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PUBLIC VERSION

COMMERCE COMMISSION

DRAFT DETERMINATION

Note: This is a draft determination issued for the purpose of advancing the Commission's decisions on these matters. The conclusions reached are preliminary and take into account only the information provided to the Commission to date.

Draft 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 C Caygill P J M Taylor 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. (c) Institute a prohibition on remuneration to players, and on the loaning of players in the Modified Division One of the new inter-provincial rugby competition.

Draft Determination: The Commission's preliminary conclusion, on the basis of the information provided to it to date, is that:

- it would be appropriate to grant an authorisation, subject to conditions, pursuant to s 61 of the Commerce Act 1986 to enter into and give effect to the arrangements in paragraphs (a) and (b) above;
- it would not be appropriate to grant an authorisation pursuant to s 61 of the Commerce Act 1986 to enter into and give effect to the arrangement in paragraph (c) above.

Date: 9 March 2006

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS.

TABLE OF CONTENTS

EXECUTIVE SUMMARY[1]

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 sections 27 and 29 of the Act.

2. In June 2005, 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 submits, after undertaking a comprehensive two-year review of the state of, and outlook for, rugby in New Zealand, that, unless changes are made to the NPC competition, there will be a continuation (and acceleration) of the trend towards uneven competition, lower spectator interest, decreasing revenues and potentially less competitive Super 14 Rugby and All Black performances. The NZRU states that this is particularly because the new structure of the NPC allows five unions previously in the old 2nd Division to be in the new PD competition. These new unions are 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 is considered 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 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.

6. A further aim is to ensure that New Zealand rugby remains commercially viable and sustainable.

7. One of the key mechanisms proposed is the introduction of a "salary cap" [2] for the NPC PD unions. A key objective of this salary cap, and the several other

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[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 Draft Determination. Readers are referred to the body of text of this document for the full analysis behind the Commission's Draft Determination.

[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.

mechanisms proposed, 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 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.

The Proposed Arrangements

8. In brief, the NZRU has asked the Commission to authorise three arrangements (the "**Proposed Arrangements**") with the following provisions:

Table 1: "Provisions" of the Proposed Arrangements

Proposed Arrangement	Provision
Salary Cap	"**Salary Cap**": Imposition of a $2m cap on payment of players by PD unions as described in the table set out in Appendix 1.
Player Movement	"**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 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 $0 maximum fee for transfers between PD unions.
MD1	"**Non-Payment of Players**": The prohibition on MD1 unions paying players any more than actual expenses, as described at para 2.9(a) of the Notice of Application.
	"**No Loan Players**": The 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 Notice of Application.

9. The NZRU and the Rugby Players Collective Incorporated (RPC) have entered into a Collective Employment Agreement (CEA) which incorporates the salary cap framework. 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 require the Commission to authorise the salary cap regulations. Rather it seeks authorisation of the salary cap framework as contained in its Application and the CEA. Further, the Applicant states that these Regulations, as drafted, will not be given effect to unless the Commission authorises the arrangements which are the subject of this Application.

Previous Authorisation

11. 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;[3]
- a quota of no more than five players may 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.

12. The NZRU claims that, subsequent to the Commission's 1996 authorisation, the rugby environment and markets for rugby players have changed dramatically, both in New Zealand and internationally. Particular emphasis is placed on the increasing professionalism of all aspects of the game worldwide.

13. In New Zealand, a major development has been the negotiation and introduction of the first collective employment agreement between the NZRU and the RPC for the period 2002 to 2005. A further agreement for the period 2006 to 2008 has recently been entered into. However, as this agreement contains the salary cap framework which is subject to this Application, it will not be given effect to, unless the Proposed Arrangements are authorised by the Commission.

Framework for Consideration

14. The Commission is responsible for deciding whether to authorise the Application under the relevant provisions of the Commerce Act.

15. 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.

16. 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".[4] Such analyses are 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 as to whether authorisation should be granted.[5]

17. 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

[3] NZRU subsequently narrowed this window from four weeks to two weeks. No authorisation has been sought or provided for this change to the arrangements that were authorised in 1996.
[4] Telecom v Commerce Commission (1992) 3 NZLR 429 (CA) at 447, per Richardson J.

[5] 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.)

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 too uncertain to be of any value.

Commission Process

18. In preparing this draft 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.

Submissions and Conference

19. The Commission is now seeking submissions from interested parties in respect of the preliminary conclusions it has reached in the Draft Determination. The deadline for submissions to be received by the Commission is 3 April 2006.

20. Pursuant to section 62(3) of the Act, the Commission gives notice to the Applicants and each other person described under section 62(2) to notify the Commission within 10 working days from 9 March 2006 whether they wish the Commission to hold a conference in relation to this draft determination. If such a request is received by the Commission then a conference will be held in relation to this draft determination on 9 and 10 May 2006.

21. If the Commission does not receive such a request for a conference under section 62(3) of the Act, the Commission may of its own motion, pursuant to section 62(6) of the Act, hold a conference in relation to this draft determination on 9 and 10 May 2006.

22. The Commission intends to release its final determination on the Application on 26 June 2006.

The Factual and Counterfactual

23. 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.

24. 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.

25. 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 No. 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.)

26. The Commission considers that arrangements to implement the proposed Salary Cap Framework are closely interrelated with arrangements to implement the proposed Player Movement Framework and should properly be considered together (these are referred to jointly as the Proposed PD Arrangements). Arrangements to implement the proposed MD1 Framework (Proposed MD1 Arrangements), however, are independent of the Proposed PD Arrangements. Although the Proposed MD1 Arrangements may presume some alteration to the MD1 transfer window, this is not considered likely to be material.

27. The Proposed Player Movement Regulations will have some effects in respect of both PD and MD1 players and teams. However, the effects on MD1 players and services will be minor and independent of the effects that will result from the Proposed MD1 Arrangements. Therefore, it is legitimate to regard the Proposed MD1 Arrangements and Proposed Player Movement Regulations as independent for the purposes of this analysis.

28. To the extent that some of the arrangements proposed to be implemented are independent of one another, it is appropriate to consider a separate factual in respect of those. The Commission considers separate factuals for: (a) the Proposed PD Arrangements; and (b) the Proposed MD1 Arrangements. In such circumstances, it might also be appropriate to analyse separate counterfactuals but that need does not arise here. The Commission considers the same counterfactual in each case.

The Factual

29. The respective factual scenarios therefore involve the following:

Table 2: Properties of factual scenarios for PD Regulations and MD1 Regulations

Characteristics considered in the Factual	**Factual for Proposed PD Arrangements**	**Factual for Proposed MD1 Arrangements**
Implementation of the new NPC competition structure, comprising the 14 team PD and the 12 team MD1	✓	✓
PD Salary Cap	✓	×
Transfer Period	✓	✓
Transfer Fees	✓	✓
Non-Payment of MD1 Players	×	✓
No Loan MD1 Players	×	✓

The Counterfactual

30. The Applicant proposes that the counterfactual is the implementation of the new inter-provincial competition format with no salary cap on Premier Division unions, no restrictions on loan players or payments to players in the Modified Division One competition, but a continuation of the existing Player Transfer Regulations.

31. However, the NZRU has acknowledged in its Application that there are a number of risks inherent in this counterfactual. Specifically, the Applicant submits there is a risk of 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 because the addition of the four new teams to the PD, a feature of both the factual and the counterfactual, will result in greater unevenness in the competition.

32. The NZRU did not put forward an alternative counterfactual in the case that the Commission does not accept their 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.

33. The Commission has concerns about the feasibility of the counterfactual in the medium and longer term. However, as a pragmatic measure to advance the analysis, the Commission has provisionally adopted the Applicant's counterfactual, i.e., the implementation of the new inter-provincial competition format with no salary cap on PD unions, no restriction on loan players or payments to players in the MD1 competition, but a continuation of the existing Player Transfer Regulations.

Recent developments re counterfactual

34. The previous paragraph sets out the counterfactual the Commission has adopted for the purposes of this Application. The Commission has recently been informed by the NZRU that the counterfactual may be different than anticipated, depending on negotiations between the RPC and the NZRU.

35. The NZRU has advised that the following arrangements have been "provisionally agreed" with the RPC:

- clause 50 of the CEA (relating to player transfers) would come into effect immediately, suspending existing Player Transfer Regulations;
- the proposed Player Movement Regulations would come into effect if authorised by the Commission; and
- in the event authorisation is not granted or is granted after 1 June 2006 (this date is still subject to negotiation), Clause 50 of the CEA will apply until the conclusion of the 2007 Super 14 season. In this event, any new regulations relating to player transfers subsequently replacing Clause 50, including the detail of transfer fees, will be subject to negotiation between NZRU and RPC.

36. The Commission considers that, at this stage, these developments are too uncertain to be taken into account properly in its consideration. The Commission will have regard to the outcome of the NZRU's negotiations with the RPC prior to issuing its Final Determination.

Discretion to grant authorisation

37. The Commission has broad discretion to decide whether to grant an authorisation where proposed conduct might breach Part II of the Commerce Act.

38. 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

39. The Commission's view is that, although section 44 means that Part II of the Act is unlikely to apply to the agreements insofar 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"

40. 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 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.

41. 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.

42. 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.

43. 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

44. 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

45. Having decided that the Proposed Arrangement(s) 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 sections 27, 29 or 30 being made out.

46. 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.

47. Under section s 61(6) the Commission must first satisfy itself that the proposed 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.

48. 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.

49. 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 with competition in the counterfactual.

50. 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.

51. 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

52. The Commission first considered whether the NZRU Regulations and the CEA amount to a contract, arrangement or understanding for the purposes of the Act. The preliminary conclusions reached to this question then apply across all arrangements and provisions being considered in each of the three relevant markets. Then, in relation to price fixing, the Commission considered whether the contract, arrangement or understanding is between persons who are in competition with each other.

53. The Commission considered it highly likely that the Regulations and CEA are each a contract, arrangement or understanding for the purposes of ss 27, 29 and 30.

54. The Commission considered that in relation to the premier player services market, an overall arrangement 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 2005. This overall arrangement would be *given effect* to by putting the CEA into effect (subject to Authorisation) and by passing the new NZRU regulations (and the application of any such regulations to members of the NZRU through the Constitution of the NZRU).

55. 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.

56. 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 (i.e., those players who are paid but who are not employees) and the provincial unions acquiring those services.

Effects in the Premier Player Services Market

Salary Cap - s 27

57. The Commission considers 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. It 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 existing player transfer regulations but no salary cap.

Transfer Fees and Transfer period - s 27

58. In relation to either the proposed transfer fee and transfer period, the Commission did not consider competition would be lessened in this market.

Salary Cap - Section 30

59. The Commission considers the salary cap arrangement is an agreement by all Premier Division 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, and thus constitutes a controlling or maintaining of prices in the premier player services market.

Transfer Fees - s 30

60. The Commission's view is 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 market for premier player services.

Effects in the Non-Premier Player Services Market

Non-payment of players – ss 27 and 30

61. The Commission considers that four provisions of these arrangements (transfer period, transfer fee, MD1 non-payment provision and MD1 no loan player provision) also have the potential to impact on competition in this market. Those arrangements with the greatest impact on players in the MD1 are the non-payment and no loan player provisions.

62. In terms of s 27, the Commission considers that it is likely the non-payment provision will hinder the ability of MD1 unions to compete in this market by removing a key method (i.e., paying players) by which they would otherwise

compete with rival unions for the acquisition of non-premier player services. This would subsequently result in a lessening of competition in this market.

63. In terms of s 30, the Commission considers that there are an unknown number of players, either currently or in the future, who could be classified as independent contractors, who are currently receiving payment either for their time, or as compensation for lost wages. Under this non-payment provision, such players will no longer receive this payment, and therefore, this non-payment will result, or would likely result, in an artificial constraint on, or interference with, the competitive determination of prices for these players' services.

Prohibition on loan players – s 27

64. The NZRU has sought authorisation for a further arrangement that no loan players will be eligible to play for MD1 provincial unions, other than front row loan players in the event of an injury.

65. The Commission considers that the proposed no-loan player provision has the likely effect of lessening competition in this market by hindering the ability of unions to acquire and non-employee players to provide non-premier player services.

Transfer period and transfer fee – ss 27 and 30

66. In relation to either the proposed transfer fee and transfer period, the Commission did not consider competition would be lessened in the non-premier player services market.

67. The Commission considers that the agreement to set maximum transfer fees is likely to have the effect of fixing, controlling or maintaining prices under s 30.

68. The Commission's view is that the MD1 non-payment provision, the MD1 no loan player provision would have, or would be likely to have, the combined, or likely combined effect, of lessening competition in the market for non-premier player services.

69. In addition, the Commission considers that the non-payment provision and the maximum transfer fee provision are likely to have the effect of fixing, controlling or maintaining prices and therefore are 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.

Effects in the Market for Sports Entertainment Services

Section 27

70. 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.

71. 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.

72. With respect to provisions relevant to the MD1 unions, the Commission considers the relatively low numbers of spectators attending MD1 matches indicates that the likely effects of the MD1 Proposed Arrangements would be unlikely to lessen competition in the context of the wider sports entertainment market.

73. Therefore, the Commission's view is that the Proposed Arrangements would not lessen or would not be likely to lessen competition in this market.

Section 29 analysis

74. 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.

75. However, the Commission considers that it is most likely that any competition effects of the salary cap/prohibition on payments to MD1 in the acquisition of player services have already been captured by the application of s 27 and s 27 via s 30, and that any further likely effects of lessening competition from a boycotting arrangement amongst competing provincial unions would be slight.

Conclusion re Exercise of Discretion

76. The Commission's view is that there is a real possibility that each of the proposed arrangements will breach one or more of ss 27, 29 and 30 of the Act. The Commission considers that it is therefore worthwhile for it to continue to apply the benefits/detriments analyses set out in s 61(6) (for authorisation of s 27 (and s 30) breaches) and s 61(7) (for authorisation of s 29 breaches) of the Act to the proposed conduct.

Public Benefits and Detriments

Background

77. The Commission's preliminary view is that a lessening of competition would occur in two markets as a result of the Proposed Arrangements: the premier players and non-premier players services markets. 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.

78. The Commission must therefore identify and weigh the likely benefits and detriments flowing from the Proposed PD Arrangements. Should it be satisfied that the benefits clearly outweigh the detriments, then the Proposed PD Arrangements may be authorised. To the extent possible, the Commission must attempt to quantify the benefits and detriments.

79. A key 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.

80. 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.

Salary Cap Model

81. 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.

82. 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

83. 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.

<u>Hardness of the Cap</u>

84. 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.

85. 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

86. 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

87. 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

88. 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

89. 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

90. 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 preliminary views as to the likely benefits and detriments of the Proposed Arrangements.

Detriments – Premier Player Services Market

91. The detriments have been considered under a number of headings in respect of both markets: allocative efficiency, productive efficiency, loss of player talent, reduction in player skill levels and loss of innovative efficiency. These have been estimated annually for the next five years.

Allocative Inefficiency

92. 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. Such player 'trades' would be blocked by the cap. The resulting player 'misallocations' provide a measure of the allocative inefficiency in the market.

93. 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 $180,000 in Year 5, and correspondingly lower numbers in earlier years.

Productive Inefficiency

94. 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 will 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 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, 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 initially be constrained, and so the monitoring effort could be focused on them, rather than on all teams.

95. The Commission's preliminary estimate is that the proposed salary cap could cost between $708,000 and $918,000 in the first year of operation, and between $490,000 and $570,000 per year thereafter at current prices.

Loss of Player Talent

96. 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, or to rugby league, might be encouraged.

97. The Commission's preliminary 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 over the five years for which their services, it is assumed, would be lost. A salary at the marginal NPC level is assumed, along with the following player losses: no players in Year 1, five in Year 2, ten in Year 3, 15 in Year 4, and 20 in Year 5.

Reduction in Player Skill Levels

98. 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.

99. The proposed replacement of the existing 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. The Commission's preliminary view is that this could be significant.

100. Overall, the Commission's preliminary view is that the proposed salary cap could have some adverse impact on player skill levels.

Innovative Efficiency Losses

101. 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. Apart from this factor, the Commission's preliminary view is that there is not likely to be any significant innovative efficiency losses.

Conclusions on Detriments - Premier Players Services Market

102. The Commission's preliminary assessment of the quantified detriments is that they might be in the order of $3.5 million and $4.0 million over the first five years in present value terms. In addition, the Commission has not been able to quantify the detriment from the reduction in player skill levels, which could be significant, and the loss of innovative efficiency, which is probably not significant.

Detriments: Proposed MD1 Arrangements

103. The elements of the Proposed Arrangements that impact significantly upon the non-premier (MD1) player services market are the ending of payments to players, and the ending of the loan-player facility.

104. A number of likely anti-competitive effects were found. The zero salaries for players is likely to result in some no longer being able to participate due to a lack of compensation for time taken off work, and MD1 provincial unions being inhibited from competing for the services of the best non-premier players.

105. The removal of the loan players exemption is likely to reduce the competition between non-premier unions to acquire the services of players, and would prevent players moving between unions to further their rugby careers.

106. The Commission's preliminary view is that much would be lost from preventing MD1 unions from taking advantage of the loan-player facility to bolster their playing strengths, and to add to the gain in skills of local players. It recognises that this might favour those MD1 unions whose regions are adjacent to those of the major metropolitan unions, from which they could draw loan-players at lower cost, in terms of transport and/or relocation costs.

107. The Commission's preliminary view is that the detriment from the 'misallocation' or non-availability of players through non-payment is likely to be small, as the economic demand for players by individual MD1 unions is likely to be very low.

108. The Commission considers that the estimates for productive efficiency losses, from the monitoring and enforcement of the zero pay and loan-player regulations for the NZRU and the twelve unions involved, could be $20,000 per year. Over the five years this figure amounts to $75,816 in present value terms.

109. The proposed ban on the use of loan-players could have a significant impact on player skill levels, as loan-players were widely used in the 2005 season. The players themselves are likely to have benefited from the experience of playing at a 'higher' level, as would the teams to which they contributed.

110. Overall, the Commission's preliminary view is that there would be detriments from the Proposed Arrangements on the MD1 Competition, and these are likely to be significant in the context of that competition.

Overall Conclusion on Detriments

111. A summary of the detriments of the Proposed Arrangements in respect of the two sets of Arrangements is given in Table 3. These are estimated in present value terms over a five year timeframe.

Table 3: Summary of Preliminary Estimates of Detriments

Arrangements	Type of Detriment	Estimated Size
Proposed PD Arrangements	Quantified (allocative and productive inefficiency, loss of player talent	$3,500,000 to $4,000,000
	Reduction in player skill levels	Significant
	Loss of innovative efficiency	Insignificant
	Total (rounded)	>$3,500,000 to >$4,000,000
Proposed MD1 Arrangements	Quantified (productive inefficiency)	$75,816
	Allocative inefficiency	Small
	Loss of player talent	Small
	Reduction in player skill levels	Significant
	Total (rounded)	>$75,800

112. These estimates suggest that, assuming the Proposed Arrangements were to have an impact, then over the five year period the present value of the estimated detriment would be in excess of $3.5 to $4 million for the Proposed Premier Division Arrangements and at least $75,000 for the Proposed Modified Division 1 Arrangements.

Benefits: Proposed PD Arrangements

113. 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.

114. The Applicant also argues that a more even competition will lead to enhanced performances by international New Zealand sides. It is claimed that this would produce a range of 'indirect' public benefits.

115. 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

116. 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*.

117. 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 uncertainty of outcome hypothesis. 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.

118. Empirical work in recent years testing the hypothesis 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.

119. 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.

120. Little empirical work has been performed to evaluate the impact of competitive balance on television viewership. 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. In light of these submissions, the Commission took the preliminary view that a more balanced competition would likely result in some increase in television viewership.

Enhanced Provincial Union Financial Performance

121. 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.

122. 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.

123. 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.

124. For example, increased spectator revenues will represent a gain to rugby union, but will 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.

125. 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

126. 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).

127. 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.

128. 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.

129. 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.

130. 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.

131. 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

132. 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.

133. 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.

134. The Commission's 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. It therefore considered that a zero to 10% increase in spectator demand under the factual to be more plausible. Also, 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. 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.

135. 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 $42,000 over five years, in present value terms.

Viewer Enjoyment

136. The Applicant also argued that 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, the Applicant arbitrarily assumed that benefits in the range of between 60 cents and $1.20 per viewer would flow under the factual. This translates to public benefits of between [
].

137. Once again, the Commission considered these estimate too generous, and difficult to justify, given the ad hoc approach from which they were derived.

138. In making its own assessment of likely viewer benefits, the Commission assumed that the additional benefits derived from a more appealing competition in the factual by the average television viewer roughly corresponds to those derived by the average spectator. By applying the expected net gain in welfare per rugby spectator to total expected viewership under the factual, the Commission estimated that the net public benefits from greater viewer interest in rugby union to be $0 to $9,000,000 over five years, in present value terms.

Increased Funding

139. The Applicant submitted that under the factual, both the NZRU and provincial unions could expect an increase in PD revenues (i.e., greater broadcasting, merchandising, royalty, advertising, and sponsorship revenues), since a more attractive PD competition would be a more marketable one. The Applicant estimates that the public benefits from increased broadcasting and sponsorship revenues would be between [ ] per annum, and public benefits from increased provincial union revenues would be between [ ] per annum. These estimates assume a 10 to 20% increase in revenues per annum under the factual.

140. The Applicant argued that, since all television broadcasting revenues derive from overseas (i.e., through a SANZAR broadcasting deal), the full expected increase in these revenues ought to be treated as a gain to New Zealand. However, the Commission notes that the service being 'exported' must be produced, incurring domestic costs, which must be netted off revenues. As a preliminary estimate, the Commission assumed that 50% of all additional overseas broadcasting revenues represent a true gain to the public of New Zealand after netting off domestic costs.

141. In principle, any additional costs associated with the local broadcaster, SKY, acquiring broadcasting rights from News Corp, would also need to be netted off any additional broadcasting revenues under the factual.

142. Furthermore, since the NZRU's current broadcasting deal next comes up for renewal four years hence, only one year of potential revenue increases were factored into the Commission's five year analysis of benefits, as current annual broadcasting revenues are fixed under the present SANZAR contract.

143. Another relevant question is, to what extent additional sponsorship is actually socially optimal? One approach would be to assume that since many firms undertake sponsorship (and these firms are assumed profit-maximisers), sponsorship must generate some economic benefit. However, it is unclear to what extent these gains are social as opposed to private. The Commission is only concerned with overall social gains when evaluating net public benefits. It may be true that sponsors find it *privately* optimal to market themselves through sponsorship; however, it may also be true that sponsorship spending is at a *socially* suboptimal level. One counter-argument is that some sponsorship expenditure may be socially desirable in some ways, for example, promoting sporting outlets for youth.

144. The Commission estimated 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 $600,000 over five years.

Assessment of Indirect Benefits

145. 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.

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

Benefits: Proposed MD1 Arrangements

147. As noted earlier, the elements of the Proposed Arrangements that impact upon the non-premier (MD1) player services market are the following:

- the prohibition on payment of any remuneration to players in the MD1 competition;
- the restriction of loan players between MD1 unions; and
- the replacement and liberalisation of player transfer regulations. In assessing likely public benefits, the Commission focussed on the first two elements since, historically, very few transfers have occurred between MD1 unions.

148. The Applicant argues that public benefits under the factual would come primarily from four sources:

- cost savings to unions and the NZRU (i.e., savings on player remuneration, loan player expenses, administration costs, and NZRU expenses in rescuing financially failing unions);
- greater crowd enjoyment resulting from a more balanced competition and greater development of local players;
- the improved financial performance of unions, owing to a more attractive MD1 competition; and

- the intangible benefits of amateurism and enhanced community-focussed rugby.

149. The Commission was of the view that because the claimed cost savings essentially represent wealth transfers between individuals, they would not in themselves represent benefits to the New Zealand public. The Commission acknowledged the possibility that some of these savings may be utilised for development of players and community rugby, but such activities would only yield true public welfare gains to the extent that they were the most efficient uses for the available resources. On balance, the Commission's preliminary view is that any such benefits (if they exist at all) would likely be small.

150. In relation to increased spectator enjoyment, the Applicant estimated (using the same simple demand model used for the PD analysis) benefits in the order of $300 to $4,700 per annum, commensurate with a 5 to 20% increase in spectator demand. The Commission considered that this estimate was likely to be too optimistic, preferring a zero to 10% range for annual demand increases. On this basis, the Commission estimated spectator benefits over five years to be in the range of $0 to $5,000 (in present value terms).

151. The Applicant considered that the claimed public benefits in relation to the enhancement of MD1 unions' financial performance would come from three sources:

- the securing of naming rights for the new MD1 competition, [ ];
- the retention of existing in-kind sponsorship by Air New Zealand, [ ]; and
- increased revenue opportunities (e.g., merchandising, royalties, advertising, general sponsorship, etc.) for unions.

152. In relation to the first two items, the Commission noted that [ ].

153. The Applicant estimated the benefits in relation to retaining the naming rights sponsorship in the factual to be approximately $[ ]. The Commission calculates the expected benefits (i.e., taking into account uncertainty) to be in the order of $3,500 to $7,000. Given the practical difficulties of doing so, neither the Applicant, nor the Commission attempted to quantify the social value of the NZRU retaining the Air New Zealand sponsorship in the factual, relative to the counterfactual. However, the Commission considered that this value was likely to be small overall.

154. The Applicant estimated that the total public benefits from enhanced revenue opportunities for MD1 provincial unions to be between $13,000 and $27,000 per annum, commensurate with a 10 to 20% increase in revenues per annum in the factual. Given the likely weak link between the MD1 Proposed Arrangements and the claimed benefits, the Commission regarded this estimate to be too high. The Commission's preliminary analysis indicated that the likely benefits would more in

the range of $0 to $64,000 over five years (in present value terms), in line with a lower revenue growth of zero to 10% per annum.

155. The Commission did not give significant weight to the intangible benefits claimed by the Applicant, given their tenuous nature.

Balancing of benefits and detriments

156. 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, and in the Non-Premier Player Services Market, as compared to the outcome in the counterfactual, are summarised in Table 4. The benefits and detriments relating to the two markets have been considered separately, because the Commission considers that the Arrangements are not sufficiently closely interrelated that they should be analysed together.

157. The balancing of benefits against detriments is shown in Table 4. A qualitative assessment of the detriments and benefits not capable of quantification is included. The impact of the latter in the aggregation of benefits and detriments has been incorporated through the use of the '<' terms. 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 preliminary view, based on the information available to it and the analysis it has conducted to date.

