. (The NZRU takes issue with some aspects of the quantification of benefits and detriments as indicated further

below in this submission and in the attached supplementary report of Mike Copeland).

The Potential Impact of the Cap

Paragraph 556

- 6 The Commission's analysis at paragraph 556 is that if the salary cap constrains at least some provincial unions, average salaries would fall, and this would increase player migration. The NZRU disagrees with this analysis.
- 7 First, as the competition becomes more even and the game more attractive the revenues of provincial unions will increase and those provincial unions that are not currently spending the amount of the salary cap will be able to spend more on players. This will increase average salaries overall. [] accordingly the NZRU expects average salaries to increase dramatically. This is referred to in more detail in Part 2 of these submissions.
- 8 Secondly, as revenues for the game increase due to the more attractive competition, overseas experience suggests that there is scope to increase the size of the salary cap for all teams as occurred with the AFL and NRL competitions in Australia.
- 9 At paragraph 14.2.1 of the Application, the NZRU sets out the experience of the AFL as reported by Dr Alan Jackson, Boston Consulting Group, 1996. In particular, Dr Jackson notes the strong increase in revenues of the AFL and teams after the introduction of the salary cap. As league and team revenues increase, player salaries will inevitably also increase as occurred in the case of the AFL where the salary cap per club increased from \$1.2m in 1987 to around \$2.4m in 1996. In relation to the NRL, page 3 of the statement of Ian Schubert (Schedule I to the NZRU application) notes how the NRL salary cap has increased. The NRL is proposing to shortly increase the size of the salary cap further for these reasons.
- 10 As acknowledged in the Draft Determination at paragraph 558, provincial union salary is only one aspect of why a player may choose to migrate overseas or to rugby league. The NZRU maintains that the migration risk (i.e. the increased migration due to the introduction of the salary cap) will be low.
- 11 Rod Fort has previously considered the issue of migration risk with overseas salary caps, for example noting in his published work that the introduction of a payroll cap system for Brazilian soccer would increase migration of players to other countries where players will receive higher pay (see also para 42 of the Fort report, Schedule H to the application). However in relation to the proposed NZRU salary cap, Professor Fort was of the considered opinion that "*there really isn't much threat that the cap will increase migration*", noting that the cap was just on NPC payments and not on payments for super rugby and All Black duty (para 85, exhibit "H" to application). The disparity between overall individual income levels in New Zealand and overseas remuneration is unlikely to be affected by the salary cap.

Calculation of Benefits/Detriments

Paragraphs 612-615

- 12 In these paragraphs the Commission identifies a number of factors that could potentially impede the effectiveness of the proposed cap in promoting balance. The NZRU makes more detailed submissions on these factors in Part 2.

- 13 However the preliminary point is that the NZRU is concerned that any calculation of benefits and detriments, having regard to the perceived effectiveness of the cap, be approached on a consistent basis.
- 14 At paragraph 615 the Commission states that in recognition of the issues discussed in paragraph 612-614, the Commission proposes to view conservatively any expected public benefits that are claimed would arise. As submitted elsewhere the NZRU does not accept that the cap will be ineffective. However, to the extent that the Commission takes the view that the cap will not be fully effective then that flows through not just to the likelihood of the expected **public benefits** being obtained in full but also to the likelihood of the expected **detriments** actually occurring.
- 15 If the cap is not fully effective then there will not be as many "misallocations" and allocative efficiency will be reduced, nor will there be the same degree of player migration due to the cap, or the same impact on player skills (although the NZRU is strongly of the view that in fact the salary cap's impact on player development will be positive).
- 16 Accordingly if the Commission proposes to take a conservative approach to the calculation of public benefits due to the expected level of effectiveness of the salary cap, then the Commission must also take a similar conservative approach to the calculation of any expected detriments as these will be impacted in exactly the same way.

Link Between Evenness of Competition and Spectator Enjoyment

- 17 The Commission has not done this to date. Instead it has taken a conservative approach to the calculation of public benefits but not to the calculation of detriments which in the NZRU's view is not appropriate.

