

COMPLIANCE, THIRD PARTY PAYMENTS AND THE THREAT TO THE NRL SALARY CAP

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Recent breaches of the National Rugby League salary cap by the Melbourne Storm have provided a unique, if incomplete, insight into aspects of salary cap systems in respect of the restraint of trade doctrine. Using these breaches as a backdrop, this paper considers the sustainability of salary caps, in particular that of the NRL, under the restraint of trade doctrine in reference to issues of compliance and third party payments to suggest the possible demise of the NRL salary cap regimen.

Introduction

A sporting organisation has always had a good argument to put before a court of law should a challenge be made under the restraint of trade doctrine to its use of a salary cap: 'the maintenance of an even contest between teams to sustain public and media interest'.¹ This paper suggests that whilst this argument remains valid, concessions to the salary cap regime permitted by National Rugby League, rather than diminishing the possibility of legal action, may in fact precipitate it.

This paper also argues that recent revelations of salary cap avoidance by the Melbourne Storm Rugby League Club indicate a system unable to further the legitimate interests of the parties necessary to justify a restraint of trade in law.

The legitimisation of third party sponsorship and the apparent ease of avoiding detection threaten not the objects of the salary cap but its capacity to meet those objects and in so doing invites legal challenge under the restraint of trade doctrine.

The restraint of trade doctrine – proof and evidence

No two cases under the restraint of trade doctrine are identical. There is merely a principle of reasonableness under which each case is determined on the pertinent facts adjudged according to the paradigms of the day. As Lord Wilberforce commented:

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¹ *Buckley v Tutty* (1971) 125 CLR 353 at 377.

The doctrine of restraint of trade is one which has throughout the history of its subject matter been expressed with considerable generality, if not ambiguity. ...

The doctrine of restraint of trade is one to be applied to factual situations with a broad and flexible rule of reason.²

As Heydon points out, ‘issues related to reasonableness are decided on evidence ...’.³ Evidence of reasonableness, unlike the obvious guilt of a motorist who goes through a red light, depends on the circumstances of the case. As no two circumstances are the same, recourse to factual precedent is of limited value; an inherent problem for those attempting to predict how the restraint of trade doctrine will apply in any given case. Were this not so, a restraint found to be unreasonable within a particular firm would see all restraints across that firm’s industry struck down. This is simply not the case. For example, the draft system declared unenforceable in the rugby league case of *Adamson* does not mandate that the draft system operating in the AFL should, if it were challenged, also be declared void – there are unique factors to be argued.

Previous cases may provide principle but they cannot give definition as to how the doctrine of restraint of trade is to be applied in any single case. One, therefore, is continually drawn back to the broad principle proclaimed by Lord Macnaghten in *Nordenfelt* – all cases are decided according to a test of reasonableness as it applies to the parties and the public.⁴ In fact Lord Macnaghten’s statement is not a test in the sense of a known quality or quantity which must be proven – it is more the proclamation of a maxim where no dictate is given other than the restraint must be reasonable. Each fact and the era in which it occurs bears upon the calculation of reasonableness; the permutations are many such that the most that can be said, as one fact varies alongside other unyielding facts, is ‘perhaps’, ‘possibly’ or ‘probably’.

This much is affirmed by Justice Hill’s assessment of the restraint of trade doctrine in *Adamson v NSW Rugby League (trial)* where, after quoting Lord Macnaghten in *Nordenfelt* and referring to a number of cases, his Honour stated, ‘These cases, while having a commonality of context, do no more than apply

² *Esso Petroleum v Harper’s Garage (Stourport) Ltd* [1967] 1 All ER 699 at 728.

³ JD Heydon, *The Restraint of Trade Doctrine*, 3rd ed, LexisNexis Butterworths, 2008 at 41.

⁴ In *Nordenfelt* the House of Lords formalised a test of reasonableness into the restraint of trade doctrine. This test is recorded in the oft quoted statement of Lord Macnaghten: ‘All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and, therefore void. That is the general rule. But there are exceptions. ... It is sufficient justification, and indeed, it is the only justification, if the restriction is reasonable – reasonable that is, in reference to the interest of the parties concerned and reasonable in reference to the interests of the public.’: *Nordenfelt v Maxim Nordenfelt and Ammunition Co Ltd* [1894] AC 535 at 565.

familiar principles and illustrate the difficulty ... of the application of these principles to the fact of a particular case.⁵

To be legally reasonable a restraint of trade must be, 'so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed ...'⁶ Where a restraint exceeds that necessary to protect the legitimate interests of the covenantee the restraint is unenforceable.

In considering the adequacy of protection a court must look to the interest or object the restraint is seeking to protect:

If the restraint is to secure no more than 'adequate protection' to the party in whose favour it is imposed, it becomes necessary to consider in each particular case what it is for which, and what it is against which, protection is required. Otherwise it would be impossible to pass any opinion on the adequacy of the protection.⁷

It is within the above context that the National Rugby League (NRL) salary cap specifically, and salary caps in general, must be considered.

