PROMOTING 'MATCH QUALITY' IN NEW ZEALAND RUGBY: AUTHORISATION OF SALARY CAPS AND PLAYER TRANSFER RESTRICTIONS UNDER THE *COMMERCE ACT 1986* (NZ)

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In recent years the New Zealand Rugby Union has adopted player salary and transfer rules designed to promote competition between teams, with the aim of increasing television audiences and attracting greater numbers of spectators. As measures that promote sporting competition on the rugby pitch may at the same time unlawfully restrain commercial competition, the New Zealand Rugby Union sought the New Zealand Commerce Commission's authorisation for its player transfer restrictions and salary cap arrangements. This article reviews the Commerce Commission's approach in investigating the efficiency effects of salary caps and transfer fees in detail and developing a novel 'match quality' hypothesis which may have application for other sporting codes.

I Introduction

The rules and arrangements under which sporting competitions are organised have often given rise to particularly challenging issues for the application of competition law. Many well-known competition law cases concern the application of competition law to the conduct of sports' organising bodies, including agreements or arrangements entered into among clubs, between leagues and broadcasters, and between leagues or clubs and their players. A sophisticated body of economic theory[1] has emerged and continues to develop to assist in analysis of this field of competition. Against this backdrop, the successive applications by the New Zealand Rugby Union[2] ('NZRU') for authorisation of arrangements, variation of authorisation and, finally, revocation of authorisation

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[1] See, Wladimir Andreff and Stefan Szymanski, 'Introduction: Sport and Economics' in Wladimir Andreff and Stefan Szymanski (eds), *Handbook on the Economics of Sport* (Edward Elgar, 2006) 1, for a concise review of the literature on the economics of sport.

[2] Prior to 2006, the New Zealand Rugby Union was named the New Zealand Rugby Football Union. For simplicity, 'New Zealand Rugby Union' or 'NZRU' is used throughout this article.

provide useful insights into the Commerce Commission's approach to qualitative and quantitative evaluation of the benefits and detriments arising from arrangements in the sporting domain, as well as the operation of the authorisation provisions under section 65 of the *Commerce Act 1986* (NZ) generally. Reference is also made to the Commerce Commission's prior determination declining to grant an authorisation sought by the Speedway Control Board ('SCB') in respect of agreements containing certain restrictive provisions.[3]

That sports in New Zealand are organised and played predominantly on an amateur basis does not entirely explain the relatively low incidence of sports-related *Commerce Act* proceedings,[4] in a country enjoying a high rate of sports participation.[5] Nevertheless, the Commerce Commission has on three occasions considered applications by sports organising bodies for authorisation under section 58 of the *Commerce Act* to permit contracts, arrangements or understandings to be entered into and given effect that would otherwise be proscribed by sections 27–30 of the *Commerce Act*. The first such application was made in 1988 by the SCB and concerned agreements that included provisions restricting clubs and drivers affiliated with the SCB from organising or racing in non-SCB meetings.[6] After the All Blacks became a professional team in the mid-1990s, the NZRU perceived a need for rulemaking in respect of player transfers. The second[7] and third[8] applications for authorisation – on which the present article focuses – were made by the NZRU in 1996 and 2005, in relation to proposals by the NZRU to make and implement regulations and rules that would control provincial unions' payrolls for premier division teams and the transfer of players between teams. Two subsequent proceedings dealt with the variation, in 2007,[9] and revocation, in 2011,[10] of the 2005 conditional authorisation. As the third application and final revocation decisions reveal, the necessity for authorisation of player transfer restrictions may be avoided where players are engaged as employees rather than as independent contractors, since the performance of work under a contract of service does not entail provision of a 'service' in a market for the purposes of the *Commerce Act*.

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[3] Commerce Commission, *Decision No 242* (14 December 1989) ('*Decision No 242*').

[4] Although 'work' may include unremunerated activities, it is likely that a large part of amateur sporting activity does not involve the provision of services in a market, since such activity does not occur in trade or pursuant to a contract: see *Decision No 242* [27]; discussion at Part III of this article.