Table 4: Balancing of Benefits and Detriments

Arrangements	Benefit/Detriment	Estimated Size
Proposed PD Arrangements	Overall Quantified Detriments	$3,500,000 to $4,000,000
	Overall Quantified Benefits	$0 to $10,000,000
	Overall Unquantified Detriments	Significant[6]
	Overall Unquantified Benefits	Insignificant[6]
	Net Public Benefit/(Detriment)	**<$(4,000,000) to <$6,500,000**
Proposed MD1 Arrangements	Overall Quantified Detriments	$76,000
	Overall Quantified Benefits	$4,000 to $76,000
	Overall Unquantified Detriments	Significant[7]
	Overall Unquantified Benefits	Small[7]
	Net Public Benefit/(Detriment)	**<$(72,000) to <$0**

158. In respect of the Proposed PD Arrangements, the Commission, on current information, is inclined to take no more than the midpoint of the range as being a

[6] Relative to the quantified detriments and benefits of the PD Regulations.
[7] Relative to the quantified detriments and benefits of the MD1 Regulations

reasonable estimate of the likely public benefits. This would lead to a net public benefit of only about $1 million or less. Given the small size of the prospective net benefits, the Commission would not be satisfied without more assurance that the benefits of the Proposed PD Arrangements would clearly outweigh the detriments. The Commission considers that conditions are necessary to reinforce the effectiveness of the cap, in particular by ensuring that it would be a 'hard' cap.

159. With regard to the Proposed MD1 Arrangements, the Commission is not currently satisfied that the benefits would outweigh the detriments from the lessening of competition. Consequently, the Commission's preliminary view is that it would decline to authorise the Application by the NZRU to pass MD1 Regulations or other wise enter into or give effect to the MD1 Framework specified in Appendix 1.

CONCLUSIONS

160. In arriving at its preliminary conclusions, 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.

161. The Commission's preliminary finding, on the balance of probabilities, is that the Proposed Arrangements 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 players services market; and
- the non-premier player services market.

162. The Commission's preliminary view is that:

- the Commission is satisfied in all the circumstances that future Player Movement Regulations and Salary Cap Regulations, to they extent they are consistent with the Player Movement Framework, and the Salary Cap Framework set out in Appendix 1, 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; and
- the Commission is not satisfied in all the circumstances that future regulations to implement the MD1 Framework as set out in Appendix 1, 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.

DETERMINATION

163. Pursuant to s 61(1)(a) of the Act, the Commission's preliminary conclusions is that it would determine to allow the application by the NZRU for authorisation under s 61 of the Act to pass the contracts, arrangements or understandings to implement Regulations and to otherwise enter into and give effect to the Salary Cap Framework and the Player Movement Framework specified in Appendix 1, Parts A and B.

164. Pursuant to s 61(1)(b) of the Act, the Commission's preliminary conclusions is that it would determine to decline the application by the NZRU for authorisation under s 61 of the Act to pass the Regulations or otherwise enter into and give effect to the MD1 Framework specified in Appendix 1, Part C.

165. The authorisation pursuant to paragraph 829 would be subject to 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.

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 ss 27, 29 and/or 30 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 need to change. In particular, the review concluded that the NPC was suffering from a significant competitive imbalance whereby semi-final appearances and championship winners are 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 argued[8] 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.

8. The NZRU states that the Proposed Arrangements are part of the NZRU's response to the recommendations made in the Competitions Review Final Report[9] and are aimed primarily at:

    - creating more competitive domestic competitions thereby, among other things, contributing to more attractive games, greater revenues, increased performance

[8] NZRU Application, paragraph 18.6.
[9] New Zealand Rugby Union Incorporated, Competitions Review Final Report, July 2004.

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 three arrangements (the "**Proposed Arrangements**") with the following provisions:

Table 5: "Provisions" of the Proposed Arrangements

Proposed Arrangement	Provision
Salary Cap	"**Salary Cap**": Imposition of a $2m cap on payment of players by PD unions as described in the table set out in Appendix 1.
Player Movement	"**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 $0 maximum fee for transfers between PD unions.
MD1	"**Non-Payment of Players**": The prohibition on MD1 unions paying players any more than actual expenses, as described at para 2.9(a) of the Notice of Application.
	"**No Loan Players**": The 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 Notice of Application.

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".

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 agreements[10]; player apparel; meals and

[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

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 interest[11]; 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 Blacks[12] and Super 14[13] 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.

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.

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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 fewer than 3 years experience receive a notional value of $20,000.

19. Even though the kinds of arrangements set out above are more correctly referred 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 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. In the interim, NZRU invited the Commission to rely on the draft regulations provided to the extent that they are relevant to any of the issues to be covered in its Draft Determination.

Player Transfer Rules

21. In relation to the arrangements concerning player transfer rules, the NZRU has stated that it is seeking authorisation of the framework of these rules as set out in the Application and in the Draft Player Movement Regulations as attached to its Application (Confidential Schedule B).

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 15-30 November 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.

Changes to rules for Modified Division One Unions

23. It is proposed there will be a prohibition on remuneration to players competing in the MD1 competition. No payments are to be made over and above reimbursing weekly expenses to a certain level as approved by IRD. NZRU has advised that the approved level is $150.00 per week.

24. No loan players will be eligible to play for MD1 provincial unions other than front row loan players in the event of an injury during the competition to a "local" front row player giving rise to safety issues. Previously six players were able to be borrowed.

25. In relation to these arrangements, the NZRU has stated that it is seeking authorisation of the framework of these rules as set out in the Application and in the Draft Division One Amateur Regulations as attached to its Application (Confidential Schedule C).

COMMISSION PROCEDURES

26. 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. Submissions were requested by 13 December 2006 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 Football Union

27. Further submissions have also more recently been received from North Otago Rugby Union, West Coast Rugby Union, Buller Rugby Union and New Zealand Rugby League Incorporated.

28. In preparing this draft 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 Applicants on a range of points;
    - considered submissions from interested parties;
    - interviewed the Applicants 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.

Submissions and Conference

29. The Commission is now seeking submissions from interested parties in respect of the preliminary conclusions it has reached in the Draft Determination. The deadline for submissions to be received by the Commission is 3 April 2006.

30. Pursuant to section 62(3) of the Act, the Commission gives notice to the Applicants and each other person described under section 62(2) to notify the Commission within 10 working days from 9 March 2006 whether they wish the Commission to hold a conference in relation to this draft determination. If such a request is received by the

Commission then a conference will be held in relation to this draft determination on 9 and 10 May 2006 (to be confirmed).

31. If the Commission does not receive such a request for a conference under section 62(3) of the Act, the Commission may of its own motion, pursuant to section 62(6) of the Act, hold a conference in relation to this draft determination on 9 and 10 May 2006 (to be confirmed).

32. The Commission intends to release its final determination on the Application on 26 June 2006.

THE PARTIES

NZRU

33. The NZRU is an incorporated society, and is the administrative body governing the participants involved in the game of rugby union throughout New Zealand. For the year ended 31 December 2005, the NZRU had total assets of around [ ][14] million and revenue of around [ ] 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 [ ] million.

34. The members of the Union 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.)

35. 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

36. There are currently 26 provincial unions throughout New Zealand. 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.

37. The NZRU constitution sets out the process for determining any proposed separations or amalgamations of provincial unions. There were 27 provincial unions in New Zealand until recently when NZRU approved the amalgamation of Nelson Bays and Marlborough into a new union, Tasman.

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[14] These figures for the 2005 year are confidential at this stage, but will become public in April 2006 when the NZRU Annual report is published.

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

38. 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.

39. 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.

40. Neither of these organisations provides representation for amateur players. Amateur players do not have separate representation at this stage.

Players

41. 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 these players are amateurs who play for their local rugby clubs.

Sponsors

42. 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.

43. 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.

44. 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.[15]

Broadcasters

45. NZRU lists its broadcasters as News Corporation Limited (News Corp), Sky Network Television Limited (Sky TV)(which has live rights) and previously, Television New Zealand for the free-to-air rights, providing delayed coverage. The

[15] NZRU Application, Schedule J, paragraphs 54, 55.

free-to-air rights are now owned by Prime, which has recently been acquired by Sky TV.

46. 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

47. 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.

INDUSTRY BACKGROUND

Grass-Roots Rugby

48. 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.

49. 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.

50. 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

51. 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.

52. 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.

53. 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.

54. 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.

55. 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

56. 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.

57. 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.

58. 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.

59. 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.

60. 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

61. 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.

62. 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.

63. 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

64. 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.

65. 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.

66. 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 [ ] of total revenue for these unions.[16]

Broadcasting Rights

67. 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 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.

68. 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, 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.

69. 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.

70. 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.

71. 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

72. 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.

73. For international fixtures, the NZRU retains all the gate takings but pays the hosting union a set fee or percentage of gate takings received.

[16] Brown Copeland Report, Schedule J, NZRU Application, table between paragraphs 54-55.

74. In 2004, total match income for the NPC Round Robin accounted for one third[17] 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.

Funding from NZRFU

75. The NZRU pays $58.50 per registered player to each provincial union or $150,000 whichever is the greater.

76. 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.

77. Other funding which is not tagged includes funding for general distribution and 1st Division NPC support.

78. 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.

79. In addition, the NZRU is currently conducting a funding review which may result in changes to its current funding arrangements.

Gaming revenue

80. Since 2001, gaming licensing and community trust revenue has emerged as a significant new source of revenue for provincial unions. According to GARAP[18] 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

81. 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".[19]

82. 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

[17] NZRU Application, Schedule J, page 12.
[18] GARAP stands for "Generally Accepted Rugby Accounting Principles".
[19] NZRU Competitions Review, June 2004, paragraph 1.2.

ensure New Zealand rugby remained both competitive and economically sustainable into the future.

83. 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.

84. 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.

85. 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.[20]

86. 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.[21]

87. 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

88. 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".

89. 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 Manukau, Tasman

[20] Ibid, paragraph 3.76-3.89.
[21] Ibid, paragraph 3.88.

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

90. 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.

91. 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).

92. 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.

93. 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

94. The previous authorisation, granted to the NZRU in 1996 to authorise its existing 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."[22]

95. 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 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.

[22] NZRU Application, para 5.1.1, 9 November 2005.

96. 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.

97. 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.

98. 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.

99. 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.

100. 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.

101. 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.

102. RPC professional players will have a new revenue-sharing arrangement with the NZRU that will see 32.4 % of all player-generated revenue go 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.

103. 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 2006[23]. It also sets out the arrangements as to what will happen if no final authorisation is granted (i.e., that the existing transfer regulations will apply and no salary cap will ensue).[24]

104. The implementation of the revenue-sharing and guaranteed retainer provisions of the CEA are perceived as very significant developments in the player contracting

[23] The NZRU and RPC have subsequently entered into negotiations to allow for a variance of this clause to provide for a later authorisation date.
[24] Clause 60 (3) (b) (i) of the Collective Employment Agreement 2006-2008.

environment, affording players a level of income protection not experienced before. The salary cap proposal was therefore negotiated in this context.

APPLICATION OF THE COMMERCE ACT

The Arrangement(s)

105. 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.

106. 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.

107. 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.

108. 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".

109. Section 2(8) deems certain conduct by associations of persons to be arrangements. Section 2(8) provides:

> (8) For the purposes of this Act—
>
> (a) Any contract or arrangement entered into, or understanding arrived at by an association or body of persons, shall be deemed to have been entered into or arrived at by all the persons who are members of the association or body:
>
> (b) Any recommendation made by an association or body of persons to its members or to any class of its members shall, notwithstanding anything to the contrary in the constitution or rules of the association or body of persons, be deemed to be an arrangement made between those members or the members of that class and between the association or body of persons and those members or the members of that class.

Authorisation

110. Under s 58 of the Act, a person may apply for an authorisation for contracts, arrangements or understandings that breach ss 27, 28, 29, 37 or 38. Section 58 provides (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.
>
> …

111. Section 58A(1)–(2) sets out the effect of an authorisation.

> **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.

112. Although the Commission cannot authorise conduct in respect of s 36 of the Act, s 36(1) provides that "[n]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.

113. 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.

114. The Commission's ability to authorise under s 61 is discretionary. However, the Commission may not authorise conduct unless the test in s 61(6) is satisfied. Because the s 61(6) test is extremely time consuming to apply, the Commission considers an application for authorisation in two steps:

- first, the Commission decides whether the application is one in which it ought to exercise its discretion to grant an authorisation (on the assumption that the s 61(6) test was satisfied). This involves consideration of a number of factors, the most significant of which is usually whether there is real possibility of the authorisation being required at all; and
- if the Commission is satisfied that the application is suitable for authorisation, it will then move to consider the test in s 61(6).

115. In conducting these steps, the Commission will comply with all other process requirements set out in ss 58–61.

116. In the remaining sections, the Commission follows this two-step process. In the next sections, the Commission considers how it should exercise its discretion. Having reached the view that it would be a correct exercise of its discretion to authorise the

conduct provided s 61(6) is satisfied, it then considers whether the test in s 61(6) is satisfied.

117. Before undertaking either of these steps, however, the Commission turns to consider a number of issues with the NZRU's authorisation application.

THE APPLICATION FOR AUTHORISATION

118. The Applicant has applied for authorisation under s 58(1), (2), (5) and (6) of the Commerce Act.[25] The Commission is required to consider whether to authorise the entering into, or giving effect to a provision of, an agreement that is the subject of the application for authorisation. This section considers the scope of the authorisation that is sought.

What does the Applicant seek to have authorised?

119. The NZRU's 9 November 2005 application sets out in part 2 "full particulars" of the proposed practices to which the application relates. Those particulars include (in relevant part):

> 2.3 A proposal to enter into and give effect to a Salary Cap with the features set out in the table below … 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.
>
> …
>
> 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

[25] Notice of Application, paras 2.10–2.11.

> 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.
>
> 2.8 A proposal to enter into and give effect to Regulations which prohibit the payment of any remuneration to players in Modified Division One of the NZRU's NPC Competition, with the exception of reimbursement of expenses. …
>
> 2.9 The key aspects of the proposed Division One Amateur Player Regulations are that:
>
> a. there will be a prohibition on payment of any remuneration to a player competing in a Modified Division One team (i.e. no payments over and above reimbursing actual expenses as approved by IRD from time to time); and
>
> b. no loan players will be eligible to play for Modified Division One Provincial Unions other than front row loan players in the event of an injury during the competition to a "local" front row player giving rise to safety issues.
>
> 2.10 Authorisation is sought under sections 58(1) and 58(5) to enter into the Salary Cap with the elements listed at paragraph 2.2 above, and Player Movement Regulations referred to at paragraph (2.6) and Division One Amateur Player Regulations as referred to at paragraph (2.8).
>
> 2.11 Authorisation is also sought under sections 58(2) and 58(6) to give effect to the Salary Cap, Player Movement Regulations and Modified Division One Regulations together referred to as the "Proposed Arrangements".

120. The Commission considers that an application in relation to such proposed "frameworks" of contracts, arrangements or understandings is a valid application under s 58. The Applicant is seeking authorisation to, in future, enter into and give effect to certain arrangements but cannot state conclusively what all terms of those arrangements will be. The Commission proceeds by considering the lessening of competition and the benefits to the public that would result or would be likely to result from the NZRU entering into or giving effect to contracts, arrangements or understandings which have the "framework" characteristics set out in the Application.

121. If the contracts or arrangements that are ultimately entered into and given effect differ from those proposed and authorised (if any authorisation is granted), the Applicant will bear the risk that entering into or giving effect to those contracts or arrangements may breach the Act.

The salary cap framework, player movement framework and modified division one framework

122. 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 framework 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. …

123. The Commission takes this to mean that the NZRU seeks authorisation to enter into and give effect to some future salary cap regulations as a contract, arrangement or

understanding that is consistent with the framework currently proposed. The Commission also takes the Application and 23 December email to mean that the salary cap "framework" is described by the Application, but the Commission may have regard to relevant terms of the CEA and the draft Salary Cap Regulations to augment its understanding of that "framework". The Commission is not, however, asked to determine whether or not it would authorise the NZRU to enter into or give effect to either the CEA or the draft Salary Cap Regulations.

124. In a letter to the Commission dated 25 January 2005 (sic) the NZRU stated (in relevant part):

> You have requested clarification of whether, in relation to Modified Division One ("MD1"), the NZRU is applying for authorisation of:
>
> a) the framework of the proposed arrangement for MD1; and/or
>
> b) the detail regulations that would give effect to those arrangements if approved.
>
> The NZRU is seeking authorisation of the framework of the proposed arrangements as set out in paragraphs 2.6(a)-(c), 2.7(a)-(c), 2.8 and 2.9(a) and (b) and also the accompanying regulations which were attached to the application.

125. The Commission takes the reference to "…and also the accompanying regulations" to mean that the Commission may have regard to relevant terms of the annexed drafts of the Player Movement Regulations and of the Division One Amateur Player Regulations in order to augment its understanding of each of those "frameworks", but the Commission is not, however, asked to determine whether or not it would authorise the NZRU to enter into or give effect to those draft Player Movement Regulations and Division One Amateur Player Regulations.

126. The Commission sets out at Appendix 1 the terms it takes to comprise the "framework" in respect of each of the salary cap, player movement and Modified Division One (the **Salary Cap Framework**, **Player Movement Framework** and **MD1 Framework**, respectively). This Draft Determination analyses the effects of those "frameworks" for the purpose of determining whether the applicant should be authorised to enter into and give effect to contracts, arrangements or understandings that are not inconsistent with those "frameworks".

127. The Commission notes that material terms of the "frameworks" are not set out in final form in the application. For example, the method of valuation of forms of remuneration and "excluded remuneration" for salary cap purposes is proposed to be specified in "compliance statements" to be issued from time to time.

Possible partial authorisation of the proposed reforms

128. The Application does not make explicit whether the Applicant seeks authorisation only of the set of arrangements comprising the proposed salary cap, player movement arrangements and Modified Division One arrangements as a whole or authorisation of those proposals individually. Section 61 of the Act requires the Commission to make a written determination in respect of a s 58 application either "declining the application" or "granting such authorisation as it considers appropriate". If the Commission considers it correct to do so, having analysed the application in accordance with the requirements of the Act, the Commission may

authorise the applicant to enter into and give effect to contracts, arrangements or understandings that will implement some but not all of the proposals set out in the Application. If the Commission ultimately authorises entering into and giving effect to only part of the proposal, then it will be up to the applicant to decide whether it should proceed on that basis or whether the decision not to authorise the whole of the proposal necessitates revision of its plans.

Conditions of Authorisation

129. 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.

130. The Commission might exercise its discretion to impose conditions on an authorisation where (without limitation) it considers those conditions necessary in order to ensure that claimed benefits will in fact be realised.

"Provisions" of the Proposed Arrangements

For this determination, the Commission must analyse the allegedly anticompetitive "provisions" of the Proposed Arrangements. It has identified the following "provisions" that it will analyse in further depth in the remainder of this determination, as set out in Table 6.

Table 6: "Provisions" of the Proposed Arrangements

Proposed Arrangement	Provision
Salary Cap as set out in the Table in Appendix 1, and the Salary Cap Regulations and the CEA to the extent that these give effect to and will be consistent with the Salary Cap Framework.	"**Salary Cap**": Imposition of a $2m cap on payment of players by PD unions as described in the table on pp 4–6 of the Notice of Application.
Player Movement	"**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.
	"**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 $0 maximum fee for transfers between PD unions.
Modified Division One	"**Non-Payment of Players**": The prohibition on MD1 unions paying players any more than actual expenses, as described at para 2.9(a) of the Notice of Application.
	"**No Loan Players**": The 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 Notice of Application.

Question 1. Are there any other provisions of the Proposed Arrangements that might infringe any provision of the Commerce Act?

WHETHER THERE ARE "MARKETS" FOR RUGBY "SERVICES"

131. The Act provides that a reference to a "market" "…is a reference to 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."[26] It is necessary to determine whether the proposed conduct would affect any "market in New Zealand for…services".

132. The Act does not define "services" exhaustively. The definition has both inclusive and exclusive components:

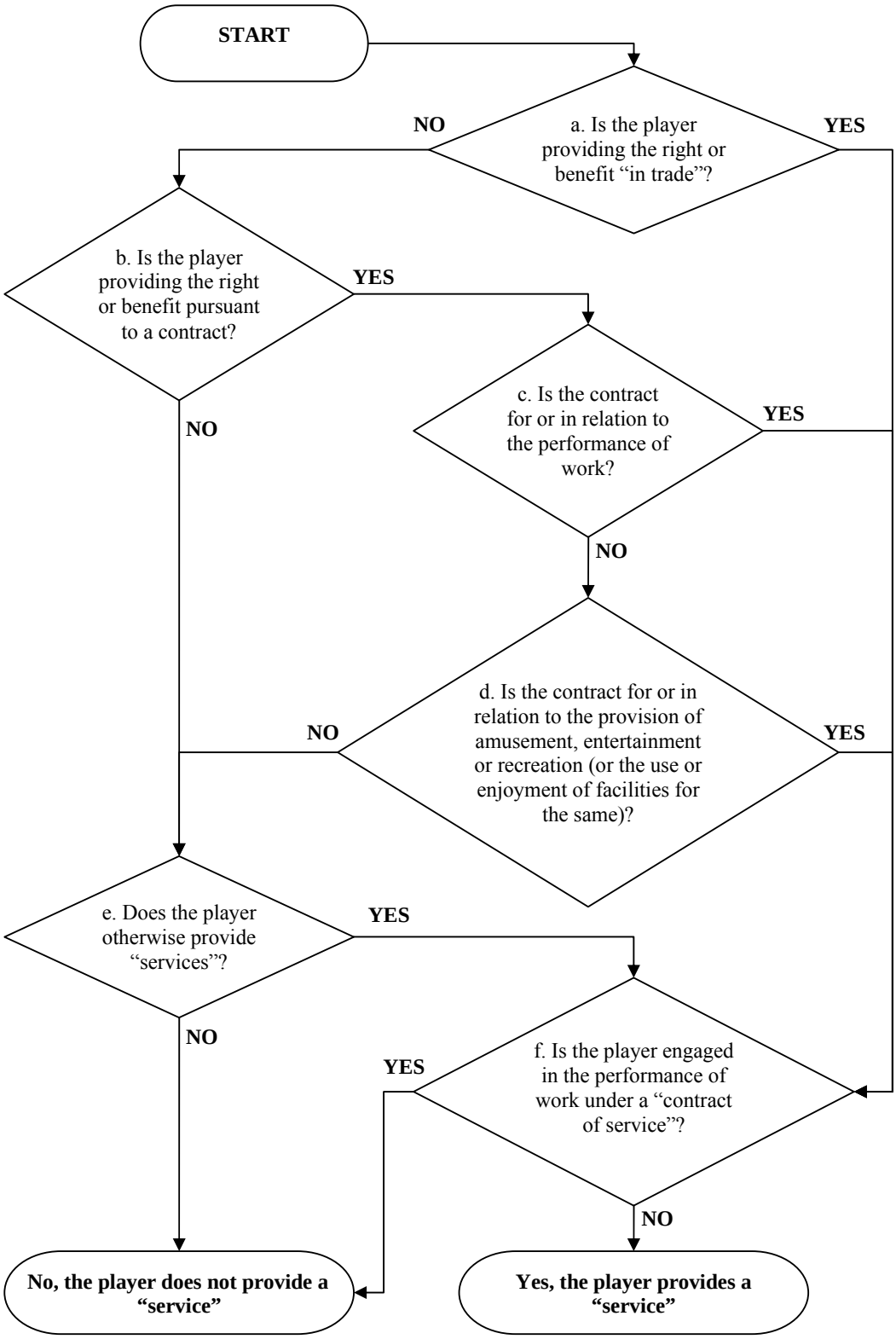
> **"services"** includes any rights (including rights in relation to, and interests in, real or personal property), benefits, privileges, or facilities that are or are to be provided, granted, or conferred in trade; and, without limiting the generality of the foregoing, also includes the rights, benefits,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

133. 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.

134. 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 Figure 1.

[26] Section 3(1A).

Figure 1: "Services" under the Commerce Act, as applied to rugby — analytical framework



135. As a further consideration, the services provided must have a "necessary notion of commerciality" for there to be a "market".[27] As the Commission has noted:[28]

> {T}here will {not necessarily} be a market for services in respect of every group of people who set up a club or association and pay membership fees or subscriptions. The Commission's view is that there is a wide spectrum of such groups, from those associations which are clearly commercial in nature, for example professional and trade associations, to groups established for reasons such as charitable, community service, environmental or cultural reasons which do not provide services in the context of a market. Each case must be determined on the basis of relevant facts.

Employment Status of Participating Players

136. The Commission finds it helpful to approach the question of whether there exist "markets" for rugby "services" by considering how relevant provisions of the Commerce Act apply to the activities of three categories of players:

- players who participate pursuant to a paid employment contract ("**Employees**");
- players who participate on a paid basis as independent contractors (i.e., not in an employer-employee relationship) ("**Contractors**"); and
- players who are unpaid or merely reimbursed their playing expenses ("**Volunteers**").

137. "**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).

138. "**Volunteers**" are those players who receive no payments or fringe benefits from playing rugby other than those deriving directly from the game (such as physical fitness and personal satisfaction) or required for playing the game at NPC level (such as access to club facilities and equipment, uniforms or travel to away matches). No Volunteer players participate pursuant to a contract of service

139. Players who are neither Volunteers nor Employees may be "**Contractors**." The Commission considers that both Premier Division and non-Premier Division players could potentially participate in rugby as Contractors.

140. 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*[29] 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

[27] *Re Speedway Control Board of NZ (Inc)* (1990) 2 NZBLC (Com) 104,522, {64}.
[28] Ibid {69}.
[29] {2005} 3 NZLR 721 (SC), {35}.

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.

141. The following observations were made obiter in *Rugby Union Players' Association v Commerce Commission*:

> 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.[30]

142. 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.[31]

143. 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.[32] 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. They do not expect that there would be any "new" independent contractors in the next 2–3 years at least.

144. 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.

145. 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

[30] [1997] 3 NZLR 301, 328–329 (HC).
[31] Interviews with selected players held at the office of the NZRU, Wellington, on 21 December 2005.
[32] NZRU Application para 22.7, 22.8

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.[33] 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.

146. A player is likely to be a Contractor rather than a Volunteer when the player receives a payment not simply for expenses incurred to ensure that the player can get to and participate in the game to the required standard (e.g., facilities, playing uniform, travel to away venue, training, insurance), but also to compensate the player for his time.

147. In respect of the remuneration factor (payment of more than direct expenses), the Commission understands that a number of players who would likely be eligible to play in the MD1 are currently paid for their time, either explicitly or as "compensation for lost income". For example, the Poverty Bay Rugby Football Union stated:

> Of chief concern to the PBRFU is the prohibition on remuneration payments (other than expenses) to players participating in the modified division one competition. The PBRFU feels that this prohibition will inhibit many players' involvement within the division as team members will be expected to take Fridays off work to travel to away fixtures. If these players are not allowed to be reimbursed for their time off work it is likely that many will not be in a position to commit to the PBRFU.

148. Whether such compensation is characterised as "compensation for lost wages" (as per the PBRFU submission) or in some other way is not determinative.

149. The Commission has interviewed a number of Division 2 and 3 players and unions to determine whether they consider the relationship to be one of employment. Most did not consider there to be an employment relationship, but nor did they think of themselves/their players as independent contractors. Most had never considered the issue at all.

Question 2. The Commission seeks further views from second and third division unions and players on the nature of their relationship. Are players "employees" of unions? To what extent are there written or unwritten obligations on players and unions (e.g., to play in the NPC team, to be paid reimbursement for expenses and compensation for time off work?)

Conclusion re Employees

150. The Commission's preliminary conclusion is that there are a number of players who are employed under the CEA,[34] playing rugby pursuant to a contract of service, terms

[33] *Bryson v Three Foot Six Ltd* [2005] 3 NZLR 721 (SC), [35].