Salary Cap Systems

A salary cap is utilised by major sporting organisations to place a limit on the amount of money their clubs may devote in salary to the provision of player services. Commonly salary caps also include less obvious means of player payment, often designed by a club to avoid the salary limit, such as the player who is 'employed' as a barman or cellarman for the licensed club.⁸

The salary cap used by the NRL is typical of this form of trade protection.⁹ Upon signing an NRL contract, the player is bound by the salary cap operating from time to time within that sport and agrees to 'submit to the jurisdiction of, and comply with the decisions and determinations of ... the Salary Cap Auditor of the NRL.'¹⁰ Under the NRL regime, a club is limited to paying a salary of \$4.1m for the 25 highest paid players at each club.¹¹ Whilst \$4.1m equates to

⁵ *Adamson and Others v New South Wales Rugby League and Others* (1991) 100 ALR 479 at 497 (*Adamson trial*). Although the decision of Hill J was overturned, his Honour's specific comments remain pertinent.

⁶ *Nordenfelt v Maxim Nordenfelt Guns and Ammunition* [1894] AC 535 at 565 per Lord Macnaghten; *Herbert Morris v Saxelby* [1916-17] All ER 305.

⁷ *Herbert Morris v Saxelby* [1916-17] All ER 305 at 316.

⁸ For example, the NRL states: 'The basic guide is that if a player is receiving money from any person as a way of inducing him to play for the Club, then that money will be included in the Salary Cap.' <http://www.nrl.com/nrlhq/referencecentre/salarycap/tabid/10434/default.aspx>

⁹ The NRL introduced a salary cap with its inception in 1998. The NSWRL introduced a salary cap in 1990. <http://www.nrl.com/nrlhq/referencecentre/salarycap/tabid/10434/default.aspx>

¹⁰ NRL Playing Contract, section 3.1 (b).

¹¹ Facts available at NRL website; <http://www.nrl.com/nrlhq/referencecentre/salarycap/tabid/10434/default.aspx>

a figure of \$160,000 per player, better players are paid considerably more than journeymen or rookies. The club itself has discretion as to how the \$4.1m will be divided between players and, in what is a ‘zero sum game’, the more one player is paid the less that is available to other players. A second tier salary cap provides for each club to spend an additional \$350,000 on players outside the top 25. Better players attract larger fees, meaning a club, which must also pay those of lesser talent, will quickly exceed the salary cap if it attempts to acquire the services of too many virtuosos of the game.

Information flowing from breaches of the salary cap by the NRL club the Melbourne Storm recently reported in the media, gives a unique perspective into the effects of a salary cap system. As such, the NRL salary cap will feature in discussion throughout the remainder of this paper.

Salary caps and the legal state of play

Bearing in mind that under the restraint of trade doctrine each case is decided on its own facts, two cases have touched upon and provide background to the salary cap issue: *Johnston v Cliftonville Football and Athletic Club*¹² and *Adamson and Others v New South Wales Rugby League*.¹³

Salary caps are often justified on grounds of preventing financially damaging interclub competition in acquiring playing staff. This was the defence mounted by the covenantee in *Johnston v Cliftonville Football and Athletic Club*.¹⁴ The issue of concern was not that of a salary cap but a near equivalent, a maximum weekly wage (set at £12).¹⁵ Johnston, in contravention of Irish Football League (IFL) directives signed for a higher than permissible salary. Murray J found the limitation to be a restraint of trade: ‘The maximum wage regulation undoubtedly interferes with the plaintiff’s liberty of action in trading, viz. With his liberty to negotiate the basic matter of the payment he is to receive for his service to his employer.’¹⁶ Of course, recognition that a restraint of trade exists is, from the covenantor’s perspective in seeking to have it removed, merely a first step.

The IFL sought to legitimise the wage restraint on the basis that, ‘a free-for-all on wages would lead to serious financial difficulties for the clubs.’¹⁷ There was, though, insufficient evidence to support the IFL’s claim, Murray J citing the need to supply ‘a general survey of the finances of the clubs in the League and

¹² *Johnston v Cliftonville Football and Athletic Club* [1984] 1 NI 9.

¹³ *Adamson and Others v New South Wales Rugby League and Others* (1991) 103 ALR 319 (*Adamson*); the case dealt primarily with an internal player draft where the salary cap was argued as an adjunct to the draft.

¹⁴ *Johnston v Cliftonville Football and Athletic Club* [1984] 1 NI 9.

¹⁵ A salary cap as constituted say in the NRL competition does not mandate specifically how much an individual player may be paid, provided the total wage is below the cap.

¹⁶ *Johnston v Cliftonville Football and Athletic Club* [1984] 1 NI 9 at 20.

¹⁷ *Johnston v Cliftonville Football and Athletic Club* [1984] 1 NI 9 at 21.

an expert opinion based on that survey' as to how the clubs would, but for the restraint, face financial ruin. Had the IFL been able to supply such information, assuming it furthered its case, the restraint could have been declared reasonable. As questions of fact vary between cases, it must again be emphasised that a bad restraint in one case does not necessarily indicate unreasonableness where a similar restraint is imposed within the same or a related industry – at best a finding is indicative only.