[5] See, Sport and Recreation Commission, New Zealand Government, *2007/08 Active New Zealand Survey* (2013) Active NZ Survey <http://www.activenzsurvey.org.nz/Results/>.

[6] *Decision No 242*.

[7] Commerce Commission, *Decision No 281* (17 December 1996) ('*Decision No 281*').

[8] Commerce Commission, *Decision No 580* (2 June 2006) ('*Decision No 580*').

[9] Commerce Commission, *Decision No 601* (11 May 2007) ('*Decision No 601*').

[10] Commerce Commission, *Decision No 721* (31 March 2011) ('*Decision No 721*').

Part II of this article briefly reviews the objects of player transfer restrictions and their treatment under competition laws generally. Part III summarises the NZRU's authorisation applications and addresses the grounds for Commerce Commission jurisdiction. Part IV examines the Commission's analysis of the NZRU's proposals, in particular its rejection of the 'uncertainty of outcome' hypothesis and its development of an alternative 'match quality' hypothesis for predicting spectator and audience enjoyment of rugby union matches. Particular factors and effects taken into account by the Commission in quantifying benefits and detriments are identified, though an economic critique of the Commission's modelling of such benefits and detriments is not undertaken in this paper.[11] Part V draws from the Commission's approach to these authorisation conclusions, relevant to the design and assessment of sports leagues' restrictions on player transfers and remuneration.

II Sports Leagues' restrictions on player transfer

Team owners and league organisers have sought to influence the market for players' labour by means of various restrictions on their employment and compensation. Such restrictions have included: player recruitment rules, rules on movement of players between clubs and leagues, and wage controls in the form of maximum salaries for individual players or 'salary caps' on aggregate payments to the players in a club or league.[12]

Prior to the commencement of the *Commerce Act*, a restriction preventing a New Zealand rugby league player from playing professionally in Australia was considered by the New Zealand High Court (and, on appeal, the Court of Appeal) under the common law doctrine of restraint of trade.[13] Australian courts have examined player transfer restrictions of various kinds under the doctrine of restraint of trade[14] and Part IV of the *Trade Practices Act 1974* (Cth).[15] Player transfer restrictions have also been the subject of extensive antitrust scrutiny in

[11] For a useful discussion of quantitative analysis and modeling techniques employed by the Commerce Commission, see David Law, Qing Gong Yang, and Michael Pickford, 'Quantitative Methods in Competition Cases: A New Zealand Perspective' (2010) 17 *Competition and Consumer Law Journal* 252.

[12] Braham Dabschek and Hayden Opie, 'Legal Regulation of Sporting Labour Markets' (2003) 16 *Australian Journal of Labour Law* 259, 263, 265–6.

[13] *Blackler v New Zealand Rugby Football League (Inc)* [1968] NZLR 547.

[14] See, eg, *Buckley v Tutty* (1971) 125 CLR 353; *Hall v Victorian Football League* [1982] VR 64; *McCarthy v Australian Rough Riders Association* (1988) ATPR 40-836; *Barnard v Australian Soccer Federation* (1988) 81 ALR 51; ATPR 40-862.

[15] Now entitled the *Competition and Consumer Act 2010* (Cth). See, eg, *Adamson v West Perth Football Club Inc* (1979) 39 FLR 199; 27 ALR 475; *Hughes v Western Australian Cricket Association* (1986) 19 FCR 10; *News Ltd v Australian Rugby Football League* (1996) 58 FCR 447; *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410.

the United States, where they have for many years been a feature of the four major sports (baseball, football, basketball and hockey) and soccer.[16]

The prototype player transfer restriction was, perhaps, the 'reserve clause' which baseball clubs began including in player contracts from 1879, in effect gaining a perpetual option on the services of their players.[17] Organised baseball was effectively exempted from the application of the antitrust laws by a 1922 decision of the Supreme Court holding that baseball was not an activity of interstate commerce or trade[18] but other team sports remained subject to the antitrust laws and, as strong players' unions developed, the player reservation systems faced increasing scrutiny.[19] Challenges to reservations systems and their related rules were brought by players and players' unions in football,[20] hockey[21] and basketball.[22] By the early 1990s, antitrust courts' decisions and negotiated settlements saw 'free agency' of players superseding reservation and player salaries growing substantially. Marburger comments that '[w]ith pocketbooks haemorrhaging to the benefit of players, professional sports owners looked to salary caps as a way to harness free agency'.[23] The imposition of salary caps was justified, against a background of antitrust scrutiny, by the claim that they were necessary to promote league balance.