[34] 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;

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,[35] does not constitute the provision of a "service" in terms of the Commerce Act. Accordingly, the Commerce Act does not apply to the extent that the proposed conduct might affect competition in the playing of rugby by Employees.

Conclusion re Contractors

151. The Commission's preliminary view is that 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.

152. The Commission's preliminary view is that many (or, perhaps, most) of the Division Two or Division Three players who are paid for more than mere expenses are likely to be part-time or casual employees of their provincial unions. The Commission also considers, however, that there is a real prospect of current or future players being paid (but for the proposed Modified Division One Regulations) for playing rugby under a contract for services, that is, as independent contractors. The statutory exclusion in respect of "performance of work under a contract of service" does not apply to players who are independent contractors and the Commission's preliminary view is that there may well be players in Divisions Two or Three who participate (or could in future participate) as independent contractors.

Conclusion re Volunteers

153. The Commission does not consider that any Volunteers play rugby pursuant to a contract of service. Accordingly, the exclusion in respect of "performance of work under a contract of service" does not apply and the Commission does not decline to consider the application so far as it relates to volunteers by reason of that limb of the definition.

NPC rugby as "services"

154. The playing of rugby as an Employee is not a "service" in the requisite sense. Whether rugby played by Contractors or Volunteers is a "service" requires consideration of the questions indicated by (a) through (e) in the diagram set out in Figure 1.

- 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.

[35] Decision No. 281, para 88.

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

155. 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.

156. "Business" is defined in s 2(1) also:

> "**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.

157. While profit making need not necessarily be the dominant objective,[36] the Commission considers that the relevant dealings must be fundamentally commercial in character to be "in trade".

158. To the extent that NPC players participate as independent Contractors, the Commission's preliminary 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.

159. Volunteer players do not participate as their business, profession or occupation. Nor do they play for gain or reward. The Commission's preliminary conclusion is that Volunteers do not engage in rugby playing activities "in trade" and do not therefore come within that limb of the definition of "services" under the Act.

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

160. 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.

161. Contractor players participate in rugby playing activities pursuant to a contract for services.

162. The Commission considers it plausible that Volunteer players may participate in rugby playing pursuant to a contract, e.g., a contract under which they agree to play rugby in return for having their expenses reimbursed. Such a contract may occur at the start of the season when signing up as a player, or on an *ad hoc* basis for each game.

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

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

163. "Work" is not a term that is defined in the Commerce Act.[37] 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."

164. *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."

165. 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.[38]

166. 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.

167. 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 preliminary view is that "work" and, hence, "services" are provided where rugby is played pursuant to a contract which entails the remuneration of the player.

168. 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".

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[37] 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.

[38] [1981] 1 WLR 399 (QBD) at 406–407.

169. Although rugby that is played by Volunteers involves physical and mental exertion to attain an end, the Commission considers that the playing of rugby on an unpaid amateur basis does not amount to "the performance of work". It follows that playing rugby on an unremunerated basis does not constitute provision of a "service" within paragraph (a)(i) of the relevant definition. (This is not to say, however, that players participating in the same competitions and even in the same games or on the same team on an employed or paid contractual basis are not engaged in "work".)

d. Is the contract for or in relation to the provision of amusement, entertainment or recreation (or the use or enjoyment of facilities for the same)?

170. Under paragraph (a)(ii) of the relevant definition, "services" include "the rights, benefits, privileges, or facilities that are or are to be provided, granted, or conferred under … a contract for, or in relation to, … the provision of, or use or enjoyment of facilities for, accommodation, amusement, the care of persons or animals or things, entertainment, instruction, parking, or recreation".

171. The Commission is satisfied that NPC players do not contract with Provincial Unions for the use or enjoyment of "facilities", in the sense intended by the definition: the definition of "services" contemplates that, if this limb of the definition is to be relied on, the service in question must itself be for the use or enjoyment of facilities. It is not enough for the use or enjoyment of facilities merely to form part of the consideration received.

172. When a spectator purchases a ticket to watch a game of rugby, a contract arises for the provision of amusement, entertainment or recreation. The service in such a case is provided by the host provincial union. Although the players' participation is an essential input to that service, the players do not themselves contract to provide entertainment directly.

173. Whether NPC players contract "in relation to" the provision of amusement, entertainment or recreation in the sense contemplated by paragraph (a)(ii) of the definition might be debated. In the absence of authority on this point, the Commission does not rule out the possibility that players might be regarded as providing services "in relation to" the provision of entertainment.

174. The Commission leaves open the question whether Contractors' playing contracts are or are not "in relation to" the provision of entertainment. The Commission does not decline to consider the application on this ground.

175. If there are or may be some amateur players who contract with their provincial unions or local clubs to play NPC Rugby, then the Commission considers it arguable that such contracts are "in relation to" the provision of rugby as an amusement, entertainment or recreation in the sense contemplated by paragraph (a)(ii) of the definition. The Commission does not decline to consider the application on this ground.

e. Do players otherwise provide "services"?

176. "Services" are not exhaustively defined in s 2(1). Even if it does not fall within either of the two inclusive limbs of the definition discussed above, providing or

conferring a benefit may nevertheless be a "service". As Neazor J has remarked (regarding the meaning of "goods" in the Consumer Guarantees Act 1993), "the definition in the Act is inclusive, so that the ordinary meaning is relevant".[39]

177. The ordinary meaning of "service" was recently considered in some depth in *R v Cara*,[40] where Potter J concluded:

> [I]n my view the word "service" is ambiguous. It is an inherently generic and broad term, and even if it is looked at in strict grammatical terms, the word "service" in s 228 (of the Crimes Act 1961) is capable of a wide interpretation and a narrow one limiting it to activities involving an economic element. The question is which interpretation is to be preferred.[41]

178. Unlike the approach taken in *R v Cara* (which concerned criminal liability for dishonest use of a document), the Commission sees no reason to adopt a narrow definition of "services" in the Commerce Act and to confine it to services containing an "economic element". The purpose of the Commerce Act is "to promote competition in markets for the long-term benefit of consumers within New Zealand". The mere fact that consumers receive some services without payment ought not to preclude the application of the Act, and the Commission does not believe that Parliament intended "services" that are provided for reasons other than for immediate payment to fall beyond the ambit of the Act. In a modern economy, many goods are supplied and services rendered for many other reasons. Generally, market forces regulate the supply of these goods and services and restrictive trade practices may adversely affect the supply and acquisition of these goods and services to the detriment of consumer welfare. Consequently, the Commission would be prepared, in an appropriate case, to recognise the provision of a "service" outside a strictly economic or commercial dealing.

179. Given that the Commission considers rugby played by paid independent contractors to be a "service" provided "in trade" and pursuant to a contract for "the performance of work", it is unnecessary for the Commission to consider whether rugby played by contractor players is a "service" within the residual scope of the term.

180. The Commission's preliminary view is that, even if NPC rugby played by volunteers does not come within one of the inclusive limbs of the definition of "services", it is still possible that amateur rugby players' activities should be regarded as "services" in the ordinary sense for the purposes of the Commerce Act.

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[39] *Electricity Supply Association of New Zealand v Commerce Commission* (1998) 6 NZBLC 102,555 (HC).
[40] [2005] 1 NZLR 823 (HC) [138]–[142].
[41] [2005] 1 NZLR 823 (HC), [138]–[142].

Summary of Conclusions on Rugby "Services"

181. The conclusions reached in the preceding paragraphs are summarised in the table below:

Table 7: Conclusions on Rugby "Services"

	Employees	Contractors	Volunteers
a. "in trade"?	n/a	Yes	No
b. pursuant to a contract?	n/a	Yes	Possibly
c. contract for "performance of work"?	n/a	Yes	No
d. contract for provision of "amusement, entertainment or recreation"	n/a	Possibly	Possibly
e. otherwise "services"?	n/a	n/a	Possibly
f. "contract of service"?	Yes	No	Possibly
Therefore, are "services" provided?	**No**	**Yes**	**Possibly**

182. For the reasons set out above, the Commission's preliminary conclusions, in summary, are as follows:

- **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;
- **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 Commerce Act; and
- **Volunteers:** Players who participate in playing rugby as mere volunteers do not do so "in trade" and do not otherwise satisfy the first limb of the "services" definition. The Commission cannot rule out, however, that such volunteers might provide their rugby playing activities pursuant to a contract, and this contract may be "in relation to" the provision of "amusement, entertainment or recreation". Therefore, volunteers might satisfy the second limb of the "services" definition. Alternatively, their rugby playing activities might be regarded as "services" within the ordinary meaning of the word. Therefore, for the purposes of assessing the present Application the Commission treats Volunteer players on the basis that they do provide "services" for the purposes of the Commerce Act.

Question 3. The Commission seeks further information as to whether all three categories of player -- "Volunteers", "Employees" and "Contractors" -- currently participate in Division Two and Division Three. Do any players in these divisions have formal employment contracts? Do any players pay PAYE or ACC contributions? Do any players sign agreements that are stated to be something other than an employment agreement? Do players and unions without a written contract consider they have an unwritten contract to play rugby?

Question 4. Is any submitter aware of any case in which a Division Two or Three player has been involved in an employment dispute with his provincial union?

SECTION 44 - EXCLUSION OF PART II

183. 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).

184. The NZRU asks the Commission to authorise provisions of the following:

- the salary cap "framework" as contained in the Application, to be given effect by the Salary Cap Regulations (to be issued by the NZRU);
- the Player Movement Regulations (to be issued by the NZRU); and
- the Modified Division One Regulations (to be issued by the NZRU).

185. In addition, although the Commission is not being asked to authorise the entering into of the Collective Employment Agreement (signed by the NZRU and the Rugby Players' Collective), the CEA is described as an act of giving effect to the Salary Cap. We therefore also consider the CEA in this section.

186. Part II potentially applies to the CEA and each of the three sets of regulations, unless Part II is excluded by ss 44(1)(c), (f) or (h). Section 44(1) provides that (as relevant) :

> Nothing in [Part II]… of this Act applies—
>
> (c) 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.

187. 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".

188. 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'".[42] For completeness, the Commission also considers the exemption in relation to the other agreements the subject of this authorisation.

189. 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".

The Collective Employment Agreement

Section 44(1)(c)

190. The Collective Employment Agreement provides for the key terms of the salary cap. The CEA is a contract between the NZRU and the players in their capacity as employees of, or contractors to, the NZRU.

191. In respect of the salary cap, the Collective Employment Agreement does not place restrictions on the work in which players may engage. Accordingly, the Commission does not consider the Collective Employment Agreement to be exempt from Part II by reason of s 44(1)(c).

Section 44(1)(f)

192. To the extent that the Collective Employment Agreement provides for the salary cap and the enforcement of amateurism on players who would or might otherwise be employees, the Collective Employment Agreement 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)

193. 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 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 players provide their services "in trade" (see discussion at paras [155]–[159]), it is highly likely that provincial unions acquire these services "in trade".

[42] NZRU Application para 23.3.

The Salary Cap Agreement

Section 44(1)(c)

194. The Salary Cap Agreement regulates the payment of professional NPC rugby players. They only regulate payments of more than $7500. As the Salary Cap Regulations are restrictions on the amount paid, they do not directly entail any restriction on "the work, … in which that person may engage during, or after the termination of, the contract". Hence, the Salary Cap Regulations are not exempted by s 44(1)(c).

195. In addition, the Salary Cap will only bind players in their capacity as members of the NZRU, not in their capacity as parties contracted to the NZRU — the Salary Cap is intended to be binding on provincial unions, not as between the NZRU and players. The Regulations are similar in this sense to the "Promoter's Agreement" between the Speedway Control Board and promoters in *Re Speedway Control Board of NZ (Inc).*[43] The Promoter's Agreement was found to be outside the scope of s 44(1)(c) because competitors were not a party to the Promoter's Agreement in their capacity as competitors.

196. The Commission therefore considers that s 44(1)(c) does not apply to exempt the Salary Cap Regulations from Part II.

Section 44(1)(f)

197. The NZRU considers that the provisions of the Salary Cap Regulations relate to the remuneration of employees as they directly affect the remuneration that provincial unions can pay to their player employees, and are therefore exempt from Part II.[44]

198. The Commission considers the Salary Cap Regulations are exempt from Part II of the Act insofar as they apply to those players employed directly under the Collective Employment Agreement or pursuant to another contract of service. However, the Commission considers that s 44(1)(f) does not exclude Part II from applying in relation to players who are independent contractors or volunteers (i.e., players who are not employees).

Section 44(1)(h)

199. For the reasons in para {193}, the Commission is not persuaded that section 44(1)(h) will exclude the application of Part II to these Regulations.

The Player Movement Regulations

Section 44(1)(c)

200. 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).

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[43] [1990) 2 NZBLC (Com) 104,521 at [89].
[44] [NZRU Application para 23.7].

201. Players would not be bound by the Player Movement Regulations in their capacity as contractors (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)

202. 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)

203. For the reasons in para {193}, the Commission is not persuaded that section 44(1)(h) will exclude the application of Part II to the Player Movement Regulations.

The Modified Division One Regulations

Section 44(1)(c)

204. The Modified Division One Regulations would:

- prevent any payments (other than of expenses) to Modified Division One players; and
- restrict the ability of Modified Division One teams to use "loan" players from other NPC unions.

205. The Modified Division One Regulations are not binding on Modified Division One players as parties to the agreement, but indirectly in their capacity as NZRU members. They are not a contract of service or a contract for services by which a person "agrees to accept restrictions" as to the work in which that person may engage. Hence, the Commission considers that s 44(1)(c) does not apply.

Section 44(1)(f)

206. The Modified Division One Regulations would relate to the "remuneration … of employees", to the extent that they may cause certain non-Premier players, who would otherwise be paid to play, to participate in the Modified Division One on an unpaid basis instead.

207. The Modified Division One Regulations would also relate to the "remuneration, conditions of employment, hours of work, or working conditions" of non-Premier players who play as employees, by removing the opportunity for them to play "on loan" to provincial teams other than their "home" team.

208. Section 44(1)(f) does not otherwise exempt the Modified Division One Regulations from Part II. The exemption would operate here only in respect of "employees", who do not provide "services" for the purposes of the Act in any event.

Section 44(1)(h)

209. As explained earlier, the Commission is not persuaded that s 44(1)(h) excludes the application of Part II to the Modified Division One Regulations.

Summary of effect of s 44 exemption provisions

210. The Commission considers that the exclusions in section 44 of the Act do not apply to exempt in their entirety any of the agreements or 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 Collective Employment Agreement is exempt from Part II insofar as it provides for the enactment of the Salary Cap Regulations in relation to Employees (but not Contractors);
- the Salary Cap Regulations are exempt from Part II insofar as they relate to the remuneration of players who are (or would otherwise be) Employees;
- the Player Movement Regulations are exempt from Part II insofar as they might limit transfers of players who are (or would otherwise be) Employees; and
- the Modified Division One Regulations are exempt from Part II insofar as they would prevent payment and "loans" of players who are (or would otherwise be) Employees.

211. 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 {90}, 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

212. 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.

213. 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.

214. 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.[45]

The Relevant Markets

215. 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.

216. 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.

217. 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,

[45] 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).

- 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.

218. 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.

219. 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

220. 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.

221. 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.

222. 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.

223. 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.

224. 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.

225. 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.

226. In *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor*,[46] 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.

227. 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).

228. 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.

229. 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".

230. 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.

[46] (1989) ATPR 40-925.

231. As noted earlier in the *Background* section, one of the proposed reforms to the provincial competition structure is the promotion of the four strongest provincial unions (one formed from 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.

232. 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.

233. 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.

234. 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 8 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 8 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 8: Average Spend on Training Facilities and Services by Division

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

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

235. 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).

236. For the avoidance of doubt, the Commission takes 'premier' rugby union players to mean all players, whether contracted to the NZRU or not[47], participating in the new NPC PD competition, and in all higher levels of competition.

Question 5. The Commission seeks further views from interested parties on the appropriateness of defining a discrete premier player services market.

Non-premier Player Services

237. A group of players not included in the premier player services market defined above, but still impacted upon by the Proposed Arrangements, 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.

238. 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.

239. 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.

240. 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.

241. The Commission's 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).

242. 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.

[47] 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).

243. 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.

244. 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).

Question 6. The Commission seeks further views from interested parties on the appropriateness of defining a discrete non-premier player services market, consisting entirely of just MD1 players and club A and B team players.

Question 7. Is it appropriate to exclude school and lower-ranked players from this non-premier player services market in order to best expose the likely and relevant competition effects?

Rights to Player Services

245. 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).

246. 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.

247. 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.

248. 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.

249. 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.

250. 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.

251. 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.

252. 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.

253. 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.

Question 8. The Commission seeks further views from interested parties on the appropriateness of not defining a separate 'rights' market.

Sports Entertainment Services

254. 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.

255. 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.

256. The Commission found evidence to support such a definition of the market for the purposes of the present case, which is summarised below.

257. 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.[48]

258. 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 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

[48] 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.

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.

259. 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.

260. 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.

261. 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.

Question 9. The Commission seeks further views from interested parties on the appropriateness of defining a sports entertainment services market. In particular, should this market be broadened to include forms of entertainment other than sports, and if so, which ones? Or alternatively, should the market be narrowed to include fewer forms of sports entertainment, and if so which ones?

Conclusion on Relevant Markets

262. 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).

THE FACTUAL AND THE COUNTERFACTUAL

263. 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.

264. 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.

265. 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 No. 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.)

266. The Commission considers that arrangements to implement the proposed Salary Cap Framework are closely interrelated with arrangements to implement the proposed Player Movement Framework and should properly be considered together (these are referred to jointly as the Proposed PD Arrangements). Arrangements to implement the proposed MD1 Framework (Proposed MD1 Arrangements), however, are independent of the Proposed PD Arrangements. Although the Proposed MD1 Arrangements may presume some alteration to the MD1 transfer window, this is not considered likely to be material.

267. The Proposed Player Movement Regulations will have some effects in respect of both PD and MD1 players and teams. However, the effects on MD1 players and services will be minor and independent of the effects that will result from the Proposed MD1 Arrangements. Therefore, it is legitimate to regard the Proposed MD1 Arrangements and Proposed Player Movement Regulations as independent for the purposes of this analysis.

268. To the extent that some of the arrangements proposed to be implemented are independent of one another, it is appropriate to consider a separate factual in respect of those. The Commission considers separate factuals for: (a) the Proposed PD Arrangements; and (b) the Proposed MD1 Arrangements. In such circumstances, it might also be appropriate to analyse separate counterfactuals but that need does not arise here. The Commission considers the same counterfactual in each case.

The Factual

269. The respective factual scenarios therefore involve the following:

Table 9: Properties of factual scenarios for PD Regulations and MD1 Regulations

Characteristics considered in the Factual	Factual for Proposed PD Arrangements	Factual for Proposed MD1 Arrangements
Implementation of the new NPC competition structure, comprising the 14 team PD and the 12 team MD1	✓	✓
PD Salary Cap	✓	×
Transfer Window	✓	✓
Transfer Fees	✓	✓
Non-Payment of MD1 Players	×	✓
No Loan MD1 Players	×	✓

The Counterfactual

Introduction

270. 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.

271. 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.[49]

272. 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 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.

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

The Applicants' View of the Counterfactual

273. The Applicant has proposed 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 or restriction on payments to players in the MD1 competition, but a continuation of the existing Player Transfer Regulations. These consist of 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.

274. The Commission notes that in addition to the above features of the Applicant's counterfactual, the MD1 unions would continue to be able to borrow up to six players from other unions.

275. 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.

276. 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.

277. 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.

278. 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 created by the larger-resourced unions compared to the new, lesser-resourced unions. Provincial unions considered that this may include changes to the funding criteria applied to provincial unions, arising from the funding review currently being undertaken by the NZRU, and/or other mechanisms, as yet unspecified.

The Commission's View of the Counterfactual

279. The Commission agrees 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 has very real reservations about the sustainability of the Applicant's proposed counterfactual in the medium and longer term. However, despite canvassing this issue widely with the provincial unions interviewed, none was able to articulate what the likely features of an alternative counterfactual might be.

280. Therefore, in order to progress the analysis of this Application, the Commission has decided to take a pragmatic approach and accept the NZRU's counterfactual in the interim, and to seek submissions on this point.

Conclusion on the Counterfactual

281. On the basis of the information it has received to date, the Commission has reached the preliminary conclusion that the likely counterfactual will have the following characteristics:

- the new competition format;
- a transfer window of 2 weeks in November of each year;
- player transfer fees to be paid by the unions acquiring players to the unions losing players, to certain prescribed maxima; and
- a quota system limiting the number of players a provincial union may acquire in any given season (i.e., no more than 5 players in any one year, with no more than one of those players being an All Black).

Question 10. The Commission seeks comment on the characteristics of its counterfactual.

Proposed Variation to Application

282. Clause 60 ("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.

283. 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.

284. The NZRU has advised that the following arrangements have been "provisionally agreed" with the RPC:

- clause 50 of the CEA (relating to player transfers) would come into effect immediately, suspending existing Player Transfer Regulations;
- the proposed Player Movement Regulations would come into effect if authorised by the Commission; and
- in the event authorisation is not granted or is granted after 1 June 2006 (this date is still subject to negotiation), Clause 50 of the CEA will apply until the conclusion of the 2007 Super 14 season. In this event, any new regulations relating to player transfers subsequently replacing Clause 50, including the detail of transfer fees, will be subject to negotiation between NZRU and RPC.

285. Should it proceed as planned, this proposed variation will have the effect of changing the Commission's counterfactual in relation to the Player Transfer Regulations and Player Movement Regulations. Under the variation, the counterfactual will change in that the existing Player Transfer Regulations would no longer apply, but that the provisions of Clause 50 of the CEA (relating to player transfers) would apply until the conclusion of the 2007 Super 14 season and any new regulations subsequently replacing Clause 50, including the detail of transfer fees, will be subject to negotiation between NZRU and RPC.

286. As this variance is only provisional, the Commission has not factored its potential effects into the analysis relevant for this Draft Determination.

Question 11. The Commission seeks comments on the likely effects of the Applicant's proposed variance on its counterfactual analysis, and the likely consequences of this on competition and its possible impact on the benefits and detriments analysis.

COMPETITION ANALYSIS - SECTIONS 27, 29 AND 30 ANALYSIS

Introduction

287. 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 finds that the practice in question lessens 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.

288. 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.

289. 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 a market for (and services provided by) non-employee players.

290. 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.

291. 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.

292. 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.

293. 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:
  - no payment provision: s 27 and s 30;
  - no loan provision: s 27;
  - transfer fee: s 27 and s 30;
  - transfer window: s 27;
- the sports entertainment market:
  - all arrangements affecting the premier player services market; and
  - all arrangements affecting non-premier player services market.

294. However, the Commission will first consider whether the NZRU Regulations and the Collective Employment Agreement (CEA) amount to a contract, arrangement or understanding for the purposes of the Act. The conclusions reached to this question will then apply across all arrangements and provisions being considered in each of the three relevant markets. Then, in relation to price fixing under section 30, the Commission will consider whether the contract, arrangement or understanding is between persons who are in competition with each other.

Contract, arrangement or understanding

295. 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.

296. 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.[50]

297. '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.

298. The Applicant has requested that the Regulations and CEA each be considered as a contract, arrangement or understanding (NZRU Application, para 2.10). The Applicant has not requested that the Regulations and CEA themselves be considered as "giving effect to" some other agreement (whether the NZRU constitution or some other agreement to enter into the regulations).

299. Regardless of the approach adopted, however, the Commission considers it highly likely that the Regulations and CEA are each a contract, arrangement or understanding for the purposes of ss 27, 29 and 30. In the next paragraphs, we identify how these Regulations and the CEA might be regarded as a contract, arrangement or understanding (for the purposes of s 27, and/or s 27 via s 30) and we set out the parties to these agreements.

The CEA

300. The CEA[51] was signed between the NZRU and the Rugby Players Collective Incorporated (RPC) on 1 November 2005. The RPC represents around 400 professional New Zealand rugby players and is recognised by the NZRU as the negotiating arm of the New Zealand Rugby Players Association (NZRPA). Subject to clause 60 ("Commerce Commission Authorisation") of the agreement, the CEA places salary cap obligations on unions, and the NZRU is empowered to make the NZRU Salary Cap Regulations and Player Movement Regulations on terms and conditions not inconsistent with the CEA.

301. The CEA creates an agreement between the NZRU and RPC and provides the terms and conditions of employment for all players who provide playing services to any New Zealand team. Although the principal parties to this agreement are the NZRU and the RPC, the CEA also binds the PD provincial unions (but not the MD1 provincial unions) and the five New Zealand Super 14 Rugby franchises, and these

[50] *Commerce Commission v Giltrap City Ltd* {2004} 1 NZLR 608, 613 para 17.
[51] NZRU and RPC Collective Employment Agreement.

parties must also comply with the terms and conditions of the CEA. Clause 1.4 of the CEA states:

> "The NZRU represents the interests of the Super Rugby Franchises and the Provincial Unions, and each of those entities agree (sic) to be bound by and comply with the terms of this Collective Agreement (insofar as those terms apply to them). Each Super Rugby Franchise and Provincial Union has indicated its acceptance of this arrangement by signing an acknowledgment document, a copy of which is annexed as Appendix 1 to this Collective Agreement."[52]

302. Appendix 1 of the CEA ("Acknowledgement of Terms") further clarifies:

> "By signing this acknowledgement each Super Rugby Franchise and Provincial Union confirms that it has read and understood the Collective Agreement, and that it will not contract out of, undermine, or act contrary to any provisions of the Collective Agreement, nor will it enter into, or attempt to enter into, any arrangement pursuant to which a Player might be required to surrender any of the rights given to him under the Collective Agreement."[53]

303. In part, this clause is intended to ensure the provincial unions do not have the ability to undermine the provisions of the Proposed Arrangements, even if they were to engage a player as an independent contractor, outside the CEA, as is provided for in clause 4.2 of the CEA. Further, even if a provincial union were to engage a player as an independent contractor, via a representative entity, that player would still be subject to the terms of the CEA through clause 4.2 (c), which provides:

> 4.2 The NZRU may enter into a Playing Contract under this Collective Agreement with a representative entity on behalf of a Player provided that: [54]
>
> (a) …;
> (b) …; and
> (c) the terms of this Collective Agreement otherwise apply as agreed by the NZRU, the RPC and the Player."

304. In the event that the NZRU engages a player who is not a member of the RPC (or who elects not to become a member of the RPC) as an employee, Clause 5.2 of the CEA requires the provincial union to deduct and pay to the RPC equivalent union fees as if he were a member and apply the terms of the CEA to that person as if he were an RPC member, including the salary cap provisions.

305. The signatures of all five New Zealand Super 14 Rugby Franchises and 14 PD provincial unions appear on the Acknowledgement Document, attached as Appendix 1 to the CEA. The Commission therefore concludes that the parties to the contract, arrangement or understanding via the CEA are the NZRU, the 14 PD unions, the Super 14 Rugby franchises, and the RPC. Also, s 2(8)(a) of the Act, which covers associations, provides that RPC players themselves are regarded as parties to the agreement (as are all NZRU and PD provincial union members).