The case of *Adamson v New South Wales Rugby League* concerned the introduction by the League of an internal draft system, a non-economic restraint, to operate simultaneously with the then existing salary cap. The draft provided for a club, in reverse order to where it finished in the previous year's competition to choose players 'coming-off contract' to play for it in the upcoming season (the last team to have first choice, the second last team to have the second choice – in descending order until all players were cleared from the draft). The purpose of the draft was to 'prevent the stronger clubs from obtaining the services of an unfair proportion of the better players at the expense of the weaker clubs.'¹⁸ The greater object was based on the proposition that, 'public support and the opportunities for players to develop and employ their skills both depend upon the League continuing to conduct the competition between evenly matched and financially viable clubs.'¹⁹

Although dealing obliquely with the salary cap, the question of reasonableness in *Adamson* was not put in issue by the parties. On the contrary, reasonableness was assumed:

The validity was assumed by all parties. I have no reason to think that the rules may be invalid – I have not considered them; but I would not wish to pre-empt the decision of this or any other court which may need in the future to deal with these rules.²⁰

Given that the salary cap was not considered by the court and with due regard to the assumption of validity, the case can be of little precedent value.²¹ Nonetheless, within Justice Wilcox's judgment in *Adamson* is a statement of some import to the present discussion: '... it is self-evident that, if salary caps are set at levels which clubs can in fact *afford* and are *observed*, spending within those limits will not threaten the clubs' viability.'²² Whilst one would not wish to extrapolate too much from his Honour's comment there is worth in

¹⁸ *Adamson* ALR at 325.

¹⁹ *Adamson* at ALR 325.

²⁰ *Adamson* at ALR 324.

²¹ It is difficult to see why the salary cap was not challenged by the players in *Adamson*; perhaps the players thought it tactical to accept one form of restraint as the price for relieving the burden of a more pernicious restraint; the draft. It is less likely these marketable players thought the financial interests of the game should take precedence over their own. Alternatively it may well be that some players recognised a form of restraint on salaries was necessary for the betterment of the competition.

²² *Adamson* at ALR 347 (emphasis added).

noting the requirement of ‘affordability’ and the necessity that clubs ‘observe’ the salary cap arrangement. Where a salary cap is too high to be affordable or is not observed, it is ineffective in redistributing talented players throughout the various clubs and will not achieve the legitimate interest for which it was introduced rendering it unsustainable under the restraint of trade doctrine. The theme of ‘observance’ is discussed in detail below.

What is the cost of salary cap protection to individual players?

The question of reasonableness must take into account the impact of a restraint upon the covenantor, in this case the players in the NRL competition.²³ Financially the salary cap lowers the income of those players who would, but for its imposition, command higher salaries in a freely operating market. Rather than being established by the forces of supply and demand a salary cap permits premium players to be supplied to the market at a discounted price to produce an artificially induced windfall benefit to the covenantee. Whatever the supposed advantage in enhancing competition between clubs, the effect of such restraints, as Ross described it, ‘represents a significant transfer of wealth from players to clubs’.²⁴ Buti also notes several other detriments to trade inherent in salary cap systems:

... one could reasonably argue that a salary cap system, indirectly at least, interferes with a player’s right to freely determine their employer, coach and team-mates and affects remuneration that is able to be earned. For example, a club may need to “cut-off” a player from their list because of salary cap restrictions, forcing that player to move to a club that they prefer not to play for. Further a person may not freely be able to obtain the salary they wish because of salary cap restrictions.²⁵

Whilst the financial impact of a salary cap is predictable in a general sense, there is difficulty in gauging the true market value of an athlete in any sport where such external influences prevent a true market price from being established with a view to adjudging reasonableness. As such, the precise dollar cost of a salary cap cannot be accurately calculated. Nevertheless, recent breaches of the NRL salary cap by rugby league club the Melbourne Storm give some indication of the financial cost to star players under a salary cap regimen: The breach by the Storm was originally ‘... estimated to be in excess of \$1.7 million over five years, around \$400,000 in 2009 and with a projected breach of \$700,000

²³ *Nordenfelt* at 565.

²⁴ S F Ross, ‘Player restraints and Competition Law throughout the World’, 15 *Marq. Sports L Review*, 2004-2005 at 50.

²⁵ A Buti, ‘Salary Caps in Professional Team Sports: an Unreasonable restraint of Trade’, (1999) 14 *Journal of Contract Law* 130 at *lexisnexis* 5.

in 2010'.²⁶ In fact a report by accountants Deloitte suggests a breach in the amount of '\$3.17 million dollars over five years'.²⁷ Some media say the excess was spent on 'Melbourne's "big four" – Billy Slater, Cooper Cronk, Cameron Smith and Greg Inglis'.²⁸ If the amount by which the salary cap was exceeded, say \$700,000, were paid to these four players each would receive, above their reported salary, \$175,000. This amount may serve as a rough estimate of what some players would receive in the absence of salary cap price controls in the NRL – of course the Storm club was not forced to compete against other suitors in a free market; a factor which would ordinarily be expected to advance the wage beyond \$175,000.²⁹

Under the *Nordenfelt* test, securing the legitimate interests of the covenantee must be considered alongside the interests of the covenantor: '... covenants must pass the test of reasonableness, that is to say, they must be reasonable in the interest of both parties'.³⁰ In respect of high profile players in the NRL rugby league competition, a loss of wages of the \$100,000 to \$175,000 range will arguably tend towards an 'unreasonable' impost. Losses in income to particular players are, though, only one side of the argument; the other is whether the salary cap can be justified as a form of restraint protecting the legitimate interests of the sport.

Justifications for a salary cap

In order to be enforced a restraint of trade must provide 'nothing more than reasonable protection against something which (the covenantee) is entitled to be protected against'.³¹ The covenantee sporting organisation (or the teams in a competition) will need to show that the restraint in question, a salary cap, is both reasonable in its scope and an interest to which an entitlement to protection attaches.³²

Co-dependency and competitive balance

There is wide recognition of a co-dependency between teams which, despite being on-field competitors, require matches between them to be evenly balanced

²⁶ NRL Website: <http://www.nrl.com/news/newsarticle/tabid/10874/newsid/58359/melbourne-storm-breach-nrl-salary-cap/default.aspx>. April 10, 2010.