The importance of competitive 'balance' in a league to the maintenance of fans' interest is explained by Quirk and Fort:

> One of the key ingredients of the demand by fans for team sports is the excitement generated because of the uncertainty of outcome of league games. For every fan who is a purist who simply enjoys

[16] Major League Soccer teams in the US are subject to salary caps that limit the teams' annual spending on players' salaries, although in recent years a 'designated player rule' has excluded from the salary cap remuneration to one or more players (three players in 2010), in order that each team can retain the services of designated 'star players' without breaching its cap. See, Tim Bezbatchenko, 'Bend it for Beckham: A Look at Major League Soccer and its Single Entity Defense to Antitrust Liability after the Designated Player Rule' in Scott R Rosner and Kenneth L Shropshire (eds), *The Business of Sports* (Jones & Bartlett Learning, 2nd ed, 2010) 104.

[17] James Quirk and Rodney D Fort, *Pay Dirt: The Business of Professional Team Sports* (Princeton University Press, 1st ed, 1992) 180–197.

[18] *Federal Baseball Club of Baltimore Inc v National League of Professional Baseball Clubs* 259 US 200 (1922). See also *Flood v Kuhn* 407 US 258, 273 (1972); *Toolson v New York Yankees Inc* 346 US 356 (1953) (Burton J dissenting); *Salerno v American League of Professional Baseball Clubs* 429 F 2d 1003, 1005 (2d Cir 1970). Regarding federal pre-emption of state antitrust laws: *Winsconsin State v Milwaukee Braves Inc* 385 US 990 (1966).

[19] Quirk and Fort, above n 17, 192.

[20] See, eg, *Kapp v National Football League* 390 F Supp 73 (ND Cal 1974); *Mackey v National Football League* 543 F 2d 606 (1976); *James McCoy (Yazoo) Smith v Pro Football Inc* 593 F 2d 1173 (DDC 1978).

[21] See, eg, *Philadelphia World Hockey Club Inc v Philadelphia Hockey Club Inc* 351 F Supp 462 (ED Pa 1972); *McCourt v California Sports Inc* 600 F 2d 1193 (1979).

[22] See, eg, *Robertson v National Basketball Association* 389 F Supp 867 (SDNY 1975); 556 F 2d 682 (2d Cir 1977).

[23] Daniel R Marburger, 'Chasing the Elusive Salary Cap' in Wladimir Andreff and Stefan Szymanski (eds), *Handbook on the Economics of Sport* (Edward Elgar, 2006) 646.

> watching athletes with outstanding ability perform regardless of the outcome, there are many more who go to watch their team win, and particularly to watch their team win a close game over a challenging opponent. In order to maintain fan interest a sports league has to ensure that teams do not get too strong or too weak relative to one another so that uncertainty of outcome is preserved. If a league becomes too unbalanced, with too much playing talent concentrated in one or two teams, fan interest at the weaker franchises dries up and ultimately fan interest even at the strong franchises dries up as well.[24]

This reasoning, known as the 'uncertainty of outcome' hypothesis ('UOH'), has often been invoked in support of salary caps and related measures. If salary caps lead to a more even distribution of playing talent across competing teams, then they may be justified as enhancing the degree of on-field competition and hence spectators' and televisions audiences' enjoyment of the sport. This logic formed the basis of the proposals set out in the NZRU's application for authorisation. The NZRU argued that without the proposed salary caps and (liberalised) player movement restrictions, the competitiveness of domestic provincial rugby would continue to decline, leading to falling spectator and viewer interest and jeopardising substantial sponsorship and broadcasting revenues.[25]