306. The Commission is satisfied that the CEA (which is subject to Commerce Commission authorisation at clause 60), constitutes a contract for the purposes of s 27 of the Act, both in the entering into of it and the planned giving effect to it.

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[52] Collective Employment Agreement, s 1.4.
[53] Collective Employment Agreement, Appendix 1.
[54] Collective Employment Agreement, s 4.2.

NZRU Regulations

307. The new regulations include:

- the proposed Salary Cap Regulations[55], which will govern the implementation and application of the salary cap by the provincial unions; and
- the proposed Player Movement Regulations[56], which govern both the player transfer period, the player transfer fees, and which replace the existing Player Transfer Regulations; and,
- the Division One Amateur Player Regulations[57], hereafter referred to as the Modified Division One Regulations or MD1 Regulations.

308. Section 5 of the NZRU Constitution provides that:

> "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."

309. This section 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.

310. In Decision 281, the Commission considered whether the Regulations and the Rules of the NZRU have been structured in such a way as to amount to bilateral arrangements between the NZRU and each provincial union individually. The Commission continues to hold the view that there necessarily exists some underlying

[55] NZRU Application, Confidential Schedule A, Draft Salary Cap Regulations.

[56] NZRU Application, Confidential Schedule B, Draft Player Movement Regulations.

[57] NZRU Application, Confidential Schedule C, Draft Division One Amateur Player Regulations.

collective arrangement between the provincial unions (for example, through section 5 of the NZRU Constitution) and the NZRU, to agree to the Regulations. In the absence of that agreement, the Regulations could not operate effectively.

311. There are, therefore, a number of ways in which the Regulations might fall within the scope of ss 27, 29 and 30:

- The overall arrangement in relation to the premier player services market has been *entered into* through a series of negotiations and consultation between the NZRU, the provincial unions and the players (through the RPC), culminating in the entering into of the CEA on 1 November 2005. This overall arrangement will be *given effect* to by putting the CEA into effect (subject to Authorisation) and by passing the new NZRU regulations (and the application of any such regulations to members of the NZRU through the Constitution of the NZRU);
- The Regulations might be the "giving effect to" of powers granted in clause 5 of the NZRU constitution, which is itself a contract, arrangement or understanding between its members; and
- The Regulations might be, at the very least, "recommendation{s} made by an association … to its members or to any class of its members" and therefore deemed to be an arrangement between the PD provincial unions for the purposes of s 2(8)(b).

Conclusion on Contract, Arrangement or Understanding

312. The Commission, therefore, concludes that it is likely that the CEA and the proposed new NZRU Regulations, through the NZRU Constitution, would each comprise an arrangement or understanding amongst all of the affiliated provincial unions and the NZRU for the purposes of ss 27, 29 and 30.

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

313. 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

314. Notwithstanding the form of any employment contracts[58] 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

[58] 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.

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 for the supply of non-employee players (i.e., players who provide rugby playing services) and hence compete for the acquisition of services.

315. 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. 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,[59] 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.

316. The Commission does not consider it is necessary to show whether other parties to the CEA are in competition with each other.

317. 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; and
- players supplying player services.

The Regulations

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

319. 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).

320. 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".[60] The Commission considers it is reasonable to assume some level of competition exists amongst unions and MD1 players.

[59] CEA clause 5.4.
[60] NZRU Response to Commerce Commission Questions dated 23 December 2005.

321. 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

322. In summary, the Commission concludes that, through both the CEA and 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; and
- PD players supplying premier player services;

or:

- MD1 provincial unions acquiring non-premier player services; and
- MD1 players supplying non-premier player services.

3. 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

323. The salary cap provision is set out within the CEA, at clauses 53-60. Clauses 53.1 and 53.2[61] state:

> 53.1 The purpose of this sub-Part is to provide for the regulation of certain payments to be made to Players by Provincial Unions on behalf of the NZRU.
>
> 53.2 The NZRU may, in consultation with the RPC develop regulations which are not inconsistent with this Collective Agreement to assist it in the management of the Provincial Union Salary Cap.

324. 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).

325. 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.

[61] Collective Employment Agreement, s 53.1

326. 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

327. 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 the continuation of the existing transfer regulations.

328. 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.

329. 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.

330. 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.

331. 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.

332. 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.

333. In addition, the Fort Report[62] 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
- 2008: [ ].

334. 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.

335. 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 team expenditure at a rate faster than the CPI.

Conclusion on lessening of competition under section 27

336. 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. In essence, the Commission considers that the salary cap will 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.

337. The Commission concludes that the salary cap provision has, or is likely to have, the effect of lessening competition in the market for premier player services.

[62] NZRU Application, Schedule H: Dr Rodney Fort Report

Does the salary cap fix, control or maintain prices under section 30?

Fixing, controlling or maintaining the price

338. 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.

339. 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".[63]

340. 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'.[64]

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

> 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.[65]

342. 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. [66]

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[63] *ACCC v CC (NSW) Pty Ltd* {1999} 165 ALR 468, at p 504.
[64] *CC v Caltex NZ Ltd* (1999) 9 TCLR 305, p 313.
[65] *ACCC v CC (NSW) Pty Ltd* {1999}, para 176.
[66] *CC v Caltex NZ Ltd* {1998} 2 NZLR 78; (1998) 6 NZBLC 102,505 at pp 84-85; pp 102,510-102,511.

343. 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

344. 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).

345. The Commission considers that its approach is consistent with the relevant case law.

Application to the salary cap provision

346. 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.

347. 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 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.

348. 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.

349. The Applicant sets out these circumstances in paragraph 26.3.3 of their 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.

350. 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.

351. 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".

352. Accordingly, the Commission considers 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

353. 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 market[67], 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.

354. 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?

355. 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 1[68] 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."[69]

356. 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.

357. In the Proposed Arrangements relevant to this Application, however, the circumstances in which transfer fee payments would be applicable have been substantially reduced to only those relatively few occasions when a representative player from a MD1 union transfers to a PD provincial union. This is because, 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 is not ultimately prevented). For

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[67] 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.

[68] 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.

[69] NZRU Application, Schedule E, Collective Employment Agreement, s 50.5.

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."

358. 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 concomitant deleterious impacts on New Zealand rugby in general. However, the transfer fees are being retained for representative players originating from MD1 unions, as 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."

359. In contrast with MD1 unions, the majority of PD unions interviewed by Commission staff agreed that the transfer fees 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.

360. 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."[70]

361. The above issues are more relevant to, and are addressed further in, the benefits and detriments section of this authorisation.

362. As previously detailed, 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 "Development Compensation Fee" (hereafter transfer fee) to be applied when the representative player transfers from a MD1 union

[70] NZRU Response to Commerce Commission Questions, 23 December 2006, Q. 12

to a PD union. Unlike the existing arrangements, no fees are payable when a player transfers between PD unions or between MD1 unions.

363. The maximum transfer fees payable by PD unions acquiring representative players from MD1 unions are stipulated by player bands. These are defined in ss 2.1 and 2.2 of the Draft Player Movement Regulations[71] submitted to the Commission, in particular Schedule 1, which provides the values listed at Maximum Transfer Fee (proposed) in Table 10. For purposes of comparison, the existing transfer fees are also contained within Table 10.

Table 10: Existing vs Proposed Maximum Transfer Fees

Band (current level of player)	**Maximum Transfer Fee (existing)**	**Maximum Transfer Fee (proposed)**
All Blacks		
Star	$125,000	-
Established	$75,000	-
Current	$50,000	-
All Blacks Former	$40,000	-
Rugby Super 12	$30,000	-
Senior A NPC		
1st Division	$20,000	-
2nd Division	$15,000	$15,000
3rd Division	$10,000	
NPC Development		
1st Division	$5,000	-
2nd Division	$3,000	-
3rd Division	$2,000	-
NZ Colt (U21)	$20,000	$20,000
NZ U19	$15,000	$15,000
NZ Schools	$10,000	$10,000

364. These sums 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

365. 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 (a continuation the existing transfer fees).

366. Representatives of the RPC, primarily concerned at the potential for transfer fees to inhibit player mobility, have expressed their concern that transfer fees may lessen competition in the market for premier player services by imposing an additional cost

[71] NZRU Application, Confidential Schedule B, Draft Player Movement Regulations, Schedule 1.

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. However, as the fees to be applied in the factual are not greater than those in the counterfactual, they could not be said to have the effect of lessening competition on this basis.

367. Most significant, however, is the fact that under the proposed transfer fee regulations, the circumstances under which transfer fees are applicable have been substantially reduced, and would only apply when a representative player transfers from a MD1 union to a PD union. In the counterfactual, the circumstances under which transfer fees are applicable are significantly greater. As such, the barriers to transfers are of a magnitude less in the factual than in the counterfactual.

368. Under these circumstances, the Commission has not found it necessary to undertake further analysis of the effect that the existing transfer fees have had on competition in the premier player services market since their inception, in order to compare this with the likely effect of the proposed fees. Given that the proposed transfer fees will be applied in significantly fewer circumstances, and, in those circumstances where they are applied, the amount of the fee is not greater than the fee structure relevant to the counterfactual scenario, the Commission does not consider that the proposed transfer fees would have the effect, or likely effect, of lessening competition in the market for premier player services.

Long-Term Contract Buy-Outs

369. 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.

370. 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.

Question 12. Do parties agree that this is a correct assessment of the effect of the Player Movement Regulations in relation to PD-to-PD transfers? What evidence is there to suggest that something else will occur? How have long-term contracts been treated under the existing Player Transfer Regulations?

371. 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.

372. 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.

Question 13. When is the NZRU "veto" right likely to be exercised? Is the NZRU seeking authorisation for this aspect of the Regulations? In either case, would the NZRU be prepared to accept the Regulations being authorised subject to restrictions on the NZRU's exercise of its veto? If so, what restrictions does the NZRU propose?

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

373. 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.

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

374. 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.

375. 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.

376. 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.

377. 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.

378. This situation is similar to that considered in Australian Competition and Consumer Commission *v CC (NSW) Pty Limited* [72] ("*ACCC v CC*"). In that case the parties arrived at an understanding for the payment of a fee by the successful tenderer to each of the unsuccessful tenderers of 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.

379. The present situation is different from that considered in *ACCC v CC*. In that case the fee, 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. In contrast, in the present situation, the transfer fee does not set a price floor but, given each player has a value to a provincial union, the transfer fee will reduce the amount that a provincial union is willing to pay that player for their services. On balance 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 or maintain 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

380. 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

381. 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 Draft Player Movement Regulations states:

> 5. Transfer Period
>
> 5.1 The transfer of a Player may only occur during the period 1 October in one year to the Friday following the Super Rugby Competition Final in the immediately following year. This period is the Transfer Period. Nothing shall prevent, however, negotiations relating to the transfer of a player from taking place at any time during the year."[73]

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

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[72] (1999) ATPR 41-732 (FC).
[73] NZRU Application, Confidential Schedule B: Draft Player Movement Regulations.

> "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…"[74]

383. 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).

384. In a written submission[75] 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

385. 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.

386. 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.

387. Under the counterfactual, premier player services can only be acquired (subject to the terms of contracts between players and provincial unions) during the last two weeks of November in any given year. As noted in Decision 281, this limited period may impact on the price a provincial union may otherwise be willing to pay and may also affect the willingness of a provincial union and/or player to compete in the market for premier player services, except near or during the November transfer period. As a consequence, beneficial trades might be delayed and competition in the market is likely to be lessened.

388. However, given the transfer period as proposed in the factual is significantly longer (circa 34 weeks) than that applying in the counterfactual (2 weeks), it must be less restrictive in terms of competition. The Commission considers, therefore, that the proposed transfer period would not result in a lessening of competition in the market for premier player services.

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[74] NZRU Application, Schedule E, Collective Employment Agreement, s 50.6.
[75] 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

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

Does the transfer period have the effect or likely effect of fixing prices under section 30?

390. 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

391. 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.

392. 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. Obviously, this is a decision for the NZRU to make.

393. 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.

394. 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:

395. The Commission concludes:

- the salary cap has, or is likely to have, the effect of lessening competition in the market for premier player services;
- the salary cap has, or is likely to have, the effect of fixing, controlling or maintaining prices in the market for premier player services;
- the transfer fees do not have, nor are likely to have, the effect of lessening competition in the market for premier player services;
- the transfer fees have, or are likely to have, the effect of controlling or maintaining prices in the market for premier player services; and

- the transfer period does not have, nor is likely to have, the effect of lessening competition in the market for premier player services.

396. 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.

397. The Commission concludes that that the salary cap provision 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.

398. In addition, the Commission concludes that the salary cap provision 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.

4. Effects in the Non-Premier Player Services Market

MD1 Regulations[76] *and Player Movement Regulations*

399. In this section, the Commission will consider whether the MD1 Regulations and 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 four provisions of these arrangements (transfer period, transfer fee, MD1 non-payment provision and MD1 no loan player provision) 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.

400. 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. The MD1 non-payment provision and MD1 no loan player provision, together encapsulated in the NZRU's Division One Amateur Player Regulations, will be explained, however, preceding an analysis of their effect, or likely effect, on this market.

Will the MD1 non-payment provision have the effect, or likely effect, of lessening competition under section 27?

<u>The MD1 non-payment provision</u>

401. In paragraph 2.9(a) of its Application, the NZRU has sought authorisation of an arrangement specifically relevant to the new MD1 competition:

[76] As provided at Schedule C of the Application, the "Division One Amateur Player Regulations" are the regulations relevant to Modified Division One (MD1) competition.

> 2.9 The key aspects of the proposed Division One Amateur Player Regulations are that:
>
> (a) there will be a prohibition on payment of any remuneration to a player competing in a Modified Division One team (i.e. no payments over and above reimbursing actual expenses as approved by IRD from time to time); and…

402. In terms of the Division One Amateur Player Regulations, clauses 2 and 3 of these regulations relate to the non-payment provision. Clause 2 states:

> 2. Application
>
> 2.1 These Regulations apply to all Division One Unions.

403. Clause 3 states:

> 3. No Payment of Players
>
> 3.1 No Remuneration shall be Paid by a Division One Union to any Player other than for the Reimbursement of Expenses up to the Maximum Amounts.
> 3.2 For the avoidance of doubt, no Remuneration may be Paid by a Division One Union to a Player for reimbursement for lost income.

404. In paragraph 16.1.2 of the application, the NZRU argued an amateur MD1 competition was seen as having a number of important advantages, including:

- cost management;
- ensuring that provincial unions spend money on developing local talent rather than being diverted to other purposes (i.e., paying players);
- using the transfer regulations to incentivise provincial unions to invest money in player development; and
- affording provincial unions more time and resources to focus on developing the game in their region, rather than administration associated with contracting and transferring semi-professional players.

Effect/likely effect of lessening competition

405. The Commission has interviewed a number of players and provincial unions, and also received a number of submissions in relation to the MD1 non-payment provision. Some provincial unions were supportive of the provision, highlighting that the provision will create a "financial level playing field" and will encourage unions to place greater emphasis on "developing and fostering local rugby talent."[77]

406. A primary concern pertaining to this proposed provision was its potential to inhibit or otherwise remove the ability of players to play rugby for their provincial unions. The Poverty Bay Rugby Football Union's (PBRFU) submission is representative of several provincial unions' concerns regarding this matter:

[77] Wanganui Rugby Football Union Submission, 24 November 2005.

> "The PBRFU feels that this prohibition will inhibit many players' involvement within the division as team members will be expected to take Fridays off work it is likely that many will not be in a position to commit to the PBRFU."[78]

407. A number of senior PD and MD1 players commented that there was a strong possibility that some players who currently receive payment for time off work when playing in the NPC 2nd and 3rd Divisions will be unable to play should this payment be removed.

408. In paragraph 16.1.3 of their Application, the NZRU stated that "some players may well seek to transfer to Premier Division Unions to retain their semi-professional status, that otherwise might not have, particularly from the former 2nd Division Provincial Unions" and also noted that some players might be financially disadvantaged as a consequence of the proposed MD1 provisions.

409. Overall, the Commission considers that, although the proposed MD1 non-payment provision may lead to some players being unable to play MD1 rugby, this is not likely to be of a magnitude to constitute a lessening of competition in the market when compared with the counterfactual (allowing for MD1 player payments).

410. Of more significance is the likelihood that the non-payment provision will hinder the ability of MD1 unions to compete in this market. By implementing an agreement not to pay players, the MD1 non-payment provision constrains the competitive advantage some MD1 unions may have otherwise enjoyed over others. In essence, the provision removes a key method (i.e., paying players) by which they would otherwise compete with rival unions for the acquisition of non-premier player services.

411. The Commission considers that the prohibition on MD1 provincial unions paying players is likely to restrict the ability of these unions to compete with other unions for the acquisition of player services, resulting in a lessening of competition in the non-premier player services market.

Conclusion on lessening of competition under section 27

412. The Commission concludes the MD1 non-payment provision has the effect, or is likely to have the effect, of lessening competition in the market for non-premier player services.

Does the MD1 non-payment provision have the effect, or likely effect, of fixing prices under section 30?

413. The Commission considers that the prohibition on payment to MD1 players (over and above reimbursing actual expenses) necessarily constitutes an artificial constraint on or interference with the competitive determination of prices for these players' services.

414. Following on from the Jurisdiction discussion in this Draft Determination, the Commission considers that the players in this market are likely to be either volunteers, part time or casual employees, or independent contractors.

[78] PBRFU Submission, c/o Woodward Chrisp Lawyers, 16 December 2005.

415. The Commission considers that there are an unknown number of players, either currently or in the future, who could be classified as independent contractors, who are currently receiving payment either for their time, or as compensation for lost wages. Under this non-payment provision, such players will no longer receive this payment, and therefore, this non-payment will result, or will be likely to result, in a price-fix.

Conclusion on whether MD1 non-payment provision has the effect, or likely effect, of fixing prices under section 30?

416. The Commission considers the prohibition on payment to players in the non-premier market will result, or will be likely to result, in a price-fix.

417. 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 section 27.

Will the MD1 no loan player provision have the effect, or likely effect, of lessening competition under section 27?

The MD1 no loan player provision

418. In paragraph 2.9(b) of its Application, the NZRU has sought authorisation for a further arrangement specifically relevant to the new MD1 competition, in particular that no loan players will be eligible to play for MD1 provincial unions, other than front row loan players in the event of an injury.

419. Clause 4 of the proposed Division One Amateur Player Regulations states:

> 4. No Outside Players
>
> 4.1 No Division One Union will be entitled to field any Outside Players during a Match except in a situation where during the Division One Competition, an injury occurs to a Player who is a front row forward and:
>
> (a) that injury occurs in the time that the Injured Player's team is assembled for the Division One Competition and renders that player unavailable for selection for one or more matches; and
>
> (b) there are no replacement players available from within the Player's affiliated union that would not result in a significant risk to the health and safety of the other players in the Player's team or the replacement player himself; and
>
> (c) the NZRU is satisfied as to the genuineness of the injury; and
>
> (d) the NZRU is satisfied as to the genuineness of the replacement being proposed.

420. The NZRU noted that in many cases, provincial unions felt compelled to use loan players to remain competitive with other unions who were already using them. The NZRU argued this was to the detriment of local players who lived, worked and played in that region.[79]

[79] NZRU Response to Commerce Commission Questions, 22 December 2005, Q.23.

421. The NZRU also identified potential significant savings for provincial unions as an objective of the no loan player policy, as the costs associated with transport and/or relocation of these players traditionally required the greatest financial outlay, commenting:

> "….loan players generally were the most "expensive" players. Having all 12 unions applying the same maximum expense reimbursement framework will mean that all players are amateur as opposed to the previous situation where there was a mixture of semi-professional and amateur players playing in the same competition." [80]

Effect/likely effect of lessening competition

422. Although the NZRU has noted "all the NZRU is proposing to do is to remove a current exemption contained in its Regulations which allows unions to use a limited number of players who are not from their club competition,"[81] the effect of the change is to institute a no loans regulation where there are loans now. Insofar as the current regulations (and those applicable in the counterfactual) allow six loan players, moving from six loan players to no loan players is inherently a restriction of player movement.

423. The MD1 no loan player provision has the effect of hindering a method by which MD1 unions are able to compete for the acquisition of non-premier player services in this market. The provision also represents a barrier to movement by players between unions and inhibits the ability of players to supply non-premier player services (if they are not engaged as employees) to potential borrowing unions. Section 3(2) of the Act[82] provides that references to a lessening of competition include the hindering or preventing of competition.

424. As such, and as compared against the counterfactual scenario, the Commission considers that the proposed no loan player provision has the likely effect of lessening competition in the market for non-premier player services - both for non-employee players providing such services and for provincial unions who may seek to acquire them.

Conclusion on lessening of competition under section 27

425. The Commission concludes that the proposed MD1 no loan player provision has the likely effect of lessening competition in the market for non-premier player services, when compared to the counterfactual.

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

The transfer fee provision

426. 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. These regulations

[80] Ibid.
[81] Ibid.
[82] Section 3(2) of the Act states "In this Act, unless the context otherwise requires, references to the lessening of competition include reference to the hindering or preventing of competition."

provide for a transfer fee to be applied where certain banded players transfer from a MD1 union to a PD union. Unlike the existing arrangements (the counterfactual), no fees are payable when a player transfers from between PD unions or between MD1 unions.

Effect/likely effect of lessening competition

427. As previously explained in the Premier Player Services Market section of the Competition Analysis**,** the circumstances under which maximum transfer fees are applicable have been substantially reduced, and would apply only when a banded player transfers from a MD1 union to a PD union. In the market for non-premier player services, in which the MD1 unions operate, the fees applicable in the factual scenario are not 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

428. The Commission concludes the transfer fee provision does not have the effect, or likely effect, of lessening competition in the market for non-premier player services, when compared to the counterfactual.

Does the proposed transfer fee provision have the effect, or likely effect, of fixing, controlling or maintaining prices under section 30?

429. 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 applies 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

430. 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

431. 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

432. As also detailed in the Premier Player Services Market section of the Competition Analysis, given the transfer period as proposed in the factual is significantly longer (circa 34 weeks) than that applying in the counterfactual (2 weeks), it must be less restrictive in terms of competition. The Commission considers, therefore, 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

433. 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.

Does the transfer period have the effect or likely effect of fixing prices under section 30?

434. 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 Provisions on Competition in the Market for Non-Premier Player Services:

435. The Commission concludes:

- the MD1 non-payment provision has, or is likely to have, the effect of lessening competition in the market for non-premier player services;
- the MD1 no loan player provision has, or is likely to have, the effect of lessening competition in the market for non-premier player services;
- the MD1 non-payment provision has, or is likely to have, the effect of fixing, controlling or maintaining prices in the market for non-premier player services;
- the transfer fee provision does not have, nor is likely to have, the effect of lessening competition in the market for non-premier player services;
- the transfer fee provision has, or is likely to have, the effect of fixing, controlling or maintaining prices in the market for non-premier player services; and
- the transfer period provision does not have, nor is likely to have, the effect of lessening competition in the market for non-premier player services.

436. The potential competitive impacts of the Proposed Arrangements on the market for non-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.

437. The Commission concludes that the MD1 non-payment provision, the MD1 no loan player provision, and the Player Movement Regulations relating to the both the transfer fees and transfer period provisions would have, or would be likely to have,

the combined, or likely combined effect, of lessening competition in the market for non-premier player services.

438. In addition, the Commission considers that the non-payment provision and the maximum transfer fee provision are likely to have the effect of fixing, controlling or maintaining prices and therefore are 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.

Effects in the Market for Sports Entertainment Services

Section 27 only

439. 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.

Do the Proposed Arrangements, taken as a whole, have the effect or likely effect of lessening competition in this market?

440. 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, the transfer period, and the MD1 non-payment and no loan player provisions, when determining whether the Application may result in a lessening of competition in this market.

441. 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.

442. 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, cricket), as well as those that have gained relatively recent popularity (e.g., basketball, motorsport and X-Air).

443. 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, [

].[83] As such, given the expansive scope of

[83] [

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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

444. 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 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.

445. 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.

446. 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.

447. 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

448. Some MD1 provincial unions have argued that the no loan player and non-payment provisions of the Proposed Arrangements will have the effect of making their team less successful, less attractive to spectators and subsequently less competitive in the sports entertainment market. This argument is countered by the NZRU's position that these provisions will actually enhance spectator numbers through both greater interest in seeing a larger number of "home-grown" local club players and a more even competition. Some MD1 unions have regularly loaned players under the

existing regulations, whilst others have had a policy of relying solely on local players. NZRU has argued that this has been one of the factors contributing to competitive imbalance in this competition.

449. NZRU advised that the average attendance at MD1 games is 725 people[84]. 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) created by future plans to feature MD1 rugby on a "Heartland" rugby programme on Sky and Prime television each week.

450. 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.

Conclusion

451. The Commission concludes that the Proposed Arrangements do not have, nor would be likely to have, the combined or likely combined effect of lessening competition in the market for sports entertainment services.

Question 14. The Commission seeks further comment on the likely effects of the Proposed Arrangements on the Sports Entertainment Market.

SECTION 29 ANALYSIS

452. As mentioned in the "Jurisdiction" section, the "services" analysis applies to the s 29 analysis[85].

453. 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;
- 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; and

[84] 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).

[85] However, the overall "market" analysis does not, since there is no reference to "market" in s 29.

454. However, it should be noted 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.

455. The provisions of the Regulations that might be exclusionary are the salary cap, transfer period and the transfer fee.

456. The NZRU have 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 (and prohibition on payment to MD1 Players) 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;
- 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; and
- all provincial unions would be party to the proposed arrangements by virtue of the NZRU's Constitution.

457. 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.

458. 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 along the lines set out by the NZRU above.

459. However, the Commission considers that it is most likely that any competition effects of the salary cap/prohibition on payments to MD1 in the acquisition of player services have already been captured by the application of s 27 and s 27 via s 30, and that any further likely effects of lessening competition from a boycotting arrangement amongst competing provincial unions would be slight. Under these circumstances the Commission does not consider that it is necessary to consider this section any further.

CONCLUSION RE EXERCISE OF DISCRETION

460. The Commission concludes that all of the proposed arrangements would or would be likely to breach one or more of ss 27, 29 and 30 of the Act. The Commission considers that it is therefore worthwhile for it to continue to apply the benefits/detriments analyses set out in s 61(6) (for authorisation of s 27 (and s 30)

breaches) and s 61(7) (for authorisation of s 29 breaches) of the Act to the proposed conduct.

461. This analysis is conducted in the remaining sections of the determination.

PUBLIC DETRIMENTS AND BENEFITS

Introduction

462. Given the preliminary 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.

463. 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.[86] 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.

464. 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.[87] The various issues raised have been discussed in a number of decisions by the Commission and the courts in recent years.[88] 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:[89]

> . . . 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.

465. 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.

466. 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

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[86] Goodman Fielder/Wattie Industries (1987) 1 NZBLC (Com) 104,108.
[87] 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.
[88] See, for example, *Air New Zealand and Qantas Airways v Commerce Commission and Ors.*
[89] *Tru Tone Ltd v Festival Records* (1988) 2 NZLR 352, at 358.

judgment.[90] However, given the inherent difficulties in such quantification, it generally is only possible to establish the range within which the actual value of a particular detriment or benefit is likely to fall. 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.