Paragraph 616

- 18 The Commission discusses here the link between a more balanced competition and the game being more attractive to spectators. The NZRU believes it is self evident that a game is more enjoyable for spectators if the team they are following has a reasonable prospect of winning the game.
- 19 There is also a body of literature supporting this. For example at para 13.2.8 of the application the NZRU referred to the paper by Kesenne "*The Impact of Salary Caps in Professional Team Sports*" Scottish Journal of Political Economy (2000) where Kesenne stated at page 3 "*Empirical investigations have shown that the uncertainty of outcome of a game or the league championship is a significant factor explaining a club's revenue like gate receipts*". Similarly in Quirk and Fort "*Pay-Dirt – The Business of Professional Team Sports*" (1992) in Chapter 7 Quirk and Fort give a number of examples of falling attendances in unevenly match competitions and conclude that interest dries up where a league becomes too unbalanced.
- 20 These historical examples and empirical investigations are backed up by recent and compelling Australasian evidence of increasing gate takings as competitions become more even:
- a. With the Australian rugby league competition (NRL), as the competition has become increasingly more even over the last 3 years, crowd attendances have soared. Attendances for 2005 were 2,963,968 compared with 2,650,850 for 2004 (Appendix Three to Schubert statement, Schedule I to application).

The Media Release dated 31 August 2005 from the NRL attached to the Schubert statement shows that for the 2005 season (said to be the most even season since 1933) crowd attendance had increased by 12%. An attachment to the media release also provides details of record attendances achieved by various clubs during the 2005 season. Over the past 3 years there has been a 27% increase in crowds equating to an additional 530,000 more people. Schubert states "*This 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*" (page 8, Schubert statement).

- b. With the Australian Rules competition (AFL) following the introduction of draft schemes and a salary cap producing a more even competition annual attendances rose between 1987 and 1996 from 2.9 million to 5.3 million, and club memberships from 71,000 to 287,000 (see report of Dr Alan Jackson, 1996, included in the supplementary bundle of material with application at tab 6).

- 21 The NZRU also refers the Commission to the supplementary report by Rodney Fort which relates to the uncertainty of outcome hypothesis and the Commission's analysis at paragraphs 616 to 630.
- 22 The NZRU maintains that there is a strong link between evenness of competition and spectator enjoyment.

Paragraph 628/Question 28

- 23 In response to paragraph 628 and Question 28 the NZRU maintains that a more balanced and even Premier Division competition will be a more attractive one from the prospective of spectators and television viewers.
- 24 In relation to the Commission's suggestion at paragraph 628 that "*there was no evidence in the data to suggest that a more balanced competition (over successive seasons) would lead to stronger crowd attendance*", the NZRU submits that the recent Australasian experience convincingly illustrates otherwise (refer para 15 above).

Paragraph 675

- 25 The NZRU is concerned that the Commission has taken unduly conservative approach to the determination of a figure for benefits in respect of greater spectator interest. The Commission states "*given the suggested weakness of the nexus between the Proposed Arrangements in competitive balance, as argued earlier, the Commission considers it is appropriate to accept benefits towards the lower end of the range reported in Table 15.*" The NZRU comments elsewhere on the question of the alleged weakness of the nexus between the proposed arrangements and competitive balance.
- 26 However, even if the nexus was assumed to be weak (which the NZRU does not accept) the NZRU is of the view that a discounting of the level of benefits should only take place at one stage of the Commission's analysis. It is not appropriate to "*double discount*" for this factor as the Commission appears to have done.
- 27 The Commission does so first at para 661. The Commission notes that Mr Copeland assumed a 10-20% annual increase in spectator demand would follow from implementing the Proposed Arrangements. The Commission states at para 661 that

its preliminary view is that such increases are likely to be too optimistic, given the suggested weak link between the Proposed Arrangements and the claimed benefits. Accordingly at para 663 the Commission assumed a 0-10% increase in demand in year 5 with lesser figures for earlier years. The 0-10% range (being a discounted range having regard to the suggested weak link between the proposed arrangements and the claimed benefits) is then set out in Table 15 under paragraph 665.

28 However having already made a discount due to the suggested weak link between the Proposed Arrangements and the claimed benefits at Table 15, the Commission then discounts from that level **again** at para 675 by suggesting that it is appropriate to choose a figure at the lower end of the range in Table 15 due to the suggested weakness of the nexus between the Proposed Arrangements and competitive balance.

29 The NZRU is of the view that this double discounting is not appropriate.

Link Between Evenness of Competition and Television Viewers

Paragraph 678

30 In this paragraph the Commission discusses the claimed benefits to television viewers. The Commission states "*The starting point for the Commission's analysis was the assumption that the quantum of additional benefits derived from greater competitive balance by the average spectator roughly corresponds to those that may flow to the average television viewer.*" Then at paragraph 683 the Commission assumed a 0-10% increase in demand for year 5 being the same assumption as in the case of spectator benefits referred to above.