²⁷ NRL Website: <http://www.nrl.com/nrlhq/nrlhqnews/nrlhqnewsarticle/tabid/10871/newsid/59433/official-release-nrl-responds-to-deloitte-report/default.aspx>. 15 July 2010.

²⁸ Adrian Prosenko, *The Sun-Herald* July 11, 2010 at 70.

²⁹ Similarly, many good players thrust onto the market could keep the additional price below \$175,000. In response to the breaches the NRL stripped the Melbourne Storm of the 2007 and 2009 Premiership titles, the Minor Premiership of 2006-8 and its 2010 competition points.

³⁰ *Petrofina (Gt Britain) Ltd v Martin and Another* [1966] Ch 146 at 179 per Harmon LJ.

³¹ *Herbert Morris v Saxelby* [1916] 1 AC 688 at 700; the statement made in respect of 'employers'.

³² 'It has been authoritatively said that the onus of establishing that an agreement is reasonable as between the parties is upon the person who puts forward the agreement, while the onus of establishing that it is contrary to the public interest, being reasonable between the parties, is on the person so alleging.' *Esso v Harper's Garage* per Lord Hodson at AC 319.

to sustain public and media interest in their sport. According to Dabscheck and Opie, 'unlike other areas of economic life sporting contests require the cooperation of competitors to create a product – namely, a game; or more often, a series of games in a league. If the league is to generate interest, and enhance its income-earning potential, it needs to maximise the uncertainty of the results of any game or contest. Uncertainty excites fans, sponsors and broadcasters; predictability turns them away.'³³ As much was accepted in *Buckley v Tutty*:

It is a legitimate object of the League and of the district clubs to ensure that the teams fielded in the competitions are as strong and well matched as possible.³⁴

Neale commented similarly: 'receipts depend upon competition among the ... teams ... for the greater the economic collusion and the more the sporting competition, the greater the profits.'³⁵ In the 'peculiar' economic interdependency of sporting teams is found the base rationale for the use of a salary cap – the need to create and to sustain competitive balance between the teams within a given competition.

This broad economic foundation is reflected in the specifics of the NRL rationale for the incorporation of a salary cap, which is said to 'serve two functions':

The first is to assist in 'spreading the playing talent' so that a few rich clubs cannot simply out-bid poorer teams for all of the best players. The NRL believes that if a few clubs were able to spend unlimited funds in such a way, that it would reduce the attraction of games to fans, sponsors and media partners due to an uneven competition. Allowing clubs to spend an unlimited amount on players would drive some clubs out of the competition as they would struggle to match the price wealthy clubs could afford to pay.³⁶

There seems little doubt that the commercial interests of professional sport are furthered where close scores generate uncertainty and excitement in the spectator base. Competitive balance is then, a legitimate interest of protection.

Having established competitive balance as a legitimate interest it is then necessary to consider the broader question of whether the salary cap actually achieves this purpose.

³³ B Dabscheck and H Opie, 'Labour Regulation of Sporting Labour Markets' (2003) 16 *Australian Journal of Labour Law* 259 at lexisnexis 3.

³⁴ *Buckley v Tutty* (1971) 125 CLR 353 at 377.

³⁵ W Neale, 'The Peculiar economics of Professional Team Sports: A Contribution to the Theory of the Firm in Sporting Competition and in Market Competition', (1964) 78 *The Quarterly Journal of Economics* 1 at 2; reported in Dabscheck and Opie op cit.

³⁶ NRL website: <http://www.nrl.com/nrlhq/referencecentre/salarycap/tabid/10434/default.aspx>.

Does the salary cap protect legitimate interests?

Salary cap breaches by the Melbourne Storm NRL club have given a unique, if incomplete, insight into aspects of the salary cap system in respect of the restraint of trade doctrine. These breaches will form the backdrop to the ongoing discussion.

To be enforceable a restraint must work to achieve the object of its incorporation – in the case of a salary cap, an even competition – and to do so with a minimum of intrusion into the trading rights of players.³⁷ The question in respect of the NRL is not with identifying the legitimate interest the League possesses in ensuring a competitive balance between teams but whether the salary cap is able to achieve this end given extensive salary cap breaches and the parochial availability of third party payments.

A restraint which is unnecessary or futile in protecting the legitimate interests of the organisation will be deemed unreasonable. In *Lindner v Murdock's Garage*³⁸ the covenantor mechanic, Mr Lindner, was restrained from working in two neighbouring country towns, Crystal Brook and Wirrabara, but was in fact only ever employed in Wirrabara. Having worked in just one town the restraint on Lindner was unnecessary in protecting the covenantee's legitimate interests. McTiernan J stated:

... I am unable to hold that it was reasonably necessary for the protection of the respondent's business that the appellant should be restrained as to both parts if, as proved to be the case, the appellant should be employed only in one part. The nature of the appellant's duties and the extent of his contact with customers of the respondent did not call for his restraint in a part of the territory in which he was not employed by the respondent. ... To be legal it should have provided for a restraint in the part of the territory in which the appellant would be employed by the respondent, or in both parts if employed by the respondent in both.³⁹

In *Brightman v Lamson Paragon*, Isaacs J indicated that a covenantee was limited to necessary precautions:

... the covenantor is entitled, whatever he has actually agreed to do or to abstain from doing, to have the fullest liberty of action consistent with all reasonably necessary precautions consented to for the adequate protection of the covenantee. That is the frontier line, so to speak ...⁴⁰

³⁷ Leaving aside other objects such as the prevention of 'cheque-book warfare'.