Efforts to create a more balanced league entail at least two kinds of risks, however. First, fans are also attracted to teams that achieve on-field 'dominance' in their league, as Quirk and Fort observe:

> There is a fascinating tension between the need for competitive balance within a league to maintain fan interest throughout the league, and the yearning of owners and fans alike for truly memorable dominant teams … the teams that fans and sportswriters talk about for years afterwards.[26]

Such a 'truly memorable' team would be expected not to emerge in a balanced league. Secondly, measures intended to enhance the on-field competitiveness of a sport may be impugned, where they tend to lessen off-field competition between rival suppliers (or acquirers) of the services involved in the sport. The Commerce Commission was concerned to ensure that if the NZRU's proposals operated as an agreement or arrangement between the competing provincial unions, they must be justified on net public benefit grounds.

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[24] Quirk and Fort, above n 17, 243.
[25] *Decision No 580* [73].
[26] Quirk and Fort, above n 17, 242.

The NZRU's proposed salary cap provisions[27] were designed to establish an agreement among the premier division provincial unions to limit each union's total spending on player salaries, in order to constrain the ability of the better-resourced unions to attract the best player talent and thereby dominate rugby competitions. The effect of the salary cap[28] provisions was that each premier division union could spend no more than NZD2.0 million per annum on payments to players in 2006 and subsequent years (with an adjustment for inflation). Spending on salaries would include non-financial benefits (such as cars or accommodation provided to players) and penalties would apply to any union spending in excess of its cap.[29]

III The NZRU'S applications for authorisation, variation and revocation

The Commerce Commission issued four determinations concerning NZRU restrictions on the transfer of players, between 1996 and 2011. The first NZRU determination (*Decision No 281*), in 1996, authorised the NZRU to enter into and give effect to a 'player transfer system' comprising a limit on the numbers of player transfers annually, maximum player transfer fees and a limited period for player transfers each year.[30] The second determination (*Decision No 580*), made in June 2006, conditionally authorised the NZRU to enter into and give effect to certain 'salary cap' arrangements and a new set of rules governing player transfers. In May 2007 the Commerce Commission made a third determination (*Decision No 601*) on application by the NZRU, to amend its 2006 authorisation so as to allow temporary relief from the salary cap arrangements for 2007 only, to accommodate arrangements considered necessary due to the participation of leading New Zealand players in the 2007 Rugby World Cup squad and conditioning programme. Finally, the Commerce Commission determined in 2011 (*Decision No 721*) to revoke its June 2006 conditional authorisation, on the basis that it was no longer required. In all four determinations, a threshold issue was whether the restrictions affected trade in relevant 'services' in terms of the *Commerce Act*. In the first three of these determinations, the Commerce Commission was also required to define the relevant markets in which such services were (or could be) traded.

[27] Set out in draft Salary Cap Regulations, provided by the NZRU to the Commerce Commission (copy with author).

[28] As the Commerce Commission observed, these kinds of arrangements 'are more correctly referred to as a total player payroll cap – because the cap applies to the total salary bill, not to individual salaries': *Decision No 580*, [19]. The 'salary cap' nomenclature was used by all parties to the NZRU determinations, so is adopted here.

[29] *Decision No 580*, [11], [18].

[30] *Decision No 281*, [32]–[35].

Jurisdiction to grant authorisation

The Commerce Commission has a discretion to grant a person an authorisation to engage in conduct that would, absent an authorisation, be proscribed by sections 27–29 of the *Commerce Act*. Section 27 prohibits entering into to a contract, arrangement or understanding that contains a provision having the purpose or effect or likely effect of substantially lessening competition in a market, and giving effect to any such provision. Where a provision has the purpose, effect or likely effect of 'fixing, controlling or maintaining' the price of goods or services, section 30 deems such provision to have the purpose, effect or likely effect of 'substantially lessening competition in a market' for the purposes of section 27. Section 29 prohibits entering into a contract, arrangement or understanding that contains an 'exclusionary provision', and giving effect to any such provision. An 'exclusionary provision' is a provision agreed between parties who are in competition with each other which has the purpose of preventing, restricting or limiting the supply or acquisition of goods or services.[31]