31 However the Commission in these paragraphs in taking a similar approach for viewer benefits as for spectator benefits is not consistent with its earlier analysis. The Commission at paragraphs 626 and 628 indicates concerns about the strength of the linkage between a more balanced competition and crowd attendance. However, in relation to television viewers, the Commission records the submission of Sky Television that a reduction in the present competitive imbalance in the NPC would attract more television viewers and states that in the light of the submissions received, the Commission took the preliminary view "*that a more balanced competition would likely result in some increase in television viewership*".

32 Accordingly the Commission accepted a stronger link between the addressing of competitive imbalance and benefits to television viewers that it accepted in respect of benefits to spectators attending matches. However this difference in approach does not appear to have flowed through to the calculation of the benefits to television viewers. Instead the same conservative assumptions (in terms of only a 0-10% increase in viewer numbers in year 5) have been taken in respect of television viewers as have been taken in respect of spectators at matches.

33 It should also be noted that television viewers are less likely to just be supporters of one team and will be more interested in watching a game, and obtain more benefit, if the game is a true contest. This is consistent with the evidence provided in the submission of Sky Television dated 13 December 2005. That submission provides examples of viewership data which show that one sided contests have much less viewership than contests that are expected to be even and are even.

Conditions attaching to Authorisation

Paragraphs 818-820 and 832

34 The Commission in paragraph 820 notes its preliminary conclusion that it would authorise the salary cap proposal subject to a condition sufficient to ensure that the cap is “hard”, including an anti-avoidance provision of the type set out in clause 4.2 of the draft Salary Cap Regulations. At paragraph 832 the Commission suggests the following conditions:

- That the NZRU puts in place robust mechanisms to monitor and enforce compliance with the Salary Cap Framework as set out in its Application. This will include putting in place anti-avoidance clauses, and ensuring that compliance with these is monitored and enforced.
- 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 One, Part A.
- That the NZRU ensure that it puts in place valuation methodologies that are consistent with generally applied valuation conventions.

35 The NZRU accepts that conditions to this general effect may be appropriate, and considers that the proposed Salary Cap Regulations satisfy those conditions.

36 The NZRU is concerned that current wording of the proposed conditions in para 832 of the draft determination is too uncertain. There may be a real difficulty in determining for example whether the NZRU had put in place “*robust mechanisms*” to monitor and enforce compliance with the Salary Cap Framework.

37 Accordingly the NZRU suggests that the Commission instead imposes the following condition on authorisation:

“That the NZRU include in Salary Cap Regulations to be passed by the NZRU the provisions in Schedule 1 to this decision, or provisions to similar effect”

The NZRU would be happy to discuss which provisions of the Salary Cap Regulations should be included in any such schedule.

38 Additional valuation methodologies are to be published by the NZRU from time to time. Any further valuation methodologies published by the NZRU will be consistent with generally applied valuation conventions. This is touched on in Part 2 of these submissions.



Steve Tew

3/04/06

Date

SCHEDULE 1 to PART 1

NZRU submissions as to why salary cap does not breach section 27, 29 and 30 of Act.

- 1 The NZRU agrees with the Commission that the only relevant transactions for the market for premier rugby services are transactions with players who are independent contractors (paras 150-151, 181-182).
- 2 The competition analysis under sections 27 and 30 in respect of the salary cap should proceed on a consistent basis with the Commission's findings to this effect.
- 3 There is nothing to suggest that competition to retain the very limited number of independent contractors (only 1 at present) is likely to be affected by the salary cap proposal.
- 4 First, there are unlikely to be many if any such players [].
- 5 Secondly, any such star players are likely to be secured first by Provincial Unions with Provincial Unions using residual funds to hire other players who do have employment status. Accordingly the salary cap is only likely to impact on players who are employees, not those "stars" who are independent contractors (if there are any at all).
- 6 Accordingly no lessening of competition is likely in relation to players who are independent contractors, who are the only players within the market for the purpose of the competition analysis. Therefore, there is no section 27 issue.
- 7 In relation to section 29, the NZRU disagrees with the Commission's analysis concerning the market for player services. Section 29 cannot apply to that market as the Provincial Unions do not supply services to each other. Accordingly the salary cap does not affect the supply of services by any of them to a third Provincial Union, and para (b) of section 29(1) does not apply.
- 8 In relation to section 30 there is 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 transactions for the purpose of the competition analysis.