³⁸ *Lindner v Murdock's Garage* (1950) 83 CLR 628 (*Lindner*).

³⁹ *Lindner* at 648 per McTiernan J.

⁴⁰ *Brightman v Lamson Paragon Ltd* (1914) 18 CLR 331 at 337.

A ‘precaution’ ineffective in providing protection when viewed alongside the covenantor’s entitlement to ‘fullest liberty of action’ is, of course, unnecessary and is likely to be labelled an unsustainable ‘bare covenant restrictive of competition.’⁴¹ This reasoning would seem germane to the judgment of Wilcox J in *Adamson* where, in answering the claim that ‘the rules are sought to be justified by arguments concerning competitive equality’, his Honour stated, ‘it seems to me to be unjustifiable to apply the same rules to a struggling third grade player ... as to a test star ...’⁴²

In the major Australian sports of the NRL and the Australian Football League (AFL), teams have been forced to release one, or several, star players to meet salary cap regulations. Whilst it is true that the object of a salary cap may be threatened if players elect to stay with a favoured club rather than accept higher wages with a rival club, such ‘loyalty’ is presumably rare and is unlikely to impact upon the overall capacity of a salary cap to create a competitive balance between teams. Bearing in mind most sporting careers are limited to a few good years, it is unlikely a player will forgo more than a few tens of thousands of dollars (if that) in the interests of a club. Again the Melbourne Storm case is instructual in suggesting an efficacy to the salary cap. The four high status players Slater, Cronk, Smith and Inglis could remain with the Storm if each was prepared to play below their market value, at least the market value established under the salary cap. Given human nature this seems unlikely to occur, indeed media reports indicate that Inglis has signed with the Brisbane club. Players will by and large do as the architects of the salary cap intended; move to a club that permits them to maximise their income. The fact that good players under compulsion must find their way to other clubs indicates that the salary cap is on some level successful in redistributing talent.⁴³

But releasing players is not necessarily a universal reaction by clubs, some of which choose to surreptitiously avoid compliance and in doing so, at least in respect of the NRL competition threaten the ongoing viability of the salary cap. The recent salary cap breaches by the Melbourne Storm have been documented earlier. What is revealing in the Storm case is the apparent dominance a team may exhibit where it retains as few as one or two stars it would otherwise have lost. The Storm won the NRL premiership twice in five years (being stripped of the 2007 and 2009 Premiership titles following discovery of the breaches) and was minor premier from 2006 to 2008 and runner up twice. This record

⁴¹ *Butt v Long* (1953) 88 CLR 476 at 486.

⁴² *Adamson and Others v New South Wales Rugby League and Others* (1991) 103 ALR 319 at 356.

⁴³ In fact it is interesting to note a possible change to traditional notions of loyalty evidenced in comments attributed to Rugby Player Kurtley Beale in respect of Quade Cooper’s reported courting of the NRL: ‘With an average age of just 24 in the touring party, Beale said he appreciated how former players might question Cooper’s tactics to boost his price. But he said football was business for the generation Y squad, and it was as simple as that. ... ‘this is all we know about rugby, it’s how it’s been since we started. ... for our generation we can separate football from business.’ J Rakic, ‘Young Wallabies confident Cooper will stay’, *The Sun-Herald*, August 22, 2010, at 60.

can be looked at in two ways: first, the presence of virtuosos can significantly boost the performance of a single (perhaps struggling) club. Alternatively, it suggests that when retaining one star to play alongside two or three other stars, a synergy occurs leading to greater than expected on-field success. On the basis that creative load is shared amongst several stars whilst at the same time the opposition must envisage a multitude of possible attackers, the latter seems the more intuitively accurate.

Leaving aside the usefulness of personal observation, one cannot be absolute as to the 'cause and effect' of the NRL salary cap in contributing to on-field balance. Team success may be due to a number of factors such as the coach, team harmony, combination of players or the contribution of administrative staff, amongst many others. On one level the strong performance of the Storm supports the rationale of the NRL salary cap. If the Storm had failed to perform well over recent years the argument could be raised that the salary cap made no difference and other factors apparently more important to the success of a team must be thought to dominate.

One would expect a team which retained star players where others have not, to perform comparatively well. This was certainly the case with the Storm. However, it may be suggested that the efficacy of a salary cap is inferred not by gaining the championship as much as by performing above the average (however that may be determined) – one cannot expect a direct correlation between the retention of talented players and premiership wins; merely an indicative correlation. The performance of the Storm is strongly indicative of a correlation between retained talent and on-field performance.

From what may be gleaned from the Storm's capacity to dominate the competition by retaining players it would otherwise lose, there is, then, a base advantage accorded to sporting competitions utilising a salary cap regimen. This base value is not in itself sufficient, however, to have a salary cap found reasonable under the restraint of trade doctrine. The question of reasonableness must also, arguably, concern the further questions of:

- Whether the restraint is readily avoidable so that some clubs under the guise of adherence benefit from secretly breaching their obligations.
- Whether 'third party payments' destroy the object of the salary cap.