467. 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—and the impact from the provisions applicable to the Modified Division 1— principally the non-payments to players and the no loan policy—are considered separately. As a first step, however, the nature and potential limitations of the Proposed Arrangements are briefly reviewed, and a theoretical model of a salary cap is introduced.

Background

468. 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.

469. 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.

470. 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

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

distributed more evenly between teams; or to forms of revenue-sharing designed to reduce the underlying inequalities in incomes between the teams.

471. 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.

The Purpose of the Proposed Arrangements

472. 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 Second 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.

473. 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.

474. 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.

475. 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.

476. 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 four weaker unions to the Premier Division under the new competition format.

477. 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.

478. 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. The NZRU desires similar outcomes for New Zealand rugby union.

479. However, 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. 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. Also, in a submission to the Commission, Ian Schubert (Director, Registration and Salary Cap Auditor – NRL) 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.

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

481. 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.

482. 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.

Question 15. The Commission seeks more information on the operation and impact of salary caps in professional sports leagues overseas. What are the key features of such arrangements, what difficulties have they encountered, and how successful have they been?

The Economics of Salary Caps

483. 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.[91] A stylised view of this market is shown in Figure 2. This model is based on the following simplifying assumptions:

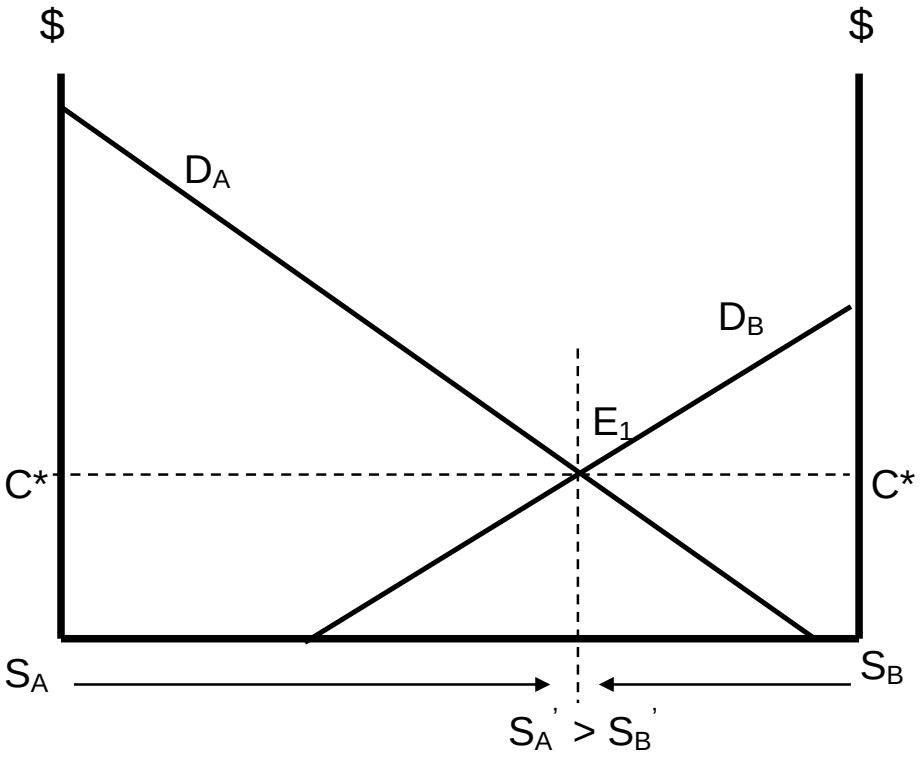
- a two-team league, comprising Teams 'A' and 'B', to allow the use of a graph-based approach;
- two grades of player are available to the league, 'regular' players and 'star' players;
- 'regular' players are available in unlimited quantities at the 'minimum wage' (assumed to be zero for simplicity);
- '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;[92]
- 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.[93]

[91] 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.

[92] 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.

[93] 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 2: A Stylised Player Market in a Two-team League

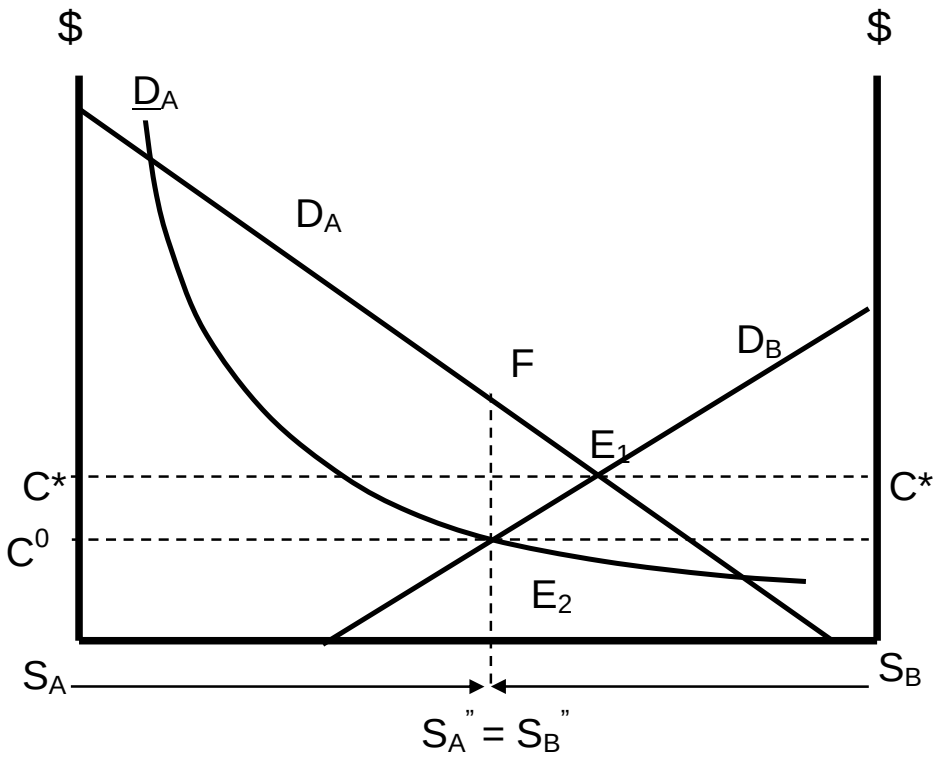


484. In the absence of any player transfer restrictions, market equilibrium is found at point E_1, where the two demand curves intersect. Both teams place the same value on the marginal star player, and so there will be no incentive to trade players, nor for players to move to gain a higher salary. The marginal cost of 'star' players is C^*, and the total league payroll is represented by the rectangular area $S_AC^*C^*S_B$.[94] 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.

485. 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 3. 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.

[94] 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 3: Impact of the Salary Cap in the Two-team League



486. 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, $\underline{D}_A$, lies below the original linear demand curve, D_A. The new, cap-constrained, market outcome is now found at the intersection between $\underline{D}_A$ and D_B, at point E_2.

487. 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).

488. 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 $S_A" = S_B"$ is one of disequilibrium, because the value of the marginal 'star' player to Team A is greater (at point F on D_A) than its value to Team B (at point E_2

on D_B). 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 FE_1E_2. Clearly, the further the salary cap moves the distribution of talent from E_1, the larger will be this loss of allocative efficiency, all else being the same.

489. The conclusion drawn from the analysis in Figure 3, that the intersection between the two teams' demand curves at point E_1 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.[95]

490. 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.

491. 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 (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.

492. 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

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[95] 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.

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.

493. 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.

494. 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.

495. 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.

496. With this background in mind, we now go on to consider, and attempt to quantify, each of the potential detriments in turn. Before we do that, we have to consider potential limitations of the salary cap proposed by the NZRU.

Question 16. The Commission seeks comments on the suitability of this model as a means of drawing out the likely effects of a salary cap.

Potential Limitations of the NZRU's Proposed Salary Cap

497. 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; and
- team-specific talent may dampen the impact of player redistributions on competitive balance.

498. Each of these factors is discussed briefly below.

Hardness of the Cap

499. 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.

500. 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 economic literature seems to adopt 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.[96] These definitions are largely consistent with those employed by Professor Fort in his submission in support of the NZRU.[97]

501. 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.

502. 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.[98] These payments may include certain fixed team performance bonuses and special payments for promotional appearances or speaking engagements, amongst others. Such possibilities appear to resemble some of the loopholes identified by Professor Fort that plagued the North American leagues when salary cap schemes were initially introduced (e.g., bonuses that were only weakly specified as player compensation).[99] 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.

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[96] 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.

[97] The Application, Schedule H: Dr Rodney Fort Report, para 28.

[98] The Application, p.5.

[99] The Application, Schedule H: Dr Rodney Fort Report, para 28.

503. 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.[100] 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.[101] However, it is unclear at present what these benefits may actually include; the NZRU is yet to develop policies in this regard via its Regulations.

504. When these possibilities were 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.

505. 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."[102] 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.

506. 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.

507. 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 Warriors,[103] and the NZRU has no previous experience of operating a 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 Agreement.

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[100] 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.
[101] The Application, p.5; Schedule H: Dr Rodney Fort Report, para 76.
[102] The Application, Schedule H: Dr Rodney Fort Report, para 89.
[103] John Matheson, "Gould tells Warriors get out", 26 February 2006, www.stuff.co.nz.

508. Given all these factors, the Commission's preliminary view is that it cannot be satisfied that the proposed salary cap would be as hard as the NZRU claims. The Commission gains some comfort from the presence of an 'anti-avoidance clause' in the Regulations, but notes that as these Regulations are in draft form only, they could in the future be changed subsequent to authorisation being granted. To be in a position to be satisfied that benefits would exceed detriments, the Commission would need to be satisfied that the cap would work as intended.

Question 17. How 'hard' is the proposed salary cap likely to be in practice, given its specifications, the draft regulations and its context?

Constraint Provided by the Cap

509. 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.

510. 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:[104]

> 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.

511. In his expert economic submission on behalf of the NZRU, Mr Michael Copeland reported that the NZRU's analysis of the effects of the salary cap, using 2004 data, showed that [ ] would have exceeded the cap, [ ] would have fallen just short, and most of the rest would have fallen [ ].[105]

512. Professor Fort undertook an analysis to predict which provincial unions would be caught by the cap over time.[106] 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

[104] The Application, Schedule H: Dr Rodney Fort Report, para 25.
[105] The Application, Schedule K: The NZRU Analysis of Impact of Cap.
[106] The Application, Schedule H: Dr Rodney Fort Report, paras 71-73.

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."

513. 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.

514. 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.[107]

515. 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.

516. The RPC has also indicated to the Commission that, given that the CEA is only for three years, it [ ] over time. This raises further concerns in terms of the longevity of the cap in its proposed form.

517. 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.[108] The statement by Mr Ian Schubert, the NRL Salary Cap Auditor, provides details.[109] 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

[107] The Application, Schedule J: Brown Copeland Report, paras 22-24.
[108] The Application, para 14.1.
[109] The Application, Schedule I: Ian Schubert Statement.

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.

518. 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 preliminary 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.

Question 18. The Commission seeks views on how constraining the proposed salary cap would be, the likely impact of the CPI adjustment and the fact that the cap has been negotiated for only a three year period.

Revenue Disparity

519. 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.[110] 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.

520. 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.[111] In the 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.[112]

521. 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.

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[110] 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.

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

[112] Ibid. See also: Zimbalist (2002).

Question 19. The Commission seeks comments on the extent to which the absence of a revenue-sharing provision would undermine the proposed salary cap.

Multiple Income Stream Incentives

522. 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.

523. 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.

524. 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.[113] 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.

525. 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).

526. 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".[114]

527. 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

[113] 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.
[114] The Application, Schedule J: Brown Copeland Report, para 26.

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.

Question 20. To what extent would the 'multiple income streams' argument limit player transfers in the face of the salary cap?

Team-specific Talent

528. 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:[115]

> … 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.

529. 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.

530. 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.

531. 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.

Question 21. To what extent do players have 'team specific' skills, and would this lead to inferior redistributions of player talent under the salary cap?

Summary

532. 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

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

their NPC salaries, and if they were to do so, whether this might result in a less efficient distribution of talent.

533. These considerations are important, because 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. 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.

DETRIMENTS – PREMIER PLAYERS SERVICES MARKET

534. The following categories of potential detriments arising from the Proposed Arrangements in the premier players' services market are considered below: allocative inefficiency, productive inefficiency, loss of player talent, reduction in player skill levels and innovative inefficiency.

Allocative Inefficiency

535. 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.

536. 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 (NPC) payments are only a small 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.

537. 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.

538. 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.

539. In terms of the Commission's modelling, the allocative efficiency loss is measured in Figure 2 by the size of the triangular area FE^1E^2. 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 the slopes) of the two demand curves (D_A and D_B) in the relevant ranges.

540. 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 to Year 5. 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 $[ ].[116] But the salaries of individual players are known to vary widely. The GARAP 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.

541. 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

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

maximum impact of the salary cap would be to push down the marginal salary to 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 estimate of $[ ] for Year 5, a rather lower figure than that calculated by Mr Copeland.

542. The comparable figures for earlier and later years would be expected to be lower and higher respectively, reflecting the assumed gradually increasing constraining impact of the cap over time. In spreading the estimates over the intervening years, the pattern assumed for spectator benefits is used, namely that no costs are incurred in the first year, about 10% of the Year Five costs are realised in the second year, about 50% in the third, 80% in the fourth, and 100% in the fifth year. The resulting time pattern of allocative inefficiency costs are then as shown in Table 11.

Table 11: Preliminary Estimate of Allocative Inefficiencies

Year	Estimated inefficiency
1	$0
2	$18,000
3	$90,000
4	$144,000
5	$180,000

Question 22. The Commission seeks comment on the methodology and assumptions it has used to estimate the allocative inefficiency detriments.

Productive Inefficiency

543. In the analysis conducted in relation to Figure 3 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 values 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.

544. 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, to soften the cap, perhaps by building in loopholes or exceptions. This likewise would weaken the impact of the cap. An example from the NRL is the Bulldogs team, which in 2002 was penalized all of

their competition points and fined A$500,000 for instigating the competition's largest and most complex salary cap breach.[117]

545. 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 "Playing Contract and Remuneration Rules" are 143 pages long, of which nearly ten pages alone are devoted to defining terms. Yet even this, and the NRL's centralised auditing processes, have been criticised by Mr Gould, the coach of the Warriors:[118]

> . . . 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.

546. Compliance costs will be imposed on all unions, and enquiry costs will 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 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. 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.

547. Professor Fort found it interesting that the only penalties are financial ones, although these are substantial. He argued that enforcement could be made more effective by including loss of competition points, and possibly also other penalties such as suspension of union executives involved in the breach.

548. In his report, Mr Copeland provided estimates of some of these costs, drawing upon NZRU sources. These are summarised in Table 12.

Table 12: NZRU's Estimates of Productive Inefficiencies

Item	Claimed range (per year)
One-off set-up costs	$150,000 to $250,000*
NZRU annual costs	$180,000 to $260,000
Union annual costs (two breach inquiries per year)	$0 to $140,000
TOTAL (rounded)	$200,000 to $430,000*

*The set-up costs are annualised at 10% over 20 years to give $17,619 to $29,365.

[117] The Application, Schedule I: Ian Schubert Statement, p. 3.
[118] John Matheson, "Gould tells Warriors get out", 26 February 2006.

549. The Commission makes the following comments and adjustments to these claimed costs, although detailed analysis is difficult given the lack of justification for most of the figures. Its preliminary estimates are shown in Table 13. These are based on today's prices (i.e., no allowance is made for inflation), and are (with one special exception) not initially discounted to present values (i.e., no initial allowance is made for the time value of money). For the purposes here, a five year period is used to assess detriments, as with benefits.

550. First, the initial set-up costs seem reasonable, but annualising them over a 20 year period does not. As the Player Transfer Regulations have lasted about ten years, it seems more appropriate to assume the same for the Salary Cap Regulations, with an interest rate of 10%. However, here costs are allocated to the year in which they fall. Once all costs have been determined, the aggregates for all five years will be discounted to present values.

551. Secondly, the NZRU estimated annual costs of operating the proposed cap roughly approximate those incurred by the 15-team NRL (A$250,000), although in his statement Mr Schubert commented: "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."[119] Table 13 contains an additional row to incorporate this effect—the "first year operating cost premium"—with the cost premium being 37.5% (i.e., (50+25)/2).

552. Thirdly, the estimate of the costs to unions of the salary cap scheme given in Table 12 seems deficient in two respects: the lower bound of the range cannot be zero when two breach inquiries a year are forecast, and the estimate makes no allowance for everyday compliance costs, which unreasonably are assumed to be zero. On the first issue, the implication of the figures seems to be that a union subject to a breach inquiry will incur a cost on average of $[ ]. Although the nature and complexity of such inquiries is not known, this figure seems unduly low, given the detailed nature of the likely regulations, and the likely involvement of senior management and legal representatives. We assume a figure of $50,000 per inquiry.

553. In addition, there are likely to be ongoing compliance costs placed upon unions. In respect of the NRL salary cap, Mr Schubert reports 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 Clubs via their CEO, Financial Controller, Football Manager and Recruitment Managers." He goes 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 appears to recognise that the time of the Football Manager and Financial Controller will also be involved.[120] We assume arbitrarily that these costs amount to $15,000 per union per year.

[119] Ibid., p. 10.
[120] Ibid., pp. 10-11.

Table 13: Commission's Preliminary Estimates of Monitoring

Item	Claimed range (per year)
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

554. 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.

555. On this basis, the Commission's preliminary estimate is that the proposed salary cap could cost between $708,000 and $918,000 in the first year of operation, and between $490,000 and $570,000 per year thereafter at current prices. This is taken as a measure of the productive inefficiency of the proposal.

Question 23. The Commission would like more information on the likely monitoring and compliance costs of operating a salary cap. Information from overseas sports leagues would be of value.

Loss of Player Talent

556. The modelling analysis above indicates that if the salary cap is to achieve its desired impact, by 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 welfare consequences might be.

557. The NZRU argued in its Application that the salary cap is 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).

558. 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 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.

559. 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.

560. 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.

561. 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 and revenue-sharing (with players) negotiated by the RPC, have made staying in NZ 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. [

].

562. 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

[122] Matheson, op. cit.

recent years, and the unions spoken to considered that the potential for such substitutability was low.

563. 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 non-pecuniary factors such as family and lifestyle.[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]

564. 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]

565. In considering this issue, it is easy to overlook the number of overseas New Zealander rugby players. 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.

566. Further, the Commission assumes that the salary cap would have some impact, as it did when discussing allocative inefficiency. 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.

567. The ability of 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, is likely to be limited unless their revenues can be increased on a sustainable basis. There is some evidence that the income 'gap' between high and low income unions could be reducing (see "Public Benefits" section below).

568. Overall, the Commission's preliminary view is that the salary cap, if and when it begins to constrain, is likely to increase outward migration of rugby players in the younger and mid-range levels to some degree, albeit that these are less attractive than more senior players to overseas clubs,. The welfare cost of this would be their lost

[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.

'productivity', which could be measured by their domestic salary over the number of years for which their services would be lost. A salary at the marginal level used for the allocative inefficiency calculation ($[ ]) is assumed.

569. It is uncertain how many players might be lost overseas because of the salary cap. For a preliminary estimate, it is assumed that five players would be lost in Year 2 and subsequent years, ten in Year 3 and subsequent years, 15 in Year 4 and subsequent years, and 20 in Year 5 and subsequent years. Ten players are equivalent to only about 2.4% of the total NPC player numbers. Moreover, these numbers of migrating players are not large compared to the number of New Zealanders being paid to play rugby overseas cited above.

570. We also assume conservatively that once lost, a player would be lost for a period of five years, and so take into account losses that would accrue in subsequent years. In addition, losses that would be incurred beyond the end of the five year timeframe for players lost during that time frame are also counted. This has been done on the following grounds. Once the player has taken the decision within the five year timeframe 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.

571. Consequently, the losses would continue to 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 aggregated - would represent the cost that would flow from the making of that decision. Other detriments do not share these characteristics; 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.

Question 24. The Commission seeks views on the methodology and assumptions it has used to estimate the detriment from the loss of player talent.

Reduction in Player Skill Levels

572. 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 NPC salaries, the potential for which was noted above, could also lead to team discord.

573. Although Mr Copeland claimed that the proposed salary cap is not intended to restrict player movements, the Commission's modelling above suggests that this might, 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.

574. Mr Copeland argued that the removal of the Player Transfer Regulations would facilitate greater player movements, which would help skill development, but at the same time 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.

575. 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.

576. Given these countervailing views and arguments, the Commission's preliminary view is that the proposed salary cap is uncertain, but it could have some adverse impact on player skill levels.

577. Another possible impact on player skill levels 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.

578. Overall, player development efforts seem likely to be reduced, relative to what would happen in the counterfactual. While this effect is very difficult to quantify, the Commission's preliminary view is that it could be significant.

Question 25. To what extent, if any, would the proposed arrangements be likely to lead to a reduction in player skill levels?

Innovative Efficiency Losses

579. Mr Copeland submitted that the Proposed Arrangements are unlikely to lead to any significant loss of innovative efficiency.

580. 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

preliminary view is that there is not likely to be any further significant detriment to be considered under this heading.

Question 26. The Commission asks for views on the scope for the proposed arrangements to harm innovative efficiency.

Conclusions on Detriments –Premier Player Services Market

581. The Commission's preliminary assessment of the detriments has been set out above. 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 the productive inefficiencies 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. This process resulted in a preliminary estimate of detriments for the five year period in present value terms of between about $3.5 million and $4.0 million ($3,510, 209 to $3,931,648).

582. In addition, the Commission has not been able to quantify the detriment from the reduction in player skill levels, which could be significant, and the loss of innovative efficiency, which is probably not.

583. However, it is important to emphasise that this assessment has been done on the assumption that by Year 5 the cap would constrain significantly. This in turn implies that the cap is a 'hard' cap, and that its level is set in such a way as to constrain. The discussion earlier indicated that the Commission has preliminary doubts on these and other matters.

Question 27. Has the Commission considered all relevant possible detriments likely to arise from the proposed arrangements?

DETRIMENTS: NON-PREMIER PLAYER SERVICES MARKET

Introduction

584. As discussed earlier, the elements of the Proposed Arrangements that impact upon the non-premier (MD1) player services market are the following:

- the ending of payments to players, and of compensation for lost income (but with continuing reimbursement of expenses);
- the ending of the loan-player facility (except in limited circumstances involving player injury); and
- the replacement and liberalisation of the player transfer regulations (widening of the transfer period and the elimination of most fees).

585. The detriments associated with each of these elements will now be considered in turn. The potential benefits will be reviewed later in the section on Public Benefits.

586. Prior to undertaking this analysis, it is useful to get an indication of the size of the market involved. First, the new Modified Division 1 competition will comprise twelve unions. Assuming a playing squad of 26 per union, a total of 312 players will be involved. In addition, because of the fact that we are dealing with a non-premier player services market, the market would include senior club players across the country. Hence, the market comprises many hundreds of players in total.

587. Secondly, in a supplement to his main report, Mr Copeland provided a comparative analysis of the average financial positions in 2004 of the ten teams in the NPC Division 1 and the twelve teams to be in the Modified Division 1.[129] The average team in the latter group had an average player payment that was only about 4% of the average payment in the former; the average NPC round robin gate income was only about 0.7%; and the average team sponsorship (in cash and kind) was only about 7%. Clearly, the unions in the Modified Division 1 operate on a vastly smaller financial scale than those in the Premier Division. This reflects the fact that they typically draw on predominantly rural regions where the populations and economic bases are limited. Players generally play for the enjoyment of the game, and to represent their province, rather than for financial reward.

588. The 4% figure is based on an estimated average payment to MD1 players of $[ ] per game. Although there are considerable variations in the approaches taken by MD1 unions with regard to player payment, which can comprise a mix of payments, bonuses and expenses, the NZRU's view is that most of it comprises reimbursement for expenses of one sort or another. The IRD has just approved payments up to a maximum of $150 per game as reimbursement for expenses.

589. In the 2005 season a total of 64 loan-players were used by the 12 MD1 provincial unions, or an average of just over five per union, although the numbers range from zero to ten (some unions used more than six over the season because of unavailability through injury or for other reasons). In terms of transfers, over the period 2003-05 there were 106 transfers of players between unions within the three NPC divisions, of which only seven occurred between and within 2nd and 3rd Division unions.

590. This brief overview suggests that the ending of player payments, and of the loan-player facility, would have the biggest impact on the MD1 unions.

Sources of Potential Detriment

591. With respect to the first element—the zero price for players—the competition assessment found that the purpose was to encourage provincial unions to spend money on developing local talent rather than using it to compete by paying players. In effect, this element operates like a very severe salary cap, in the sense that it is akin to a cap set at zero. The following anti-competitive affects were found to be likely:

[129] "Quantification of Competitive Detriments and Public Benefits of Proposed Regulations for Modified Division 1", 12 January 2006, p. 1.

- some players might no longer be able to participate, as the result of no longer being compensated for time taken off work on Fridays prior to away games on Saturdays; and
- the prohibition on MD1 unions paying their players would inhibit their ability to compete for the services of the best non-premier player services.

592. With respect to the second element—the removal of the present exemption to use a limited number (up to six) of loan-players—the competition assessment found that the declared aim was to encourage local development of the game, and of local players, and avoid incurring the administrative costs (e.g., reimbursement for transport costs, relocation costs) associated with contracting in loan-players. The following anti-competitive effects were likely:

- it would reduce the competition between non-premier unions to acquire the services of players; and
- it would prevent players moving between unions to further their rugby careers.

593. With respect to the third element—the liberalisation of transfer regulations—the elimination of many of the fees was found not to be anti-competitive, but did amount to a fixing or controlling of price.

594. In its submission, the North Otago Rugby Football Union (NORFU) expressed strong concerns about the impact of the Proposed Arrangements on the new MD1 competition and on the North Otago Team in particular, in terms of its ability to compete. Despite being the smallest of the NPC unions, it won the Third Division title in 2002 and gained promotion to the Second Division in the following year. There, it reached the semi-finals in every year from 2003 to 2005. In doing so it played teams, like Manawatu, that have been promoted to the new Premier Division even though they never reached the Second Division semi-finals during this period.

595. The foundation for NORFU's considerable success appears to have been its ability to loan club players from the adjacent area of the Otago Union. A maximum of six could be fielded at any one time, so the bulk of the team remained local players. This arrangement had advantages for both the loan-players, in being able to play at a representative level, possibly as a first step on a rugby career path for young players; and also for the local players, who could learn from the significant skills brought to the team by the incomers, and pass those skills on to their local clubs as well. The playing success of the North Otago team also galvanised interest in rugby in the local community.

596. The Commission has often heard the view that a good club side in one of the main cities would easily beat any of the Third Division NPC sides. This suggests that there would be much to gain from allowing MD1 unions to take advantage of the loan-player facility to bolster their playing strengths, and to add to the gain in skills of local players.