Authorisation may be sought by a person who wishes to enter into a contract or arrangement, or arrive at an understanding, or give effect to a provision of a contract, arrangement or understanding, to which that person considers sections 27 or 29 would or might apply.[32] A different test applies in each case. Before granting an authorisation in respect of conduct which is subject to section 27, the Commerce Commission must be satisfied that entering into or giving effect to the contract or arrangement or arriving at the understanding: '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'.[33] In order that it may grant an authorisation in respect of conduct to which section 29 would or might apply, the Commerce Commission must be satisfied that entering into the contract, arrangement or understanding, or giving effect to the exclusionary provision:

> … 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.[34]

Before applying either of these public benefit tests, the Commerce Commission must satisfy itself that it has jurisdiction to grant the authorisations sought.

[31] *Commerce Act 1986* (NZ), s 29(1).
[32] *Commerce Act 1986* (NZ), s 61, subs (1), (2), (5) and (6).
[33] *Commerce Act 1986* (NZ), s 61(6).
[34] *Commerce Act 1986* (NZ), s 61(7).

In the case of the NZRU's authorisation applications, there were four principle steps to the Commission's analysis.

First, in the case of the NZRU's first application, the Commerce Commission had to be satisfied that an 'arrangement' in terms of the *Commerce Act* was proposed to be entered into and had not already been entered into. By the time of the NZRU's second application, amendments to the *Commerce Act* permitted the Commission to consider applications for authorisation where the contract, arrangement or understanding in question had already been entered into or arrived at prior to the Commission making its determination, though conduct occurring prior to any authorisation will remain a contravention.[35] In both cases the Commission had little difficulty in determining that the arrangements proposed were pursuant to a contract, arrangement or understanding. In *Decision No 281* the Commission considered that 'there necessarily exists some underlying collective arrangement between the provincial unions … to which the [NZRU] is also a party, to agree to the Regulations' implementing the player transfer system.[36] In *Decision No 580* the Commission considered the proposed salary cap arrangements[37] 'to be at least an arrangement or understanding, if not also a contract'[38] for the purposes of sections 27 and 30, and the proposed Player Movement Regulations were held to be a contract, arrangement or understanding for the purposes of the relevant provisions.[39]

Secondly, the Commerce Commission had to determine whether the Proposed Arrangements would or might affect 'services' or a 'market' as defined in the Act, prior to defining the relevant markets and assessing the effect of the proposed arrangements on competition in those markets. Thirdly, the Commerce Commission had to determine in *Decision No 580* whether Part II of the *Commerce Act* was disapplied in respect of the Proposed Arrangements by reason of the specific exemptions set out in section 44, subs (1)(c), (1)(f), or (1)(h). Fourthly, the Commerce Commission was required to determine whether the relevant contract, arrangement, understanding, or provision would result or be likely to result or be deemed to result in a lessening of competition. According to the Commission's general approach, if there is no such lessening (or no likelihood or deeming of lessening) of competition, then authorisation will be declined on the basis that it is not required under the Act.[40] If, on the other hand, the relevant contract, arrangement, understanding or provision would result or

[35] *Commerce Act 1986* (NZ), s 59 was substituted, and ss 59A and 59B were inserted, as from 26 May 2001, by the *Commerce Amendment Act 2001* (NZ) (No 32 of 2001), s 13.
[36] *Decision No 281*, [153].
[37] Authorisation was sought expressly for the 'salary cap arrangements' and not Salary Cap Regulations, presumably to allow some flexibility in formulation of those regulations. The effect of this was that the authorisation would authorise relevant NZRU regulations but only to the extent they give effect to the 'salary cap arrangements' before the Commerce Commission: *Decision No 580*, [400].
[38] Ibid [395].
[39] Ibid [399].
[40] See *Decision No 281*, [23]; *Decision No 580*, [268].

be likely to result or be deemed to result in a lessening of competition, then the Commerce Commission will proceed to assess the benefits and the detriments that would result or be likely to result.