Avoidance and detection

A major difficulty in using a salary cap to create competitive balance is the possibility, or perhaps likelihood, that some teams will pay players discretely, effectively cheating the system. There have been a number of examples in the AFL and NRL competitions of this practice. In 2002 NRL club, the Canterbury

Bulldogs, was fined \$500,000 for payments in excess of the permissible level. The Warriors were fined \$430,000 in 2005 with numerous other breaches, large and small, occurring since the early years of the NRL competition. The teams Carlton, Essendon, Melbourne and Fremantle have each breached the salary cap regulations of the AFL.

A necessary precondition to effectively cheating a salary cap is avoiding detection. Where one or two talented players make the difference between winning or losing, a salary cap ineffectively policed is unlikely to secure the legitimate interests of the organisation thereby lessening the case for reasonable implementation under the restraint of trade doctrine. Under such circumstances those clubs which do not abide by the cap, all things being equal, will win more often, attract more gate receipts, sponsors and media revenue; clearly to the cost of compliant teams. Where cheating is rife or perhaps where it is merely influential in the outcome of matches, the salary cap is arguably ineffective in meeting its object and may thereby be struck down.

Where a breach of the salary cap is readily discoverable, teams rationally fearful of fines and the loss of competition points will be more willing to comply. That is, where detection is perfect there should be perfect compliance. However, in practice such a level of detection is almost impossible. Player income may be 'off-the-books' through both internal and external sources. A club supporter, a corporate sponsor or any interested party can pay players to stay with a particular club unbeknown to the organisation or the club. Internally, through a board member or a collective of board members, the player may receive additional funds unbeknown to the organising body. Major sport has long been rife with rumours of 'boot money' placed in the shoes of a star or a brown paper bag left on the table after the board retires from meeting a player – speculations which would be damaging to the legitimacy of a salary cap if ever shown to be accurate.

Davies makes the point that neither individual breaches nor the difficulty of enforcement should determine the reasonableness of a salary cap regime as, 'penalties imposed by the governing bodies have, and will continue to act, as a deterrent against future breaches.'⁴⁴ The basis of the suggestion appears to be that of deterrence by unavoidable detection. This claim, given the extent of the Storm breaches must now be categorised as optimistic, not only because teams on recent evidence have and do cheat the system but because, demonstrably, they may do so without detection over a considerable length of time – in the case of the Melbourne Storm for a suggested period of five years.⁴⁵ If, and for how long, the deterrent effect lasts in the NRL following the Melbourne Storm's loss of premierships titles and competition points, is a matter of conjecture, though

⁴⁴ C Davies, 'The use of salary caps in professional teams sports and the restraint of trade doctrine', (2006) 22 *Journal of Contract Law* 246 at *lexisnexis* 7.

⁴⁵ *Sydney Morning Herald*, 24 July 2010.

certainly such penalties will give pause to clubs considering similar breaches of the system.

As discussed previously, teams within a single tournament have a common interest in creating a balanced on-field competition. What is good for the collective, however, will not necessarily optimise individual outcomes where, for example, a single club is prepared to outwardly adhere to the rule but enter into secret negotiations with players in avoidance of the restraint. In this sense salary cap regimes are the basis for the formation of a cartel where teams which, although engaged in hard competition with each other, recognise a mutual benefit in limiting the amount required to secure playing talent. In other words a salary cap is a means of fixing the price of labour to maximise profits. The difficulty in maintaining such a level of cooperation between these disparate entities is the temptation for some to forsake the arrangement and acquire players at a price above the controlled price. If this can be done at a wage below the the natural intersection of supply and demand, all the better.

Where suspicion of non-compliance develops within a cartel, members begin to step outside the rules; the system eventually breaks down and full scale price competition results. The outcome is as predictable in sport as it is in business; as a General Electric executive once commented in *Fortune* magazine in respect to his company's membership of a cartel: 'No one was living up to the agreements and we ... were being made suckers. On every job someone would cut our throat; we lost confidence in the group.'⁴⁶ Possibly veiled comments in respect of the NRL suggest a growing suspicion of salary cap breaches arguably sufficient to cause the system to be challenged for compliance levels inadequate to achieve the stated purpose of the restraint. Commentator Phil Gould remarked in respect of star players going to the Brisbane Broncos Club: 'Many have viewed these signings with jealousy and even disgust. The word 'cheats' has been mumbled on many occasions. ... I don't look at it that way. I don't care if a football club looks after a player's family with housing and employment, sends him on exotic holidays, helps him invest in profitable business ventures, uses him in TV commercials for sponsors, donates money to the player's favourite charity or church, or even slips him a little extra spending money.'⁴⁷

In short, where cheating is rife the salary cap is not performing its stated object and must be abandoned. Indeed, the case may be put that where even one or two teams are undetectable in cheating, the restraint should be removed. It might be added that where a cartel mentality develops and loyalty to the wider ideal vanishes, the mere rumour of non-compliance is sufficient to instigate the movement towards inefficacy.

⁴⁶ RA Smith, 'The Incredible Electrical Conspiracy', *Fortune* April 1961, quoting Clarence Burke.

⁴⁷ P Gould, 'Why Brisbane Deal Stinks' *The Sub-Herald*, August 15, 2010 at 20.

Third party payments

Some sports permit athletes to be paid by third party interests rather than through their club as salary. In the NRL, all clubs are permitted to seek 'third party sponsorship' but not all clubs are able to access such benefaction. This practice, depending on the extent to which players are drawn to, or retained by, clubs through third party payments, is, it may be suggested, sufficient to challenge the salary cap system under the restraint of trade doctrine. Third party payments may damage the object of the salary cap in two ways: one, by limiting the number of players entering the market and two, skewing players towards contracting with clubs able to access third party payments.