597. However, the NZRU has pointed out that the loan-player facility favours those MD1 unions whose regions are adjacent to those of the major metropolitan unions, since they can borrow players at relatively low cost (in expenses terms) compared to those other unions located more remotely from the major provincial unions. As a result, if

the loan-player facility were to continue, and be utilised to the maximum extent by all MD1 unions, the more remotely located unions would face a considerable cost penalty to keep up in the competition for loan players, and possibly also face a disadvantage in attracting the better talent.

598. The Commission believes that, while this may be so, the alternative preferred by the NZRU—that the MD1 unions be encouraged to spend their limited resources to develop "home grown" talent—is unlikely to do much to narrow the competitive imbalance likely to arise given the considerable differences between these unions in terms of population and revenues.

Detriment Analysis

599. Mr Copeland implicitly treated the various restrictions outlined above as a generic whole when attempting to quantify detriments. He employed a similar analysis to that used for the Premier Player Services Market, but scaled it down substantially to reflect: the expected small impact of the regulations; the low levels of remuneration involved; and the limited player "misallocation" effects thought to be likely. For allocative inefficiency, he assumed an upper limit of one player "misallocation" per team, or twelve in all, and an efficiency loss per player in the range of $500 to $1,500 per year. This gave an upper limit of $6,000 to $18,000 per year in total.

600. The NZRU considered that there would be little additional productive efficiency losses incurred over-and-above those associated with the salary cap. The resources used to monitor and enforce the salary cap would also cover the monitoring and enforcement of the MD1 regulations. There is not expected to be any additional costs for the provincial unions involved, unless breaches were to be identified, but even in that circumstance the costs are expected to be low, say $10,000 per year in total.[130]

601. In terms of player skill levels, the NZRU expects that, although the absence of loan and some semi-professional players would result in some diminution of the pool of talent available to the MD1 unions, this would be more than offset by the improved motivation from the greater nurturing of "home grown" talent.

602. The Commission's preliminary view is that the detriment from the 'misallocation' or non-availability of players because of non-payment is likely to be small, but very difficult to quantify. The economic demand for players by individual MD1 unions is likely to be very low because the revenues generated are very low. Even the loss of a key player, and the possible subsequent loss of playing success and lower levels of spectator interest, would probably not translate into a substantial reduction in revenues in absolute terms. Likewise, a player lost through the inability of the union to compensate him for lost wages would not be likely to suffer a significant personal loss. Indeed, he could probably continue to play at the club level. Viewed in this light, Mr Copeland's estimates seem reasonable.

603. The Commission considers that the estimates for productive efficiency losses are likely to be quite small, but that the NZRU's estimate of $10,000 per year seems unduly low given that there are twelve unions involved, and costs on both sides. A

[130] The Application, para 28.2.3.

preliminary figure of $20,000 per year seems to be more appropriate. This figure discounted at 10% over five years amounts to $75,816 in present value terms.

604. In terms of player skill levels, it seems likely to the Commission that the proposed ban on the use of loan-players could have a bigger impact. Five of the twelve unions in 2005 used at least six loan-players, and all bar one used at least three. Some at least of these loan players came from clubs in non-MD1 unions. As mentioned, North Otago drew players from Otago. Also, Buller obtained four players from Wellington. On the other hand, Wanganui (an MD1 union) borrowed players from Manawatu (a Premier Division union). Regardless, it seems reasonable to infer that the loaned players would not have played, or would not have played as much, for their 'home' unions as they did for the unions to which they were loaned. Hence, these players likely benefited from the experience of playing at a 'higher' level, as did the teams to which they contributed. One would expect to see a loss of the cross-fertilisation of ideas and tactics with the ending of the loan-player facility. Again, this is very difficult to quantify, but it could be significant.

605. Overall, the Commission's preliminary view is that there would be detriments from the Proposed Arrangements on the MD1 Competition. While these are difficult to quantify, the dollar values are likely to be small relative to the size of those estimated for the arrangements affecting the Premier division competition, but significant in the context of the MD1 unions.

OVERALL CONCLUSION ON DETRIMENTS

606. The detriments of the Proposed Arrangements in respect of the premier player services market are summarised earlier, as are those for the non-premier player services market. These estimates are brought together in Table 14:

Table 14: Summary of Preliminary Detriments Estimates,

Market	Type of Detriment	Estimated Size
Premier Player Services	Quantified (allocative and productive inefficiency, loss of player talent	$3,500,000 to $4,000,000
	Reduction in player skill levels	Significant
	Loss of innovative efficiency	Insignificant
	Total (rounded)	**>$3,500,000 to >$4,000,000**
Non-Premier Player Services	Quantified (productive inefficiency)	$75,816
	Allocative inefficiency	Small
	Loss of player talent	Small
	Reduction in player skill levels	Significant
	Total (rounded)	**>$75,800**

607. These estimates suggest that, assuming the Proposed Arrangements were to have an impact, then over the five year period the present value of the estimated detriment would be in excess of $3.5 to $4 million for the Proposed Premier Division

Arrangements and at least $75,000 for the Proposed Modified Division 1 Arrangements.

PUBLIC BENEFITS

608. 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.

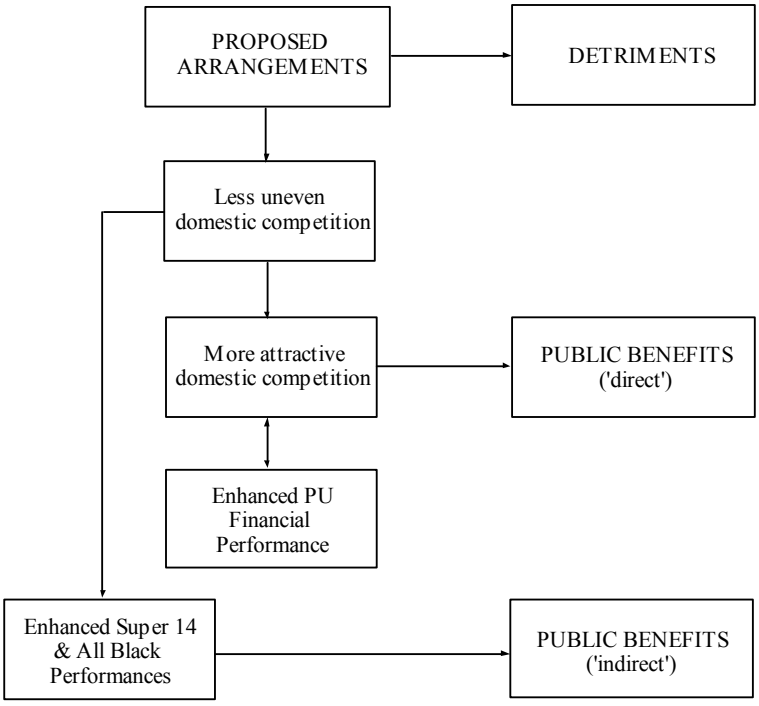
609. The Applicant argues that there is a clear nexus between implementation of the Proposed Arrangements and a range of 'direct' public benefits. This nexus, according to the NZRU, may be explained in two steps:

- 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, the flow of 'direct' public benefits.

610. 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.

611. A stylised view of the nexus between the Proposed Arrangements and the public benefits claimed by the Applicant is given in Figure 4 below. All of these purported links are now discussed in turn.

Figure 4: Stylised View of Detriments and Claimed Benefits



The Role of Proposed Arrangements

612. 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 has 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.

613. Each of these factors was discussed above. 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.

614. 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.

615. 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.

Competitive Balance and the Uncertainty of Outcome Hypothesis

616. 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.

617. 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.[131] 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 states in his submission to the Commission:[132]

> 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).

618. This proposition has become known in the sports economics literature as the *uncertainty of outcome hypothesis*.

619. 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).[133] Many of these restrictions have led to antitrust cases being taken against administrators.

620. A key argument advanced by league operators in numerous antitrust defences appeals to the uncertainty of outcome hypothesis. The argument typically rests on three core claims:[134]

- inequality of resources leads to unequal competition;
- fan interest declines when outcomes become less uncertain; and
- specific redistribution mechanisms produce more uncertainty of outcome.

621. 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).

622. Testing of the uncertainty of outcome hypothesis has been the subject of much empirical work in recent years, both overseas, and in New Zealand. The results of this work have been less than conclusive. Szymanski surveyed 22 separate

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[131] 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.

[132] The Application, Schedule H: Dr Rodney Fort Report, para 9.

[133] 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.

[134] See Szymanski (2003), op. cit., p.1153.

empirical studies of the uncertainty of outcome hypothesis; 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).[135]

Evidence from New Zealand

623. In New Zealand, Owen and Weatherston recently conducted two separate econometric studies: one examined the effect of match and within-season uncertainty on attendances at Super 12 rugby matches (2004a);[136] the other examined the impact of match and within-season uncertainty on attendances at NPC rugby matches (2004b).[137] Both studies found very little evidence that uncertainty of outcome has 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.

624. 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 that long-run domination is the norm (p.238).

625. The findings of Owen and Weatherston are very 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
- 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.

626. Owen and Weatherston's results have important implications for the present case as they potentially undermine one of the key arguments underpinning the NZRU's rationale for seeking to introduce the Proposed Arrangements. As mentioned earlier, 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

[135] Downward, P., Dawson, A., (2000), *The Economics of Professional Sports*, Routledge: New York.
[136] 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.
[137] 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 Competition Review", *University of Otago Economics Discussion Paper*, 0408.

Arrangements were successful in distributing talent more evenly between unions, it is not obvious that the benefits claimed by the Applicant would flow.

627. One limitation of Owen and Weatherston's work is that the relationship between inter-seasonal uncertainty (i.e., the uncertainty surrounding competition outcomes over successive seasons) 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;[138]
- average weekly income;
- average ticket prices;[139]
- uncertainty of a union's overall performance in a season;[140]
- certainty of a union's overall performance in a season;[141]
- a union's previous success (or otherwise) in having reached a semi-final;[142]
- a union's marketing expenditure;[143] and
- some other unobserved union-specific characteristics.

628. 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-finalist, were significant in explaining demand.[144]

629. Surprisingly, little empirical work has been performed to evaluate the impact of competitive balance on television viewership. Owen and Weatherston (2004a, p.365) point to a lack of data as a reason for this. The NZRU did provide the Commission with three years of NPC television viewership data. However, the truncated nature of the time series did not permit any robust econometric investigation of the relationship between uncertainty of outcome and viewership.

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[138] Market size was proxied by the population within each union's catchment area.
[139] 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.
[140] '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.
[141] '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.
[142] This factor is captured using dummy variables for past appearances in semi-final matches.
[143] This variable was included to control for unions' efforts in promoting the game within their provinces.
[144] See Appendix 2 for a summary of the regression analysis.

The Commission, therefore, had to rely on more qualitative factors to form a judgment in this regard.

630. The Commission received submissions from two broadcasters on the NZRU's Proposed Arrangements, and both were generally supportive of them. 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. In light of these submissions, the Commission took the preliminary view that a more balanced competition would likely result in some increase in television viewership.

Question 28. The Commission seeks further views from interested parties on the Applicant's claim that a more balanced PD competition would be a more attractive one, from the perspective of spectators and television viewers.

Enhanced Provincial Union Financial Performance

631. 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 perhaps derives 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. Enhanced financial performance is expected through growth in spectator and broadcasting revenues, and sponsorship.

632. However, the NZRU does not elucidate 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.

633. 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.

634. 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.[145]) 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.

635. 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, which in turn will go towards generating further public benefits.

Question 29. The Commission seeks further views from interested parties on the likelihood that a more attractive PD competition would lead to increased revenue opportunities (in terms of additional sponsorship, merchandising, royalty income, advertising, etc.) for PD unions and the NZRU.

Question 30. How strong is the likely link between the enhanced financial performance of provincial unions and benefits to the public of New Zealand? What, if any, are these benefits likely to be?

Conclusion on the Nexus for 'Direct' Public Benefits

636. 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. 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.

637. A scarcity of data prevented the Commission from undertaking any serious empirical investigation of the claimed link between a more balanced competition and increased television viewership. However, the Commission did receive submissions from some broadcasters in support of this hypothesis. In light of these submissions, the Commission took the preliminary view that a more balanced competition would be likely to lead to some increase in television viewership.

638. Finally, 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) as a sort of 'feedback' mechanism. A second round of public benefits may be expected to flow as a consequence of reinvestment in the domestic competition. However, these benefits would only be realised to the extent that the implementation of the Proposed PD Arrangements did in fact lead to a more attractive competition, and thereby, a greater source of income for unions.

[145] The Application, Schedule J: Brown Copeland Report, para 51.

Enhanced International Performances

639. 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.

640. 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.

641. 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.

642. 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.

643. 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 will 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.

644. 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 proposes to not give significant weight to this claimed benefit.

Question 31. The Commission seeks further views from interested parties on the likely strength of the link between the Proposed PD Arrangements and the claimed likely improved performance of New Zealand international representative sides?

Question 32. Would there be any deleterious effects as a result of such improved performances (as a direct consequence of the Proposed PD Arrangements), which ought to be considered when evaluating any claimed 'indirect' benefits? If so, what are these effects and how significant are they likely to be?

Conclusion on Nexus for 'Indirect' Public Benefits

645. 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 PD Public Benefits

646. As mentioned earlier, the Act requires the Commission to consider public benefit claims on the basis that any benefits to the public of New Zealand are to be included. The Commission's consideration is not limited to the market in which competition is lessened, nor indeed to only the markets affected by the Application.

647. The Commission has accepted that there is a nexus, albeit weaker than suggested by the Applicant, between the Proposed PD Arrangements and the promotion of a less uneven domestic provincial competition. The NZRU claim that this will maintain the domestic competition as a spectacle, compared to the counterfactual, from which certain 'direct' public benefits would flow. The Commission also accepts a possible further weak and indirect nexus between the promotion of a less uneven domestic competition and improved competitiveness of New Zealand national representative squads (e.g., Super 14 sides, All Blacks) relative to their overseas counterparts. The NZRU argues that the resulting success in international competitions by New Zealand teams will generate further 'indirect' benefits relative to the counterfactual. These two groups of claimed benefits, direct and indirect, are as follows:

Direct Benefits

- a more attractive domestic provincial competition for spectators and television viewers; and
- enhanced domestic sponsorship and broadcasting interest and funding.

Indirect Benefits

- 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.

648. The Applicant did not attempt to quantify any of the claimed indirect benefits.

649. 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.

650. Each of the claimed benefits is now assessed in turn.

Spectator Enjoyment

651. 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.

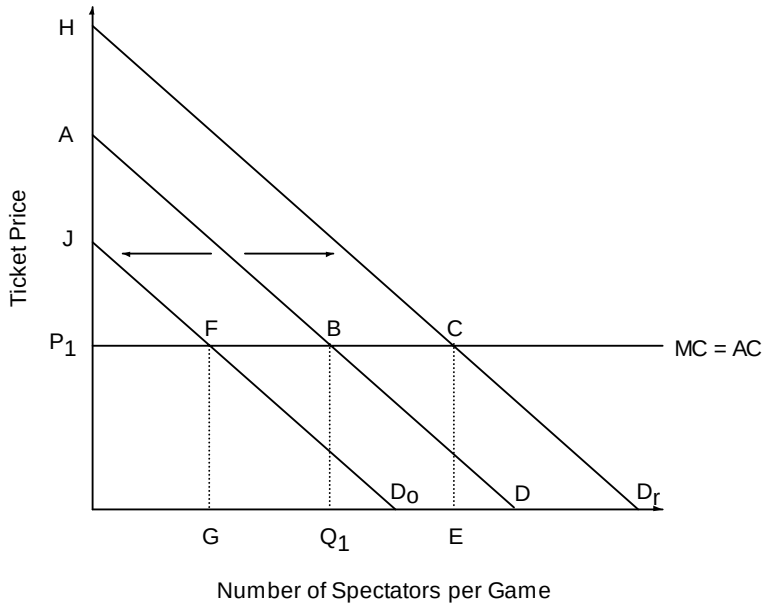
652. The intangible nature of this benefit makes it difficult to quantify, yet because of its potential significance, it is important that the effort be made. One measure might be the increase in the numbers of spectators and viewers, or the rise in gate takings, but this would be only a partial measure because it would not include the extra benefit enjoyed by existing spectators and viewers, nor would it incorporate off-setting losses in entertainments from which the increased spectators and viewers have shifted patronage.

653. 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 estimates these net public benefits to be between $105,000 and $420,000 per year (commensurate with a 10 to 20% increase in spectatorship).

654. 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 modelling results are presented.

655. 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



656. 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';[146]
- 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.

657. 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.

658. Now suppose that as the consequence of the greater interest in the domestic provincial competition resulting from the improved balance, 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

[146] 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.

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 rugby union entertainment services, shown by the area AHCB, is greater than the loss of consumers' surplus from buying other sports entertainment services of AJFB.

659. 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:

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

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

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

660. 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 using average price and aggregated annual attendance data.[147] 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 net gain in consumers' surplus represented by equation (1). See Appendix 3 for a more detailed description of the methodology employed.

661. As mentioned earlier, Mr. Copeland assumed a 10 to 20% annual increase in spectator demand would follow directly from implementing the Proposed Arrangements when quantifying the claimed benefits. The Commission's 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.

662. It also seems unlikely that benefits would flow uniformly over time 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 PD Arrangements.[148]

663. The Commission chose a five year horizon over which to assess the likely public benefits. In calculating benefits over this five year period, the Commission assumed that a zero to 10% increase in demand would materialise in year five (relative to year zero), and calculated the corresponding value of spectator benefits in that year. Benefits in each preceding year were calculated by assuming that a certain proportion of the year five benefits would materialise in that year. In particular, it was assumed that:

- 80% of the year five gains would be realised in year four;
- 50% of the year five gains would be realised in year three;
- 10% of the year five gains would be realised in year two; and

[147] See Appendix 3 for a summary of the estimation results.
[148] The Application, Schedule J: Brown Copeland Report, para 16.

- no benefits arise in year one.

664. 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.[149] In doing this the Commission employed a discount rate of 10% per annum.[150]

665. 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 15.

Table 15: Estimated Net Public Benefits Resulting from Increased Spectatorship for PD Rugby Union

Percentage Increase in Spectator Demand (Year 5)	Estimated Net Gain in Public Benefits
0	$0
2	$1,690
4	$6,760
6	$15,210
8	$27,040
10	$42,249

666. 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. It is likely that relaxing the various assumptions would alter the quantified benefits.

667. One major assumption made is that demand for all sports entertainment other than PD rugby could be 'compressed' into some single nebulous measure of demand, captured by an 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.

668. 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

[149] 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 (ibid, 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 tomorrow, 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.

[150] The Commission adopted the same discount rate employed by Mr. Copeland when assessing "Productive Efficiency Losses" (ibid, para 36).

two forms of entertainment overlap one another 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.

669. 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.

670. A 2005 Colmar Brunton survey suggests that rugby union is by far the most popular sporting code in New Zealand (approximately [ ]% of respondents follow 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 in relation to other forms 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.

671. The model described above assumes a linear demand functions for the purposes 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).

672. 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.

673. 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.

674. 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.

675. Given the suggested weakness of the nexus between the Proposed Arrangements and 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 Commission's preliminary view is that it is reasonable to conclude that the estimated net public benefits from greater spectator interest in rugby union to be between $0 and approximately $42,000 over five years.

Question 33. The Commission seeks further views from interested parties on the reasonableness of the methodology and assumptions underlying the Commission's quantification of likely benefits flowing from increased spectators' demand under the factual (relative to the counterfactual).

Question 34. Is the range of possible spectators' benefits flowing from the implementation the Proposed PD Arrangements reasonable? Why/why not?

Viewer Enjoyment

676. The Applicant also argued that 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 60 cents 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 PD Arrangements, to be between $6,000,000 and $12,000,000 per annum.

677. 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. In part, this reflects the fact that the expected benefits are difficult to quantify robustly. For example, in the case of the demand for televised rugby matches, viewership data is difficult to acquire, and there is no obvious 'price' (comparable to, say, the gate price for spectating) associated with viewership.[151] Hence, conducting an analysis similar to the type performed above for spectatorship, although in principle appropriate, would be overly complicated and likely to be fraught with error.

[151] NPC matches are either broadcast live on pay television (SKY), or through delayed coverage on free-to-air channels. In the case of live matches, the viewer must pay a fixed monthly channel subscription fee, but then may watch all broadcast matches during that month without restriction (distinct from the pay-per-view case). Hence, the minimum 'per match price' could be thought of as the fixed monthly payment spread over the maximum number of games in a month. In the case of delayed coverage, the per-match viewing 'price' could be taken to be zero; however, the possible disutility of settling for delayed coverage should be factored in. In both the live and delayed coverage cases, the viewing 'price' must also reflect any opportunity cost of time spent watching rugby (i.e., the cost of foregoing other forms of leisure, or other productive pursuits). These disutility factors and opportunity costs are likely to vary significantly across different viewers, and therefore, estimation of a viewing 'price' is difficult and unlikely to be reliable.

678. Given the lack of supporting evidence provided by the Applicant for its own analysis in this area, the Commission sought to assess the claimed benefits to television viewers using a different approach. 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.[152] By applying the expected net gain in welfare per rugby spectator to total expected viewership under the factual, it is possible to derive some estimate of the likely net benefits that may flow to television viewers.

679. The expected net gain in welfare per spectator, for a given increase in the level of competitive balance, was calculated from Figure 5 as follows:

$$\frac{AHCB - AJFB}{E} \qquad (4)$$

680. The Commission further assumed that spectator demand for PD rugby and television viewership of PD rugby tends to increase (or decrease) by the same proportions. For instance, a five percent increase in spectatorship is assumed to be matched by a five percent increase in viewership. Likewise, a 10% fall in spectatorship is assumed to be matched by a 10% fall in viewership.

681. According to the information provided by the Applicant, in 2004 the total number of viewers of NPC matches on TV3 and SKY Sport totalled [ ]. This was taken to be the base level of viewers.[153]

682. The net public benefit to television viewers, for a given viewership, was found by multiplying expression (4) by the total expected number of television viewers following the implementation of the Proposed PD Arrangements.

683. As in the case of spectator benefits above, the Commission assumed that a zero to 10% increase in demand would materialise in year five (relative to year zero), and calculated the corresponding value of viewers' benefits in that year. Benefits in each preceding year were calculated by assuming that a fixed proportion of the year five benefits would materialise in that year. In particular, it was assumed that:

- 80% of the year five gains would be realised in year four;
- 50% of the year five gains would be realised in year three;
- 10% of the year five gains would be realised in year two; and

[152] In reality, some viewers may derive more utility from watching a match at home than at a stadium; there is the ability to switch channels (i.e., access alternative forms of entertainment) whenever desired, and some individuals may prefer the comfort of watching a match in their own home than at an open rugby ground. Equally, some spectators may prefer the atmosphere of being in the midst of the live action at a stadium to watching from home. Whilst the utility that viewers and spectators derive may vary considerably across individuals, it seems plausible that on average all followers of rugby in New Zealand (be they live spectators or television viewers) derive roughly the same level of enjoyment as one another.

[153] Like the Applicant, the Commission applied no adjustment to compensate for the increase in the number of games per season from 48 to 70. The Commission considers that this is appropriate since the focus is on the public benefits that derive from introducing the Proposed Arrangements; accommodating the effect of the new competition format would distort the assessment of likely public benefits.

- no benefits arise in year one.

684. The estimated benefits, over a range of proportional increases in viewership, are reported in Table 16.

Table 16: Estimated Net Public Benefits Resulting from Increased Television Viewership for Rugby Union over a Five Year Period

Percentage Increase in Viewership (Year 5)	Expected Net Welfare Gain Per Viewer	Estimated Net Public Benefits (in Present Value terms)
0	$0.00	$0
2	$0.02	$390,074
4	$0.09	$1,538,622
6	$0.20	$3,416,230
8	$0.34	$5,997,117
10	$0.52	$9,258,581

685. Given that the estimated net welfare gains per viewer 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 16.

686. Once again, given the suggested weakness of the nexus between the Proposed Arrangements and competitive balance, the Commission considers it is appropriate to accept benefits towards the lower end of the range reported in Table 16. The Commission's preliminary view is that it is reasonable to conclude that the estimated net public benefits from greater viewer interest in rugby union to be $0 to $9,000,000 over five years.

Question 35. The Commission seeks further views from interested parties on the reasonableness of the methodology and assumptions underlying the Commission's quantification of likely benefits flowing from increased television viewership under the factual (relative to the counterfactual).

Question 36. Is the range of possible viewers' benefits flowing from the implementation the Proposed PD Arrangements reasonable? Why/why not?

Increased Funding

687. 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.

688. 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.[154]

689. 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.[155] The Applicant therefore contends that any increase in overseas television broadcasting revenues would represent a public benefit to New Zealand.

690. 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'.

691. 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. It is difficult to assess precisely how much ought to be netted off as domestically-incurred costs in this particular case. As a preliminary estimate, for the purposes of the analysis below, the Commission assumed that 50% of all additional overseas broadcasting revenues represent a true gain to the public of New Zealand.

692. Furthermore, in Decision 281 the Commission noted that, in terms of public benefit, any broadcasting income derived from overseas should be balanced against the outlay by SKY in acquiring the New Zealand rights. Given that News Corp now owns SKY, it is unclear to the Commission whether SKY still incurs any costs when acquiring domestic provincial competition broadcasting rights. In principle, any such costs would 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.

693. 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.

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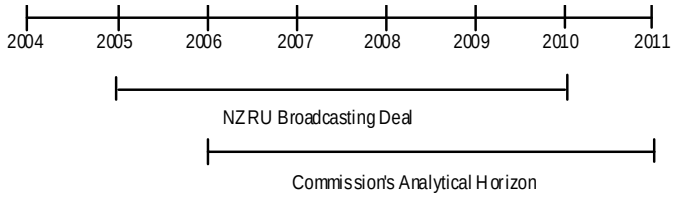
[154] The exception to this is when some individual provincial unions sell broadcasting rights to local radio stations. In such cases, all broadcasting revenues are paid directly to the contracted provincial union. The Commission understands that this is a rare occurrence, and in any case, the sums of money involved are likely to be relatively small.

[155] The Application, Schedule J: Brown Copeland Report, para 51.

694. 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



695. 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 additional sponsorship is actually socially optimal? One approach would be to assume that since many firms willingly allocate spending towards sponsorship of sport (and given that these firms are likely to be rational profit-maximisers) sponsorship must be a welfare-enhancing activity. This is the view Mr. Copeland adopts in his submission.[156]

696. Although it might well be true that the companies sponsoring rugby union view it as the best vehicle to put the company name before the public, these choices need to be viewed in the wider context of a number of big companies using various avenues to achieve the same marketing outcomes for themselves.

697. It may be correct to assume that sponsors are profit-maximisers; however, profit-seeking behaviour by oligopolists can result in an outcome where spending is jointly excessive, but none individually can unilaterally initiate a reduction in spending. Just as advertising expenditures in an oligopoly context can be carried to excess, so it may be the same with sponsorship, with each company trying to outdo others by trumping others' messages, resulting in much expenditure with little social gain. It is difficult to assess, but it seems unlikely that sponsorship spending is at an optimal level from a social perspective.

698. One countervailing argument is that some of this sponsorship expenditure may be socially desirable in some ways, for example, promoting sporting outlets for youth.

699. 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.

[156] The Application, Schedule J: Brown Copeland Report, para 52.