The Commerce Commission's reasoning in relation to sporting 'services' and the effects of the proposed arrangements on competition are considered in more detail in the following two sections.

'Services' in the sporting domain

The definition of the term 'services' in section 2 of the *Commerce Act* is complex and has proved controversial as bodies involved in sports administration have sought to convince the Commerce Commission that their activities ought not to fall within the scope of the Act. In the SCB authorisation proceeding, this argument was premised on the supposedly non-commercial character of organised sports. In the more recent NZRU proceedings, it has been the employment status of the sportsmen involved that has been the focus of enquiry.

In 1988, when the SCB applied for authorisation in respect of two agreements containing provisions to enforce its rules against clubs, promoters and competitors, the New Zealand Assembly for Sport ('NZAS') filed a submission which argued that the *Commerce Act* ought not be applied to sports bodies because 'the Act is only concerned with commercial markets, and that there is an 'in trade' requirement in the definition of 'services' contained in the Act.'[41] The Commerce Commission was not persuaded by the NZAS's references to Australian case law on this point and rejected the submission.[42] The NZAS also argued that businesses and sports bodies have different motivations and different roles in society.[43] Although the Commerce Commission determined to decline authorisation, on other grounds, it observed that:

> A non profit-making objective does not exempt an association from the provisions of the Commerce Act, nor does the fact that membership of an association is voluntary nor that members have a common interest. Many trade and professional associations would meet those criteria. The Commission does not consider that these are relevant factors in its consideration of whether or not a matter before it falls within s 27, s 29 or other provisions of the Act.[44]

The Commission must be considered correct in this view, though the basis on which individuals participate in an organised sport is likely to be relevant to the

[41] New Zealand Assembly for Sport, *Submission in the Matter of an Application Made by the Speedway Control Board of New Zealand Inc* (undated), [27].
[42] *Decision No 242*, [23].
[43] New Zealand Assembly for Sport, *Submission*, above n 41, [143].
[44] *Decision No 242*, [27].

questions of whether they are providing 'services' that are traded in 'markets' and whether section 44 applies to exempt such services from Part II of the *Commerce Act*.

The meaning of 'services' and whether the term encompassed activities of the organising body were again in issue in each of the NZRU's 1996 and 2005 applications for authorisation. Infringement of section 29 of the *Commerce Act* requires that the supply of goods or 'services' be affected and section 27 requires that competition in a 'market' must be lessened. A 'market' must be 'for goods or services'.[45] Importantly, the services of employees are not traded in a 'market' in terms of the *Commerce Act*:

> The effect of this section [section 2] is to provide that the services exchanged in employment contracts are not 'services' in terms of the Act, and therefore that the buying and selling of services under an employment contract does not occur in a 'market' as defined in the Act. Although there exists a market for these services in a commercial sense, there is no such market in terms of the Act. This has the effect of removing contracts of service from the jurisdiction of the Act.[46]

In the 1996 application, the question arose as to whether services provided to the NZRU by rugby union players were provided under employment contracts (contracts of service), and hence outside the definition of 'services'[47] and therefore not bought and sold in a 'market'.[48] The Commerce Commission declined to determine this issue but stated that it 'will proceed on the basis that some of the contracts might be contracts for services or that the market for player services might develop in such a way as to cause many contracts to be construed as contracts for services.'[49] In the context of a subsequent appeal against the grant of authorisation, Smellie J. remarked obiter that 'there clearly is 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', though his Honour observed that a holding on the point was not called for on this appeal and expressly left the question for another occasion.[50]

In determining the NZRU's 2005 application, in *Decision No 580*, the Commerce Commission addressed the issue of player 'services' squarely. Applying the somewhat complex definition of 'services' to the playing of rugby union, the Commerce Commission distinguished between 'employee players … for