According to the NRL:

Third party agreements are payments made by companies directly to players. There is no restriction on the amount a player can earn through third party agreements where he is being paid for his own intellectual property, without the need to employ club logos or names and where the company involved is neither a club sponsor nor are they acting on behalf of a club to secure the player's services.⁴⁸

In addition to the salary cap and third party payments, the NRL permits a 'Marquee Player Allowance' to be paid to any top 10 player at a club up to \$50,000 per player limited to \$150,000 per club (\$300,000 in 2011),⁴⁹ by club sponsors seeking to use a player's intellectual property.

Sports commentator Roy Masters quoted a former chairman of an NRL club as stating, 'There is an acceptable level of cheating in the NRL and an unacceptable level.' Masters was referring to permissible 'third party payments': '... there are legitimate mechanisms for a club to retain or hire players, provided it has a coterie of wealthy supporters and keeps them at arm's length. The Thoroughbreds, a group of 20 mainly Brisbane based businessmen, support the Broncos. The really rich ones stay in the background, content for the club to be competitive.'⁵⁰

The Brisbane club was reported as agreeing to pay its players a total of \$5.15 million in 2011 (the base salary cap is set at \$4.1) through third party sponsorship (where no limit is applied by the NRL), a 'marquee player' allowance (\$300,000) and a long-service allowance (\$200,000 in 2011).⁵¹

⁴⁸ <http://www.nrl.com/news/news/newsarticle/tabid/10874/newsid/58360/nrl-salary-cap-explained/default.aspx>;

⁴⁹ <http://www.nrl.com/NewsViews/LatestNews/NewsArticle/tabid/10874/newsId/59147/Default.aspx>.

⁵⁰ R Masters, 'On the business of salary cap rorting' *The Sydney Morning Herald*, August 14-15, 2010 at 'sports day' 2.

⁵¹ A Prosenko, 'What the Broncos would cost your team' *The Sub-Herald*, August 15, 2010 at 71.

Similar levels of payment were mentioned when NRL club the Parramatta Eels attempted to secure the services of rugby union player Quade Cooper: 'Parramatta's offer is close to \$1 million a year ... and it includes a compensation payment of \$150,000 for this year if the ARU suddenly dumps him if chooses to head to league. ... The level of interest the club has shown is enormous. They have car deals and third party sponsors lined up.'⁵² Under the salary cap regime a wage of near \$1 million in the absence of a third party sponsor would see one player paid around a quarter of the club's permitted limit – obviously lessening the payment to other, likely to be disgruntled, players. Clearly, only those clubs in a position to gain third party sponsors are able to offer such terms, leaving clubs less favoured by sponsors no recourse but to make offers inclusive of the salary cap limit.

Returning to the justifications of the NRL salary cap:

The NRL believes that if a few clubs were able to spend unlimited funds ... it would reduce the attraction of games to fans, sponsors and media partners due to an uneven competition. Allowing clubs to spend an unlimited amount on players would drive some clubs out of the competition as they would struggle to match the price wealthy clubs could afford to pay.⁵³

The express purpose of the salary cap is to prevent 'uneven competition' and to prevent unaffordable player payments which would 'drive some clubs out of the competition'. Third party payments threaten the first purpose. The point being made is not whether the salary cap works when all teams are equally restrained but whether it can be justified where alternate means of player payment are accessible to some clubs but not by others, or indeed, where the quantum of third party payments differ between clubs. The stated object sought to be achieved in capping player payments is defeated and the restraint of trade must be seen as futile. Had the use of third party payments been granted exclusively to those clubs which could not afford to spend to the salary cap limit, the restraint could at least be argued as to reasonableness; such is not the case.

Do third party payments distort the functionality of the salary cap? Where clubs retain players they would otherwise lose to rivals clubs, the simple answer is yes. The purpose of the salary cap is to distribute playing talent across the pool of teams in the knowledge that all things being equal, closer matches will be the result.

Does it matter that a team apparently advantaged by third party payments, the Brisbane Broncos, have not won the competition since 2001? The use of such performance statistics to either justify or condemn a salary cap is, however, an

⁵² D Weidler, 'Quade's Bill a Mill', *The Sun-Herald*, August 22, 2010 at 71.

⁵³ <http://www.nrl.com/nrlhq/referencecentre/salarycap/tabid/10434/default.aspx>.

inexact methodology and open to interpretation.⁵⁴ For example, the Broncos have only won the premiership once since 2001, but have made the final 8 every season since 2000 (admittedly a less impressive statistic). In addition, where players are retained through third party sponsorship but appear to add nothing to a team's performance there are arguable implications for the salary cap regimen – why restrict player payments when better paid teams perform less well than poorer paid teams. In any case, as previously stated it is not really to the point to expect a precise correlation between retained playing staff and premiership titles given the variables that go to make a winning team.

The 'marquee player' allowance (to go to \$300,000 in 2011) and the 'long-service allowance' also work to defeat the direct object of the salary cap and could be included in complaints of unreasonableness if only because each, in potential or in practice, tilts the system away from equality of purchasing power between.⁵⁵

Additional means of player payment were perhaps introduced by the NRL to assuage clubs facing the loss of long term talent, players concerned at a loss of earnings or to reduce the likelihood of actions under the restraint of trade doctrine. There can also be little doubt that the NRL is concerned with the movement of players to other codes or to off-shore rugby league teams. The concern is not with the freedom to trade expressed through third party sponsorship but how this particular freedom impacts upon the usefulness of the salary cap restraint. Retaining talent through third party payments and redistributing talent through a salary cap regimen are mutually exclusive goals. To attain one means damaging the other. Whilst the NRL's motivation may have its logic, the concessions are sufficiently destructive to the object of the salary cap as to possibly render its objects unattainable. The goal of talent distribution is not being achieved where some clubs are permitted, and able, to spend amounts not available to other clubs.