This effect needs to be factored in when assessing the overall gain from any potential increase in sponsorship funding.

700. 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.[157]

701. 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.

702. 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), $[ ].[158]

703. The Commission ignored any impact on gate revenues as any gains in this regard would have been captured in the evaluation of public benefits arising from increased spectator demand. Including them at this point would effectively result in double-counting.

704. 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.

705. Summing across all these income streams (both NZRU and provincial union) provides a total revenue figure (in 2005-dollar terms) of $[ ]. This total is taken to be the base year value, upon which any future increases (under the factual) would be counted.

706. 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

[157] 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.

[158] '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.

larger, the associated duties also increase). This suggests that it would be inappropriate to treat all incremental sponsorship revenues as pure profit.

707. 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.[159] 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.

708. In quantifying the claimed public benefits, Mr. Copeland assumed that the Proposed MD1 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 zero to 10% range is more plausible, given the likely weak link between the Proposed PD Arrangements and a more attractive PD competition.

709. In the analysis that follows, it is assumed that benefits begin to flow immediately from the implementation of the Proposed PD Arrangements. In practice though, if any benefits do flow, they are likely to do so with some lag as the proposed cap is likely to constrain only over time. One way to accommodate this is to apply a relatively high discount rate when calculating the expected present value of benefits. The Commission therefore applied a discount rate of 20% per annum.

710. Adopting the Applicant's assumption that 10% of the total expected annual increase in domestic revenues, and 50% of all revenue increases derived from abroad (NZRU broadcasting), represent true gains to the New Zealand public (as opposed to transfers of wealth), the present value of the expected net public benefits were estimated. Table 17 presents the results of the quantification exercise for the expected upper-end of the benefits range (i.e., assuming a revenue growth rate of 10% per annum).

Table 17: Estimated Net Public Benefit Arising from Increased PD Revenues

Year	Net Domestic PD Revenues	Annual Increase in Revenues	Annual Increase in Broadcasting Revs.	Net Public Benefit	Present Value
0	$14,379,683				
1	$15,788,443	$1,408,760	$0	$140,876	$117,397
2	$17,334,866	$1,546,423	$0	$154,642	$107,390
3	$19,032,365	$1,697,499	$0	$169,750	$98,235
4	$20,895,655	$1,863,290	$0	$186,329	$89,858
5	$22,940,879	$2,045,225	$195,000	$399,522	$160,559
Net Present Value					$573,439

[159] 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 R^2 was 0.6045; 79 observations were included in the sample.

Notes: Net Provincial PD-related Revenues for each year were estimated by subtracting from total expected revenues (across the 12 MD1 unions) expected sponsorship servicing costs; hence, net revenues in year 0 equal [ ]. It was assumed that 10% of the total expected increase in domestic revenues, and 50% of all increases NZRU broadcasting revenues, which derive entirely from overseas, represent true gains to the New Zealand public. Present values were calculated using a discount rate of 20% per annum. It was assumed that a 1% increase in sponsorship revenues would lead to a 1.1% increase in sponsorship servicing costs.

711. 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.

712. However, the Commission considers the claimed nexus between the Proposed Arrangements and enhanced attractiveness of the PD competition is weak. On this basis, 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 $600,000 over five years, which is commensurate with a zero to 10% increase in PD-related provincial union and NZRU income.

Question 37. The Commission seeks further views from interested parties on the reasonableness of the methodology and assumptions underlying the Commission's quantification of likely benefits flowing from increased PD funding.

Question 38. Is it reasonable to net domestic 'production' costs off foreign broadcasting earnings derived from 'exporting' PD rugby when estimating public benefits? If so, what proportion of broadcasting earnings should be netted off as domestic costs?

Question 39. Is it reasonable to assume that additional sponsorship of rugby union would produce benefits to the public of New Zealand? If so, what would be the nature of these benefits?

Question 40. Is the estimated range of quantified benefits flowing from increased PD revenue opportunities resulting directly from the implementation the Proposed PD Arrangements reasonable? Why/why not?

Assessment of Indirect Benefits

713. 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.

714. 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.

715. 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. 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, and therefore, that the resulting benefits are likely to be relatively minor.

716. 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 offshore. 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 preliminary view that this link is likely to be quite weak.

717. 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 likely reduce them significantly. It is possible that some firms may enjoy indirect gains through association (i.e., the pure 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.

718. 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.

719. 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.

720. 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.

Question 41. The Commission seeks further views from interested parties on the likely significance of the 'indirect' benefits claimed by the Applicant. In particular, how much weight should the Commission attribute to these claimed benefits when performing its balancing exercise?

Conclusion on PD Benefits

721. The Commission's preliminary assessment is that the following benefits are likely to flow as a result of the Proposed PD Arrangements:

- expected benefit from increased spectatorship of PD rugby union ($0 to $42,000 over five years);
- expected benefit from increased television viewership of PD rugby union ($0 to $9,000,000 over five years);
- expected benefit from increased PD revenues ($0 to $600,000); and
- expected indirect benefits (insignificant).

MD1 Benefits

722. As noted earlier, the elements of the Proposed Arrangements that impact upon the non-premier (MD1) player services market are the following:

- the prohibition on payment of any remuneration to players in the MD1 competition;
- the restriction of loan players between MD1 unions; and
- the replacement and liberalisation of player transfer regulations.

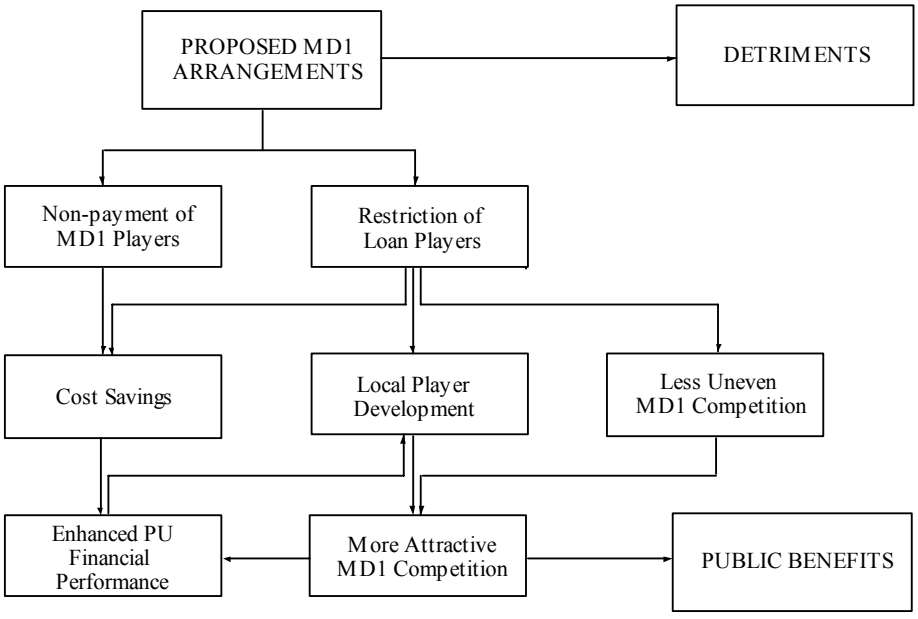
723. As noted in the *Detriment* section, historically, very few transfers have occurred between and within unions in the 2nd and 3rd Divisions of the NPC. Therefore, it seems likely that the ending of player payments, and of the loan-player facility, would have the biggest impact on the MD1 unions. On this basis, the Commission focussed its attention on the first two elements (the 'Proposed MD1 Arrangements'), when assessing the likely extent of public benefits.

724. The Applicant argues that implementation of the Proposed MD1 Arrangements will, through a series of critical steps, produce a range of public benefits. These key steps may be summarised as follows:

- The Proposed MD1 Arrangements would produce a number of direct cost savings, both to the NZRU and MD1 provincial unions, which may include: savings to provincial unions with respect to player payments and loan player relocation expenses; lower administration costs; and a reduction in costs to the NZRU of "propping up financially failing unions".[160]
- The claimed cost savings would yield greater profitability for MD1 provincial unions.
- Enhanced provincial union financial performance would facilitate greater development of local players, which would in turn help produce a more even MD1 competition.
- The restriction of loan players would aid a more even competition between MD1 teams, as well as incentivise provincial unions to develop local talent.
- A more balanced MD1 competition would make for a more attractive one.
- The promotion of local talent would also add to the attractiveness of the competition via increased crowd enjoyment.
- A more attractive competition would enhance the marketability of the MD1 competition, and therefore lead to increased sponsorship opportunities and further improvement in the financial performance of the MD1 provincial unions.

725. These steps are schematically represented in Figure 7. The suggested links are now discussed below under three headings: Cost Savings; Improved Competitive Balance; and More Attractive Competition.

Figure 7: Stylised View of Detriments and Claimed Benefits



[160] NZRU Response to Commission's Questions, 23 December 2005, Q.27.

Cost Savings

Player Remuneration

726. The Applicant contends that the prohibition of remuneration to MD1 players will result in savings to some provincial unions (which are smaller and less financially secure than PD unions). According to the NZRU, some poorly-resourced unions have in recent times "ratcheted up" their payments to players in order to compete, as other unions spend more on players. The NZRU argues that that eliminating such payments would generate savings to unions that may be diverted to other uses, such as developing local talent, and fostering club competition and age-group teams.

727. The Applicant accepted that any such savings are very difficult to accurately quantify, and likely to be fairly modest. Notwithstanding the difficulties in making an accurate assessment of likely cost savings, the NZRU estimates, using historical GARAP data, that $[ ] per annum could be saved by abolishing player remuneration.[161]

728. As discussed earlier, the saved expenditure on MD1 players effectively represents a transfer of wealth from players to provincial unions (with the likelihood that some talent exits the player services market altogether). As noted earlier, when assessing net public benefits the Commission does not count transfers between individuals. Therefore, the Commission does not consider the suggested cost savings, in themselves, to be a gain to the public of New Zealand.

729. It is possible that the saved expenditure could be channelled towards improving the productivity (skill levels) of those players who remain in the market, and the development of 'grassroots rugby'. One view would be that any such improvement in players' skills ought to be viewed as a productive efficiency gain, and therefore qualify as a public benefit.

730. The counterview is that the proposed restrictions may be inefficient in that they do away with measures that some unions clearly find welfare enhancing, and have freely adopted. In other words, in an unrestricted environment at least some unions find it more optimal to pay players than invest further in development. For these unions imposing restrictions that move them away from their 'optimal' allocation of resources may be welfare-destroying.

731. However, the NZRU argues that some unions pay players not because they find it privately optimal to do so, but because without such payments they risk losing key players to competing unions that do offer remuneration. Some MD1 unions have supported this claim. For example, Wanganui RFU, who strongly support the abolishment of player remuneration, submitted that under the factual "players will no longer 'jump provinces' due to promises of greater remuneration".[162] It is suggested that the Proposed MD1 Arrangements would provide a 'level playing field', thereby allowing unions, who would otherwise not pay players, to allocate their scarce

[161] This estimate was derived by calculating (using 2004 GARAP data) the total amount by which MD1 unions exceeded an assumed annual player reimbursement amount of $[ ] per union. The maximum reimbursement a union may provide under the Proposed MD1 Arrangements is $48,000 ($1,920 per player, assuming a squad size of 25).

[162] Submission provided by Wanganui RFU, 24 November 2005, p.2.

resources towards what they actually value most (i.e., the development of players and local rugby).

732. In investigating this claim, the Commission found no evidence to suggest that players at the MD1 level switch between unions on the basis of pay. Some fluidity between adjacent unions may exist, but on the whole it seems unlikely that the size of payments involved would offer sufficient inducement for players to incur the costs of relocating to play for a new provincial union. Indeed, this claim seems to contradict the NZRU's stated view that most participation in the lower levels of the domestic provincial competition is motivated primarily by provincial pride. Hence, the Commission is disinclined to give weight to the argument that some unions remunerate players for fear of losing them to rival unions.

733. In summary, there appear to be competing arguments over whether any utilisation of player payments savings towards development activities ought to count as a public benefit. Some unions clearly consider it optimal to remunerate players, given that they have freely elected to do so; there is no preferable use for the funds they presently allocate towards player payments, including further development activities. For these unions, any restrictions that remove their ability to pay players will mean a welfare loss.

734. On the other hand, the NZRU argues that some unions would actually prefer to use their funds for development rather than player remuneration, but are compelled to do so in order to remain competitive. However, for the reasons outlined above, the Commission considers this unlikely. On this basis, the Commission concludes that any player development that flows from the abolishment of MD1 player payments ought not to be counted as a public benefit.

Loan Player Expenses

735. The Applicant submitted to the Commission that imposing restrictions on the use of loan players would yield significant cost savings across all MD1 unions, as these players have historically required the greatest financial outlay, both in terms of actual payments to players, as well as relocation.

736. The NZRU, advised the Commission that in some cases loan players had to be financially incentivised to travel away from home to play for another union. In such instances, borrowing unions would have to make direct payments to loan players that generally exceeded those made to local players. However, according to the NZRU, more significant than the cost of remunerating loan players are the costs associated with physically relocating the player. These would typically include travel, accommodation and meals.

737. It was suggested by the NZRU that some provincial unions (e.g., [ ]) have enjoyed a comparative advantage in attracting quality loan players due to their geographical proximity to the large metropolitan unions; loan players from strong PD unions may prefer to travel shorter distances to play for neighbouring provinces than travel frequently to distant provinces. The NZRU suggests that, for this reason, weak unions (typically in poorly populated and distant regions) have had to incur proportionally greater costs to attract loan players and remain competitive.

738. The Applicant submitted that estimating the size of these cost savings was difficult because the cost to each union depended on how far its loan players needed to travel. For example, [

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739. Nevertheless, the NZRU canvassed the 12 MD1 unions (ten of which responded) to glean some idea of the likely savings. On the basis of the information gathered in this way, the Applicant estimates that the expected savings on loan player expense across the MD1 would be approximately $[ ] per annum. The Applicant acknowledged that this figure may be too high in the sense that some of these claimed savings include savings on player remuneration, which were already captured in the previous subsection ($[ ]). Recognising this double-counting, the anticipated loan player expense savings are likely to be slightly lower than $[ ] per annum.

740. However, as with player remuneration cost savings discussed above, the Commission does not consider that these savings would in themselves represent a public benefit; they effectively reflect transfers of wealth from loan players, and businesses providing transportation, accommodation and meals to loan players, to MD1 provincial unions.

741. The NZRU contends that to the extent that these savings could be diverted to local player development and the fostering of community rugby, there would be a gain to the public of New Zealand. However, it is difficult to estimate reliably the quantum of any such gains, if they exist at all. (Of course, these gains would need to be balanced against any welfare loss to unions as a consequence of no longer being able to utilise skilled loan players, who may lift overall team performance.)

742. A counter-argument is that in an unrestricted setting, at least some unions have shown their preference is to utilise loan players. Prohibiting loan players would mean a loss of welfare to such unions.

743. However, the NZRU contends that in many cases, unions have felt compelled to obtain loan players in order to remain competitive with other unions that routinely utilise loan players. In the case of these unions, loan player restrictions may free-up resources that could be diverted towards more productive pursuits. A number of MD1 unions expressed support for this view.

744. From this discussion, it seems that some unions stand to benefit from the loan player restrictions, in terms of economic welfare, while others (those unions who willingly utilise loan players at present) may be made worse-off. The Commission understands that the NZRU's proposal to restrict access to loan players has the support of most MD1 unions. Of the MD1 unions canvassed by the Commission, three (i.e., the [ ]) raised objections to the proposed scheme. Purely on the number of unions who appear to support the scheme, it seems plausible that the net effect on unions' welfare may be positive.

745. Whilst it is difficult to reliably estimate the quantum of any overall welfare gains, if at all they exist, the Commission is of the preliminary view that any such gains would be small.

Administration Costs

746. The Applicant argued that the Proposed MD1 Arrangements would lead to a reduction in administration costs to the provincial unions; time and effort presently spent on player contracting, player movement and administration could be diverted to development of provincial rugby.

747. The Commission considers that the same arguments raised above apply here. It is possible that at least some unions find it efficient to spend time on player contracting, and on administration work related to loan player arrangements, rather than on further development work. It may be argued that the unions in this category are those who, in an unrestricted environment, willingly choose to allocate time and effort to these activities. For such unions, reducing administration work in these areas and increasing development efforts may represent a 'second-best' alternative, i.e., represent a welfare reduction.

748. On the other hand, some unions may have in the past incurred these administration costs not because they individually found it optimal to do so, but because these activities were necessary to remain competitive. For these unions, eliminating administration costs relating to the contracting of players, and acquisition of loan players, may represent welfare gains to the extent that any savings would be diverted towards more productive uses.

749. The Commission is of the preliminary view that if any public benefits do exist in this regard, they are likely to be relatively small.

NZRU Emergency Funding

750. The Applicant submitted to the Commission that some MD1 provincial unions have in the past faced financial difficulties stemming from increasing player remuneration costs and expenses associated with acquiring loan players. In the Applicant's view, these two factors have contributed towards some MD1 unions spending beyond their means, and it is reported that, at least in the case of one union ([ ]), the NZRU was forced to intervene by providing emergency funding. The NZRU also cited [ ] instances in the past where it [

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751. The NZRU did not provide any evidence to suggest that these past interventions were due to overspending on players, or the over-utilisation of loan players.

752. The Applicant submitted that it expects the financial position of some unions to worsen under the counterfactual due to likely increases in spending on player remuneration and loan players, thus likely requiring further such interventions. The NZRU argues that by introducing the Proposed MD1 Arrangements, unions would

become more financially sustainable, and therefore, it could avoid the cost of "propping up financially failing unions".

753. Based on past experience, the Applicant estimates that the cost of providing such assistance to struggling MD1 unions in the counterfactual would be approximately $[ ] per annum. The NZRU contends that under the factual it would be able to utilise these funds in more productive pursuits.

[

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754. [

]. An examination of the profit margins for individual MD1 unions (see Appendix 4) shows [

]. Whilst it is true that provincial unions are not profit-oriented entities, it is desirable, from a funding and planning perspective, that they at least do not make persistent losses.

755. It is unclear, however, that the payment of players and the utilisation of loan of players [ ]. In the PD, player salaries, bonuses, and expenses account for a very small proportion—only [ ]%—of total operating expenses. If the same were true in relation to MD1 unions, then it is unlikely the Proposed MD1 Arrangements would significantly improve the financial sustainability of these unions. Unfortunately, a lack of detailed and consistent MD1 cost data prevented the Commission from investigating this claim in a more robust empirical manner.

756. [

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757. The Commission accepts that gains to the public of New Zealand would flow, to the extent that the NZRU could divert resources otherwise committed to rescuing failing unions to more productive uses. Given the uncertainties surrounding the likely need for such interventions under the counterfactual, and a lack of information on what the alternative uses for these NZRU resources might be, it is difficult to assess the size of this claimed benefit.

758. On balance, the Commission is of the preliminary view that any such benefits, if at all they exist, are likely to be small.

Question 42. The Commission seeks further views from interested parties on the likely size and effect of cost savings under the factual, relative to the counterfactual. In particular, are the suggested cost savings above likely, and if so, are they likely to provide overall welfare gains to the public of New Zealand?

Question 43. How significant are any benefits referred to in the previous question likely to be?

Improved Competitive Balance

759. The Commission conducted an empirical investigation into the state of competitive balance in the old NPC 2nd and 3rd Divisions. The analysis, which utilised several measures of competitive balance,[163] suggested that the level of competitive balance in the 3rd Division has remained fairly stable between 1997 and 2005; however, the 2nd Division has seen a general worsening in balance over the same time period.

760. As noted earlier, the new competition format involves promotion of the five strongest unions (in terms of playing history, income, and population) from the old 2nd Division to the new PD. (The remaining 12 unions will form the new MD1.) The Applicant submitted that this in itself will considerably balance the lower levels of the domestic provincial competition.

761. However, the Applicant argued that implementing the Proposed MD1 Arrangements would act to further balance the MD1 competition in two ways. First, the restriction on loan players would prevent wealthy unions 'buying in' talent from outside their province, often from higher Divisions,[164] in order to win matches, to the detriment of less wealthy unions. Unions would instead be incentivised to develop local players as they would no longer be able to rely on external talent. Second, all MD1 unions, including the financially weaker ones, could utilise any cost savings (discussed earlier) to develop local talent, which would allow them to compete more strongly.

762. In submissions to the Commission, provincial unions such as North Otago RFU, West Coast RFU, and Buller RFU expressed concerns that they would be placed at a significant competitive disadvantage if no longer permitted to field loan players.

763. The Applicant acknowledges that some unions, such as North Otago RFU, have enjoyed great success in recent years against traditionally strong NPC 2nd Division unions, such as Hawke's Bay and Manawatu, with the aid of loan players.[165] However, the NZRU argues that with the promotion of the five strongest unions in the 2nd Division to the PD, unions such as North Otago RFU need no longer be bolstered by the addition of loan players in order to be competitive in the MD1. Unions opposed to the implementation of the Proposed MD1 Arrangements did not address this point in their submissions to the Commission.

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[163] The various measures of competitive balance were the same as those used to for the PD analysis, and included: the relative standard deviation of winning percentage, league points, and match points; Gini coefficients of league and match points; C4 concentration ratios of league and match points; and the Hirschman-Herfindahl concentration index of league and match points. The results of the analyses proved to be consistent over all measures used.

[164] Mr. Good advised the Commission that in the majority of cases, players tend to be loaned from club teams in higher Divisions to unions in lower Divisions. However, he also noted, without elaborating on the specific circumstances, that there is ample evidence of intra-Divisional loans occurring, and even loans from lower to higher Divisions.

[165] It appears that the success of North Otago RFU's loan player policy may, at least in part, be attributable to the fact that it draws its loan players from Otago RFU—one of the more successful unions in the 1st Division of the NPC.

764. The Commission agrees that under the new competition format, which in itself seems likely to improve balance, unions within the MD1 are unlikely to require loan players in order to be competitive. The Commission also largely accepts that, absent loan players, unions may likely face stronger incentives to develop local talent. However, it is not obvious that increased development of local players, per se, would produce a more balanced competition. It may be that the financial inequalities between the unions mean that wealthier unions spend more on development than poorer unions, and continue to be relatively more successful.

765. Nor is it clear that the promotion of local players at the expense of loan players would produce greater enjoyment for local audiences. One attraction for spectators may be the overall performance of their union, which may in large part be driven by the contribution of skilled loan players. This is discussed in greater detail below.

Question 44. The Commission seeks further views from interested parties on the likelihood of the Proposed MD1 Arrangements producing a more balanced competition. In particular, is it reasonable that under the new competition format, MD1 unions will not require loan players in order to be competitive?

Question 45. Is it likely that the Proposed MD1 Arrangements would lead to greater local player development, and would this necessarily produce a more balanced competition?

Question 46. Is it likely that the apparent financial inequalities between provincial unions at the MD1 level hinder a more balanced competition developing under the factual?

More Attractive Competition

Spectatorship

766. The Applicant argues that introduction of the Proposed MD1 Arrangements would make the lower levels of the domestic provincial competition more attractive in two ways. First, a more balanced competition would draw a greater following. Second, the promotion of local talent (over loan players) would produce more crowd enjoyment.

767. On the first point, the Commission has already noted, in relation to the Proposed PD Arrangements, that the claim that a balanced competition is more appealing to spectators than an unbalanced competition is a tenuous one. Although an intuitively appealing notion, the empirical work from overseas has proved inconclusive on the subject, and recent investigations on NPC (and Super 12) rugby in New Zealand has rejected this hypothesis.

768. Furthermore, if competitive balance were a determinant of spectator interest, it is likely that it is only one among a range of factors. It seems likely that a key driver of crowd interest is the proficiency of the competing unions. A contest may be very balanced in that all the competing teams play equally poorly. But this does not imply spectator enjoyment will follow; if the competition lacks spectacle and dynamism, crowd enthusiasm is likely to wane. It may be argued that skilled loan players go some way towards providing dynamism to local teams. The apparent success of the North Otago RFU is an example of this.

769. The NZRU argues that in time unions will be forced to develop local players sufficiently to take the place of loan players. While this may be so, the required development of players is likely to take some years, in which time spectators may have lost interest in the competition. Furthermore, this forced development of local players results from the NZRU overriding the choices made by the provincial unions in a 'free market' setting. As noted earlier, it is arguable that, from an economic welfare perspective, unions would be worse-off as a consequence.

770. The Commission accepts that crowd enjoyment may be enhanced with the development and success of local players. However, parochialism may be only one determinant of spectator demand. For instance, crowds may find a strong display of skills by talented loan players just as (if not more) appealing as watching local players compete. The relationship between the fielding of talented players and crowd attendance is well-supported in the empirical literature. For example, Owen and Weatherston (2004a, 2004b) find that the presence of 'star players' (as an indicator of the skills they bring to the game) is a significant explanation of attendance. This may be especially true if the effect of including these players is to lift the performance of the local team as a whole. Hence, the loss of enjoyment to spectators from being unable to watch quality out-of-province talent playing for their union, due to the proposed loan restrictions, may at least partially offset the increased satisfaction to spectators of watching local players participate.

771. In addition, a 2005 Colmar Brunton market research study commissioned by the NZRU found that [ ].[166] Furthermore, only 11% of respondents to the same study agreed strongly that [ ]. These findings suggest that crowd enjoyment may not be as closely linked to the promotion of local players as suggested by the NZRU.

772. For these reasons, the Commission proposes to treat conservatively any public benefits to spectators that are expected to flow from the enhancement of competitive balance in the new MD1, or the development of local players.

Sponsorship

773. The Applicant contends that an attractive MD1 competition would make for a marketable 'product' capable of attracting more sponsorship revenues. This will in turn enhance the profitability of the MD1 provincial unions. Increased profitability would then feed through to further player development and "financial sustainability".

774. However, this presupposes that the MD1 competition would indeed increase in attractiveness under the Proposed Arrangements. As the Commission has indicated (and notwithstanding any potential improvement in competitive balance), it is not obvious that this would be the case.

775. Furthermore, the Commission is of the view that even if the Proposed MD1 Arrangements were to lead to increased sponsorship opportunities, this would not in itself represent a net public benefit. As mentioned earlier, the Commission does not

[166] [ ].

consider changes in the distribution of income or economic welfare, where one group gains at the expense of another, as 'benefits' when weighing up the 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.

776. For example, increased spectator revenues will represent a gain to rugby union, but will commensurately represent a loss to other forms of entertainment. Likewise, increased sponsorship revenues for MD1 provincial unions must necessarily be to the detriment of other potential recipients of sponsorship, such as local charities or the arts. Hence, it would be incorrect to count the full quantum of expected additional revenues as a net public benefit; any relevant offsetting losses must also be accounted for.

777. The Commission concludes that if there were a nexus between the Proposed MD1 Arrangements and the enhancement of the attractiveness of the competition, both to spectators and sponsors, it is likely that this link would be weak. Therefore, the public benefits that are likely to flow as a result are likely to be modest.

Question 47. The Commission seeks further views from interested parties on the likelihood of the Proposed MD1 Arrangements producing a more attractive MD1 competition. In particular, is a more even competition at the MD1 level likely to be more appealing? What other factors (apart from evenness) would lend appeal to the MD1 competition, and do the Proposed MD1 Arrangements facilitate these factors?