Legitimising payments through 'third party' sponsorship threatens the viability of the salary cap scheme under the restraint of trade doctrine. From the examples cited above there are a number of clubs with access to wealthy third party benefactors prepared to supplement player salaries. The effect of such parochially sourced payments is likely to render the stated object of the salary cap, competitive balance, nugatory, opening the way to legal challenge as an

⁵⁴ See in this respect see general comments of Hill J in *Adamson and Others v New South Wales Rugby League and Other (trial)* (1991) 100 ALR 479 at 505-506.

⁵⁵ **Consider for example the following:** 'The Sydney Roosters had long been tipped to snare the signature of one of the game's hottest talents, but recent increases for marquee players helped Canberra lay a crucial foundation for their future by tying Dugan up until the end of 2012.' Storm scandal helped strike Dugan, Ben Horne AAP Sun, 11 Jul 2010: http://www.nrl.com/news/news/newsarticle/tabid/10874/newsid/59381/storm-scandal-helped-strike-dugan-deal/Storm_scandal_helped_strike_Dugan_dealPrint - Font + Font RSS By Ben Horne AAP Sun, 11 Jul 2010default.aspx.

unreasonable restraint of trade. On a factual basis, third party sponsorship may well worsen the competitive balance between teams should those clubs with a winning record attract the majority of third party sponsors.

The particular difficulty facing sporting bodies such as the NRL, where rival codes exhibit on-going interest in their players, is to continue the salary cap while retaining talented athletes who, with limited playing careers, must seriously consider offers from other sports.

Conclusion

Sporting organisations with little doubt possess a legitimate interest in creating a competitive on-field balance between teams engaged in their sport. The object of competitive balance, a recognised marketing tool in generating income through spectator, media and sponsor involvement, can be described as part of 'the special character of the area in which the restraint operates'.⁵⁶

The question of reasonableness under the restraint of trade doctrine is determined according to the specific circumstances applying in each sport. Recent revelations of salary cap breaches by the NRL club, the Melbourne Storm, have provided insight into the specific circumstances of players restrained in their trade by the NRL salary cap. The suggested cost of the salary cap to each 'star' player of the Melbourne Storm was an amount approaching \$175,000 a year. Although the forgone earnings of a covenantor must be considered under the *Nordenfelt* test of reasonableness, it cannot be certain, when considered alongside the legitimate interests of the NRL in providing evenly matched teams, that such an impost is alone sufficient to have the salary cap declared unreasonable.

Where, however, the salary cap is ineffective in securing the legitimate objects of its incorporation, principally the distribution of playing talent across the various clubs to create an even contest between teams, the restraint of trade doctrine may be utilised to see the cap declared unenforceable. A covenant which is unable to achieve its object or is ineffective in doing so may be classified as a 'bare covenant restrictive of competition'.⁵⁷

It is suggested that the capacity of teams to avoid the salary cap and the related difficulty of detection demonstrated in the Melbourne Storm breaches, may be so significant as to prevent the achievement of competitive balance between NRL teams.

The success of a salary cap in meeting its objects ultimately depends on the rational judgment of decision makers who, although tempted to breach their

⁵⁶ *Adamson* at ALR 364, quoting Lord Wilberforce in *Eastham* at Ch 432.

⁵⁷ *Butt v Long* (1953) 88 CLR 476 at 486.

agreement must weigh clandestinely sourced gains against the prospect of detection and punishment. In this sense the teams functioning under a salary cap are a cartel tempted by the apparent advantages of non-compliance but constrained by the fear of detection and the break-down of cartel advantages. Because there can be no guarantee that business entities acting under a cartel arrangement will not seek to maximise individual advantage to the cost of other members, an effective system of detection and deterrence is needed to avoid litigation under the restraint of trade doctrine. Deterrence in the form of point penalties, removal of premierships titles and fines are arguably effective deterrents – the problem remains that of detection. Where honest clubs are denied access to superior athletes through breaches of the salary cap, legitimate or otherwise (to use the words of Roy Masters) the system does not meet its legitimising object and may be declared an unreasonable restraint on trade.

It is further proposed that the use of concessions such as ‘third party payments’, whilst outwardly a gesture going to ‘reasonableness’ under the restraint of trade doctrine are, ironically, destructive to the object of creating an even competition between NRL teams. Those clubs where third party sponsors are available to assist in acquiring the services of top line players will, all things being equal, win more often than those clubs without access to similar benefactors.

To be enforceable under the restraint of trade doctrine a salary cap, as a restraint on player trade, must work to achieve the object of its incorporation. The principal object of the NRL salary cap is the maintenance of an even competition between teams. The difficulty, if not the impossibility of detecting salary cap breaches by teams within the NRL threaten the capacity of the salary cap to deliver on this stated objective. Third party payments, whilst beneficial to certain individual players are not accessible to all clubs to the same level, thereby creating an imbalance in purchasing power. These factors are argued to have significantly compromised the purpose of the NRL salary cap scheme and to have done so to such an extent to threaten its viability under the common law restraint of trade doctrine.