Question 48. Is it likely that the development and fielding of local players would produce more crowd enjoyment (i.e., a more appealing competition) than the fielding of skilled out-of-province loan players?

Question 49. The Commission seeks further views from interested parties on the likelihood that a more attractive MD1 competition would attract greater revenues to provincial unions (through sponsorship, merchandising, royalties, advertising, etc.)

Evaluation of Claimed MD1 Public Benefits

778. The NZRU has claimed the following public benefits of implementing the Proposed MD1 Arrangements:

- revenue associated with selling naming rights to the MD1 competition;
- retention of in-kind sponsorship from Air New Zealand (favourable ticketing arrangements);
- increased revenues from merchandising, royalties, gate revenues, signage, and sponsorship from other sources; and
- increased spectator enjoyment.

779. Each of these claimed benefits is evaluated in turn.

Sponsorship Revenues

780. Mr. Copeland advised the Commission that the NZRU is expected to achieve new sponsorship in the form of naming rights for the new MD1. The NZRU anticipate a minimum amount of $[ ] for this sponsorship. Mr. Copeland argues that should the new MD1 competition prove to be "uneven and uninteresting as a consequence of disparities in player remuneration levels or lack of financial viability of some unions" (i.e., in the counterfactual), this sponsorship would be at risk.[167] Assuming that 10% of this total sponsorship represents a net welfare gain to society (i.e., net of transfer from one sector of the economy to the NZRU), the total loss of welfare to the public of New Zealand if this sponsorship were to not eventuate was estimated by Mr. Copeland to be $[ ].

781. The Commission accepts in principle the approach taken to quantify this net benefit with one proviso. As Mr. Copeland notes, there is a *risk* of this sponsorship being lost if the new MD1 competition proves unattractive; there is no *guarantee* that this loss would occur in the absence of the Proposed MD1 Arrangements, as Mr. Copeland seems to assume. Where uncertainty is involved, it is appropriate to calculate the *expected* benefits that may flow.

782. The Applicant did not provide a view on the likelihood of failing to achieve this sponsorship in the counterfactual when questioned by the Commission, submitting only that "if interest declines, that risk remains". In lieu of any clear evidence to the contrary provided by the Applicant, the Commission assumed that there is a [ ] to [ ]% chance that this sponsorship would not eventuate under the counterfactual. The Commission also assumed that this sponsorship would be in the form of a lump-sum payment, made to the NZRU in the 2006 season. Given these assumptions, the public benefits from retaining this sponsorship in the factual (in present value terms) is expected to range between $3,500 and $7,000.[168]

783. In addition, Mr. Copeland suggests under the counterfactual there is a risk of losing some in-kind sponsorship provided by Air New Zealand (due to an unattractive competition evolving), which would not be threatened under the factual. At present, provincial unions are [

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784. Mr. Copeland estimates, on the basis of 2004 cost data, that the total cost of air travel for the 12 MD1 unions is approximately $[ ]; however, he does not go on to estimate the public benefit associated with this sponsorship, citing as a reason the difficulties associated with deriving a reliable estimate. Mr. Copeland nevertheless concludes that the benefit to the NZRU [ ] is significant, [

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785. The Commission makes three comments in relation to this claimed benefit under the factual. First, as the Commission does not count transfers between individuals when

[167] Submission to the Commission on behalf of the NZRU, 12 January 2005, Brown Copeland & Co. Ltd, para 7.
[168] Suppose that under the counterfactual there is a [ ]% chance of losing the entire estimated public benefit associated with the MD1 sponsorship ($[ ]), but a [ ]% chance of securing it (so that the total loss is zero). Then the expected loss (gain) to society under the counterfactual (factual) is equal to $3,500 = [ ] x $[ ] + [ ] x $0.

calculating public benefits, it would not be appropriate to consider the full quantum of potentially lost sponsorship (under the counterfactual) as a gain to society in the factual. In particular, Air New Zealand faces an opportunity cost when it provides the NZRU with in-kind sponsorship; [ ]. If Air New Zealand ceases to provide this sponsorship it also ceases to bear this opportunity cost. In other words, any public benefits assessed in the factual as arising from Air New Zealand's sponsorship must take into account any such opportunity costs.

786. Second, Mr. Copeland does not discuss in his submission the possibility that this sponsorship might continue in the counterfactual, nor does he recognise the risk that it may be withdrawn even under the factual. Acknowledging these uncertainties, it would be appropriate to consider the *expected* public benefits arising from this sponsorship. The expected benefits are likely to be considerably less than would be the benefits if the loss of sponsorship were a foregone conclusion under the counterfactual, or an impossibility under the factual.

787. Third, it is unclear that this in-kind sponsorship is as valuable as Mr. Copeland argues. [ ].

788. On balance, the Commission's preliminary view is that the value of any benefits from retaining this in-kind sponsorship in the factual is likely to be fairly small, overall.

789. The Applicant also considers that a more attractive MD1 competition would lead to an overall increase in provincial union revenues (via merchandising income, royalties, gate revenues, signage and advertising, and sponsorship from other sources). Mr. Copeland estimates the expected public benefits in this regard to range between $13,450 and $26,910 per annum, assuming that implementation of the Proposed MD1 Arrangements would lead to a 10 to 20% increase per annum (from 2004 levels) in such revenues, and that 10% of this increase represents a net gain to the public of New Zealand (as opposed to transfers between individuals).

790. The Commission considers that revenue growth of zero to 10% per annum (attributable to the implementation of the Proposed MD1 Arrangements) would be more plausible, given the likely weak link between the Proposed MD1 Arrangements and a more attractive MD1 competition.

791. In order to evaluate these claimed benefits, the Commission aggregated (into what is broadly referred to below as 'provincial union revenues') three key revenue streams suggested by the Applicant: merchandising income and royalties; signage and advertising; and sponsorship. The impact on gate revenues was ignored as these gains ought to be captured in the evaluation of public benefits arising from increased spectator demand; including them at this point would effectively result in double-counting.

792. Using the NZRU-supplied GARAP data (available up to 2004), the Commission estimated 2005 revenue totals for the 12 MD1 unions across the three key income categories as follows:[169]

- merchandising and royalties, $[ ];
- signage and advertising revenues, $[ ];[170] and
- sponsorship (cash and in-kind), $[ ].[171]

793. Summing across these three revenue streams provides a total of $[ ]. This amount was taken as the base (2005) revenue figure from which expected benefits were calculated.

794. As discussed in the context of evaluating the benefits of the Proposed PD Arrangements, an increase in sponsorship revenue would be expected to also lead to an increase in what the NZRU terms 'sponsorship servicing costs'. The NZRU's latest GARAP data provides information on total sponsorship servicing costs across all MD1 unions in 2004. Using this information, a base year (2005) amount, $[ ], was estimated.[172] For the purposes of the analysis, the Commission assumed, as in the PD analysis, that a 1% increase in sponsorship revenue would yield a 1.1% increase in sponsorship servicing costs.

795. Taking the Applicant's assumption that 10% of the total expected annual increase in revenues represents a true gain to the New Zealand public, and assuming a discount rate of 10% per annum, the present value of the expected net public benefits were estimated. Table 18 below presents the results of the benefits quantification exercise for expected upper-end of the end range (i.e., assuming a revenue growth rate of 10% per annum).

Table 18: Estimated Net Public Benefit Arising from Increased MD1 Provincial Union Revenues over a Five Year Period

Year	Net MD1 PU Revenues	Annual Increase in Revenues	Net Public Benefit	Present Value
0	$1,410,454			
1	$1,550,551	$140,097	$14,010	$12,736
2	$1,704,554	$154,003	$15,400	$12,727
3	$1,873,841	$169,287	$16,929	$12,719
4	$2,059,929	$186,087	$18,609	$12,710
5	$2,264,482	$204,554	$20,455	$12,701
Net Present Value				$63,594

Notes: Net Provincial Union Revenues for each year were estimated by subtracting from total expected revenues (across the 12 MD1 unions) expected sponsorship servicing costs; hence, net revenues in year 0 equal [ ]. It was assumed that 10% of the total expected increase in revenues represents a true gain to the New Zealand public. Present values were calculated using a discount rate of 10% per annum. It

[169] 2005-equivalent amounts were calculated by scaling up 2004 GARAP totals at the rate of inflation (3%).
[170] 2005-equivalent amounts were calculated by scaling up 2004 GARAP totals at the rate of inflation (3%).
[171] 'Sponsorship' includes all major and minor team cash sponsorship; major and minor team in-kind sponsorship; and Air New Zealand in-kind travel sponsorship.
[172] Once again, the base year amount was calculated by adjusting the 2004 figure upward to account for inflation.

was assumed that a 1% increase in sponsorship revenues would lead to a 1.1% increase in sponsorship servicing costs.

796. In summary, the Applicant has suggested that the Proposed MD1 Arrangements would lead to a more attractive competition at the MD1 level (through enhanced competitive balance and player development). The NZRU further contends that with a more appealing competition, provincial unions could attract higher revenues, and a proportion of these increases would represent an overall welfare gain.

797. However, the Commission considers the claimed nexus between the Proposed MD1 Arrangements and enhanced attractiveness of the MD1 competition is weak. On this basis, the Commission concludes that the net public benefits (in present value terms) attributable to more profitable provincial unions under the factual would be between $0 and $64,000 over five years.

Question 50. The Commission seeks further views from interested parties on the likelihood of current sponsorship (mentioned above) being lost if the Proposed MD1 Arrangements were not implemented.

Question 51. The Commission seeks further views on the reasonableness of the range of quantified benefits relating to increased MD1 revenues.

Spectatorship

798. Mr. Copeland attempted to quantify the public benefits in terms of increased spectator enjoyment from "a more even and 'community-based'" MD1 (as a result of the Proposed MD1 Arrangements) using the same model employed to estimate PD spectator benefits. In calculating the claimed benefits, Mr. Copeland assumed the following:

- an average attendance per game of 725;
- an average ticket price of $3;
- 54 games per year in the new MD1;
- a price elasticity of one; and
- an increase in crowd size (resulting directly from introduction of the Proposed MD1 Arrangements) of between five and 20%.

799. On the basis of these assumptions, Mr. Copeland estimated the public benefits arising from greater spectator interest in MD1 rugby to be between $300 (for a 5% increase in crowd size) and $4,700 (for a 20% increase in crowd size) per annum.[173]

800. Given the limited crowd attendances generally found at 2nd and 3rd Division NPC matches, and the very small likelihood that the Proposed MD1 Arrangements would lead to a more attractive competition, it seems likely that any public benefit arising from greater spectator interest (as a result of implementing the Proposed MD1 Arrangements) would be reasonably modest. Therefore, the Commission considers

[173] The basic formula for this calculation is to multiply the total number of games in the season (54) by the average ticket price ($3) times the assumed percentage change in crowd size, squared, divided by average crowd size (725).

that the results of Mr. Copeland's quantification exercise are likely to be too optimistic.

801. In its own evaluation of public benefits, the Commission assumed that spectator interest would increase under the factual by between zero to 10%. According to the framework used by Mr. Copeland, this would produce an expected (undiscounted) gain in spectators' benefit ranging between $0 to $1,200 per annum. Assuming a 10% discount rate, this translates to expected benefits over a period of five years in the range of $0 to $4,549, in present value terms.

Question 52. The Commission seeks further views from interested parties on the reasonableness of the assumed increase in spectator demand attributable directly to the implementation of the Proposed MD1 Arrangements.

Unquantified and Intangible Benefits

802. In addition to the claimed benefits that the Applicant has attempted to quantify, a number of unquantified benefits have also been suggested. These include:

- improvement of MD1 players' skills (productivity) and development of 'grassroots' rugby, facilitated by cost savings to MD1 provincial unions;
- the better utilisation of NZRU funds, in lieu of providing emergency funding to financially failing unions; and
- the intangible benefits associated with "maintaining a financially sustainable and vibrant amateur rugby base in regions outside the main metropolitan areas of New Zealand".[174]

803. The first of these two claimed benefits were covered in the preceding discussions. The Commission concluded that any likely gain from the development of local rugby resulting from cost savings to provincial unions under the factual would likely be small. The Commission also concluded that the benefits generated by savings to the NZRU under the factual from no longer having to rescue failing unions would likely be small.

804. The third claimed benefit—relating to the promotion of an amateur competition—seems to be a key focus for the Applicant. League operators overseas have argued that amateurism for its own sake (i.e., participation purely for enjoyment of the game, without regard for monetary reward) is a desirable outcome. For example, the so-called 'Olympic Ideal' has been upheld as a justification by the National College Athletic Association in the United States, to impose amateurism on college level sports. The claimed benefits are necessarily intangible in nature.

805. Critics have opposed this view on the grounds that under a free market system (i.e., absent restrictions), the status of sports (amateurism or otherwise) will naturally evolve according to the value that society ascribes to it. In other words, it is efficient for society to pay for sports entertainment and sports players to the extent that it values these; artificial restrictions that prohibit remuneration of players are likely to

[174] Submission to the Commission on behalf of the NZRU, 12 January 2005, Brown Copeland & Co. Ltd, para 16.

produce economic distortions, and therefore be welfare-inferior.[175] These arguments were canvassed in the *Detriments* section.

806. The same could be argued with respect to the loan player restrictions. If unions value loan players sufficiently to incur the expense of acquiring them, then significantly restricting loans may produce a relatively substantial loss of welfare.

807. Given the intangible nature of the claimed benefits above, and the difficulties associated with providing any reliable numerical assessment, the Commission has not attempted to quantify them. However, the Commission does not consider that they would be so large that significant weight ought to be given to this claimed benefit when making its overall assessment.

Question 53. The Commission seeks further views from interested parties on the likely significance of these claimed unquantified benefits. In particular, are such benefits likely to emerge under the factual, and if so, should the Commission give them any significant weight?

Conclusion on MD1 Benefits

808. The Commission's preliminary assessment is that the following benefits are likely to flow as a result of the Proposed MD1 Arrangements:

- expected benefit from the retention MD1 naming rights sponsorship ($4,000 to $7,000);
- expected benefit from the retention Air New Zealand in-kind sponsorship to the MD1 (small);
- expected benefit from increased MD1 provincial union revenues ($0 to $64,000 over five years);
- expected benefit from increased MD1 spectatorship ($0 to $5,000 over five years);
- expected benefits from increased local development of rugby resulting from provincial union cost savings (small);
- expected benefits from savings to the NZRU from no longer having to rescue failing unions would likely be small (small); and
- expected intangible benefits associated with "maintaining a financially sustainable and vibrant amateur rugby base in regions outside the main metropolitan areas of New Zealand" (small).

[175] See for instance Goldman, L. (1990) "Sports and Antitrust: Should College Students be Paid to Play?", *Notre Dame Law Review*, 206.

OVERALL CONCLUSION ON BENEFITS

809. The estimated benefits of the Proposed Arrangements are summarised in Table 19.

Table 19: Summary of Preliminary Benefits Estimates

Arrangement	Type of Benefit	Estimated Size
Proposed PD Arrangements	**Direct Benefits**	
	Spectator' Benefits	$0 to $42,000
	Television Viewers' Benefits	$0 to $9,000,000
	Increased PD Revenues	$0 to $600,000
	Indirect Benefits	Insignificant
	Total (rounded)	$0 to $10,000,000
Proposed MD1 Arrangements	**Benefits from Cost Savings**	
	Player remuneration costs	Small
	Loan player expenses	Small
	Administration Costs	Small
	NZRU Emergency Funding	Small
	Other Benefits	
	Retained Air New Zealand Sponsorship	Small
	Retained Naming Rights Sponsorship	$4,000 to $7,000
	Increased MD1 Revenues	$0 to $64,000
	Spectator' Benefits	$0 to $5,000
	Intangible benefits from amateurism	Small
	Total (rounded)	$4,000 to $76,000

BALANCING

810. 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 is 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.

811. 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".[176] 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 as to whether authorisation should be granted.[177]

812. The identification and quantification of the benefits and detriments resulting from implementation of arrangements consistent with the proposed "frameworks", as compared to the counterfactual, have been discussed extensively above, and are summarised in Table 20. The benefits and detriments likely to result from implementation of the Salary Cap Framework and the Player Movement Framework have been considered separately from the benefits and detriments likely to result from implementation of the proposed MD1 framework. They have not been aggregated in Table 20, because the Commission does not regard them as being sufficiently closely interrelated that they should be analysed together. Indeed, the Applicant has stated that the two are not necessarily interdependent[178]. The assessment represents the Commission's preliminary view, based on the information available to it and the analysis it has conducted to date.

Table 20: Balancing of Benefits and Detriments

Arrangements	Benefit/Detriment	Estimated Size
Proposed PD Arrangements	Overall Quantified Detriments	$3,500,000 to $4,000,000
	Overall Quantified Benefits	$0 to $10,000,000
	Overall Unquantified Detriments	Significant[179]
	Overall Unquantified Benefits	Insignificant[177]
	Net Public Benefit/(Detriment)	**<$(4,000,000) to <$6,500,000**
Proposed MD1 Arrangements	Overall Quantified Detriments	$76,000
	Overall Quantified Benefits	$4,000 to $76,000
	Overall Unquantified Detriments	Significant[180]
	Overall Unquantified Benefits	Small[178]
	Net Public Benefit/(Detriment)	**<$(72,000) to <$0**

813. The Commission has estimated benefits and detriments over a five year period ahead and then discounted them to present values. The Commission also notes that benefits

[176] Telecom v Commerce Commission (1992) 3 NZLR 429 (CA) at 447, per Richardson J.

[177] 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.)

[178] NZRU Response to Commerce Commission Questions, 23/12/05, question 30.

[179] Relative to the quantified detriments and benefits of the PD Regulations.

[180] Relative to the quantified detriments and benefits of the MD1 Regulations

and detriments may extend beyond a five year period, but considers that this further period is too distant and uncertain to allow projections to be made.

814. The quantification of benefits and detriments is designed to inform the Commission, and to assist it in the exercise of its judgement. A qualitative assessment of the sizes of the detriments and benefits not capable of quantification, with some assessment of the relative magnitude of each, has also been included in Table 20. The impact of each in the aggregation of benefits and detriments has been incorporated through the use of the '<' terms in the aggregate positions.

815. The Commission notes that taking into account the 'unquantified' factors pushes the range further into negative territory than the quantified net public benefits/detriments alone suggest.

816. The Commission's preliminary findings on quantified and non-quantified benefits and detriments are summarised in Table 20. On the basis of current information and analysis, this shows that the Proposed Arrangements would be likely to result in:

- a net effect resulting from the Proposed PD Arrangements of between a net public detriment of greater than $4 million and a net public benefit of less than $6.5 million; and
- a net effect resulting from the Proposed MD1 Arrangements of between less than zero and a net public detriment of greater than $72,000.

Balancing Public Benefits Resulting from the PD Arrangements

817. On current information, the Commission, in respect of the Salary Cap Framework and Player Movement Framework, is inclined to take no more than the midpoint of the range, as being a reasonable estimate of the likely public benefit. This would generate a net public benefit of the order of only $1.00 million or less. Given the size of the prospective net benefits, the Commission would not be satisfied without more assurance that the benefits of the Proposed Arrangements would clearly outweigh the detriments.

818. However, the Commission notes that much of the uncertainty of the assessment of the benefits of implementing the Salary Cap Framework is a result of the "framework" not specifying how "hard" the cap would be in practice. The Commission is of the view that, if measures were put in the Salary Cap Regulations to ensure that the cap is and would remain a hard cap, then this would tend to make the benefits of the salary cap framework more certain. This would strengthen the Commission's preliminary view that the benefits of a "hard" cap would outweigh the detriments. The Commission notes that other conditions might be necessary to reinforce the effectiveness of the cap.

819. The Commission's preliminary conclusion, therefore, is that it would authorise the NZRU to enter into and give effect to arrangements consistent with the Salary Cap Framework and the Player Movement Framework, subject to a condition sufficient to ensure that the cap is "hard". Such a condition would contain an "anti-avoidance" provision of the type set out in clause 4.2 of the current draft of the Salary Cap Regulations. The Commission notes that such a clause is included in the current draft Regulations.

Question 54. The Commission seeks views on the drafting of a suitable condition to provide sufficient certainty that the cap would be a "hard" cap. (The more certain the Commission can be that the cap is hard, the more confidence the Commission can have that it is appropriate to authorise this Application.)

820. The Commission has already noted that there is significant uncertainty in the description of the "exclusions" in the Salary Cap Framework as set out in Appendix 1, with defined terms referring to the current draft of the Salary Cap Regulations (which has itself been subject to further change since the Application was received). The Commission's conclusions as to the relative benefits and detriments of the framework will be influenced by the extent to which these exclusions can be given an objective, clear meaning to the satisfaction of the Commission.

Question 55. What condition would enhance certainty as to the scope of the "exclusions" and other exceptions in the salary cap framework?

821. The Commission does not propose to authorise contracts, arrangements or understandings that contain any further anticompetitive provisions beyond those proposed in the Application. The Commission, therefore, notes that, pursuant to its discretion to grant "such authorisation as it considers appropriate" (s 61(1)(a)), and should authorisation be granted, it would authorise only those features of the Salary Cap Framework and Player Movement Framework that are set out as features of those frameworks in Appendix 1.

822. Assuming that its current tentative view of benefits and detriments holds, the Commission is prepared to authorise entering into and giving effect to the Proposed PD Arrangements set out in Appendix 1 *and on the conditions* referred to at paragraphs 819, 820 and 821.

Balancing Public Benefits resulting from the MD1 Arrangements

823. The Commission has also had regard to both quantified and non-unquantified benefits and detriments in the Non-Premier Player Services Market. Taking all benefits and detriments together, the Commission is not currently satisfied that the benefits of the Proposed MD1 Arrangements will outweigh the detriments from the lessening of competition that will be likely to and will be deemed to result.

824. Although this net detriment is small in relation to the effects in the Premier Player Services Market, it is significant with respect to the monetary amounts that are involved by MD1 unions in the NPC.

825. Based on its current assessment of the relative level of benefits and detriments that would result from the Proposed MD1 Arrangements, pursuant to s 61(6), the Commission's preliminary view is that it should decline the Proposed MD1 Arrangements.

CONCLUSIONS

826. In arriving at its preliminary conclusions, 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.

827. The Commission's preliminary finding, on the balance of probabilities, is that the Proposed Arrangements 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 players services market; and
- the non-premier player services market.

828. The Commission's preliminary view is that:

- the Commission is satisfied in all the circumstances that future Player Movement Regulations and Salary Cap Regulations, to they extent they are consistent with the Player Movement Framework, and the Salary Cap Framework set out in Appendix 1, 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; and
- the Commission is not satisfied in all the circumstances that future regulations to implement the MD1 Framework as set out in Appendix 1, 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.

DETERMINATION

829. Pursuant to s 61(1)(a) of the Act, the Commission's preliminary conclusions is that it would determine to allow the application by the NZRU for authorisation under s 61 of the Act to pass the contracts, arrangements or understandings to implement Regulations and to otherwise enter into and give effect to the Salary Cap Framework and the Player Movement Framework specified in Appendix 1, Parts A and B.

830. Pursuant to s 61(1)(b) of the Act, the Commission's preliminary conclusions is that it would determine to decline the application by the NZRU for authorisation under s 61 of the Act to pass the Regulations or otherwise enter into and give effect to the MD1 Framework specified in Appendix 1, Part C.

831. The authorisation pursuant to paragraph 829 would be subject to 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.

APPENDIX 1

PART A - SALARY CAP FRAMEWORK[181]

Level of Cap
▪ $2.0m in 2006. ▪ $2.0m plus CPI in 2007. ▪ Subsequently, the previous years Cap plus annual CPI adjustment.
Remuneration Included in Salary Cap
▪ 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
▪ 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
The following forms of Remuneration are excluded: ▪ 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):

[181] NZRU Application, Table set out on pages 4, 5 and 6.

- 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.

PART B - PLAYER MOVEMENT FRAMEWORK

- The transfer window be extended from 1 October to the Friday after the Rebel Sport Super14 final;
- Transfer fees only apply for players moving up from Modified Division One to Premier Division; and
- There is no limitation on the number of transfers that may occur in a season.

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

- 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;
- the deletion of the current quota on players who can transfer during the transfer window; and
- 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.

PART C - MODIFIED DIVISION ONE FRAMEWORK

A proposal to enter into and give effect to Regulations which prohibit the payment of any remuneration to players in Modified Division One of the NZRU's NPC Competition, with the exception of reimbursement of expenses.

The key aspects of the proposed MD1 Regulations are that:

- there will be a prohibition on payment of any remuneration to a player competing in a Modified Division One team (i.e. no payments over and above reimbursing actual expenses as approved by IRD from time to time); and

- no loan players will be eligible to play for Modified Division One Provincial Unions other than front row loan players in the event of an injury during the competition to a “local” front row player giving rise to safety issues.

APPENDIX 2 – ECONOMETRIC ESTIMATION RESULTS

1st Division Crowd Attendance and Uncertainty of Outcome

	1		2		3		4	
lnatt	Coef.	P>|t|	Coef.	P>|t|	Coef.	P>|t|	Coef.	P>|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%).

APPENDIX 3 – METHODOLOGY FOR ESTIMATING SPECTATOR BENEFITS

1. Figure 5 on page 162 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.

2. 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.

3. By Figure 5, the net gain in total social welfare can be estimated by calculating the difference:

$$\text{AHCB} - \text{AJFB}, \qquad (1)$$

$$\text{where AHCB} = (\text{HCP}_1 - \text{ABP}_1),$$

$$\text{and AJFB} = (\text{ABP}_1 - \text{JFP}_1).$$

4. 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:

$$Q(P) = a + bP + u \qquad (2)$$

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).

5. A summary of the regression analysis for equation (2) is reported below.

Demand for NPC 1st Division Rugby

attendance	Coefficient	*t*	Prob>|*t*|
price (b_hat)	-2418.492	-2.33	0.025
constant (a_hat)	74724.82	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. Aggregate 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.

6. Rearranging equation (2) in terms of *P* (and dropping the error term) gives what is known as the *inverse demand function*:

$$P(Q) = \frac{Q - a}{b} \qquad (3)$$

7. Evaluating equation (3) by setting $Q = 0$ permits calculation of the intercept along the vertical axis, $P(0) = -a/b$.

8. 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:

$$D_r: \quad Q(P) = a(1+\Delta) + bP,$$

$$\text{and } D_o: \quad Q(P) = a(1-\Delta) + bP.$$

where Δ is an assumed percentage change in spectator demand for rugby union for a given improvement in competitive demand.

9. Finally, in his analysis, Mr. Copeland assumes an average match ticket price of $15. The Commission therefore adopts, as a working assumption, that $P_1 = \$15$.

10. 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 $ABP_1 = ½ (A - P_1) Q_1$. 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.

11. Similarly, the area of $JFP_1 = ½ (J - P_1)G$. 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.

12. Finally, the area of $HCP_1 = ½ (H - P_1)E$. 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.

13. Combining ABP_1, JFP_1, and HCP_1, the net gain in consumers' surplus, represented by equation (1), can be evaluated. In this model, producers' surplus is ignored. 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 4 – MD1 PROFIT MARGINS

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