[45] *Commerce Act 1986* (NZ), s 3(1A).
[46] *Decision No 281*, [88].
[47] *Commerce Act 1986* (NZ), s 2(1).
[48] *Decision No 281*, [88].
[49] Ibid [92].
[50] *Rugby Union Players' Association Inc v Commerce Commission (No 2)* [1997] 3 NZLR 301, 329.

whom the playing of rugby is 'the performance of work under a contract of service'[51] and 'independent contractors'. Employee players of rugby union were considered not to be providing 'services' because the definition of that term excludes 'the performance of work under a contract of service'. Independent contractors could, however, be providing 'services' in a 'market'.[52] At the time of the determination, only one star player provided his services as an independent contractor but, importantly, clause 4.2 of the Collective Employment Agreement ('CEA') between the NZRU and the Rugby Players Collective Incorporated[53] ('RPC') expressly provided for the possibility that players might be engaged as contractors. In respect of such independent contractor players, the Commission reasoned that their playing constituted 'the performance of work' and hence was a 'service':

> The Commission considers that not every remunerated activity necessarily is work and, by the same token, work can encompass activity that is unremunerated. In the present context, however, the Commission considers that whether a player receives monetary reward in return for playing rugby is an important indicator of whether the player is engaged in work or not. The Commission's view is that 'work' and, hence, 'services' are provided where rugby is played pursuant to a contract which entails the remuneration of the player.[54]

The Commerce Commission had also to consider whether any of the various exemptions under section 44 of the *Commerce Act* applied to preclude Part II of the Act applying to the Proposed Arrangements. It concluded that section 44 did apply to exempt some aspects of the Proposed Arrangements but only insofar as those concerned employee players.[55]

Ultimately, the adoption of a variation to the CEA to expressly rule out engagement of players as independent contractors resulted in the Commission's most recent determination concerning NZRU player transfer restrictions. Neither the version of the CEA that was in force until December 2009 nor the version that commenced in January 2010 included a provision equivalent to clause 4.2 of the 2006–2008 CEA. Rather, both of the latter versions of the CEA provided that '[p]layers may be employed to play Rugby for a New Zealand Team (and, for the avoidance of doubt, may not be retained on any basis other than employment)'.

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[51] *Decision No 580*, [283].
[52] *Commerce Act 1986* (NZ), s 2(1).
[53] The Rugby Players Collective Incorporated is a 400-member registered trade union and incorporated society. It served as the vehicle by which professional rugby players in New Zealand negotiated the Collective Employment Agreement with the NZRU: *Decision No 580*, [48].
[54] Ibid [303].
[55] Ibid [310]–[324].

In March 2011 the Commerce Commission determined that this change in the terms of the CEA was 'a material change of circumstances' in terms of section 65(1)(b) of the *Commerce Act* and that the Commission should exercise the discretion arising under that section to revoke the authorisation granted in June 2006. The Commission reasoned that:

> The position under the new employment environment has changed to the extent that there are currently no players playing in the [Premier Division] who are engaged as independent contractors and there is no prospect under the current contractual arrangements of players being engaged as independent contractors in the future. As a consequence, all rugby players participating in the [Premier Division] are now employees of the NZRU, which means that the exception in section 44(1)(f) of the Act applies and the anti-competitive provisions of the Act have no application to such employment arrangements.

Clearly, the employment status of any sportsmen potentially affected by player transfer restrictions will be crucially important to whether those restrictions are subject to Part II of the *Commerce Act* and therefore require authorisation.

The markets for Rugby Union Services

Three relevant markets were defined by the Commerce Commission in *Decision No 281*:

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

In the 'premier rugby union player services' market, the Commission considered that players compete to supply their skills and services to provincial rugby unions and provincial unions compete to acquire skilled players. The market was not one for 'sports players' or 'rugby union and rugby league players' because, 'as a matter of fact and of commercial common sense',[56] the services of other sports players and rugby league players were not substitutable for those of players at the 'banded' levels of rugby union:

> The Commission not only considers that the services of other sports players, including for present purposes rugby league players, do not

[56] *Decision No 281*, [70].

> fall within the relevant 'product' market, but that most rugby union players are also excluded. The skills of the vast majority of the total rugby union playing population are simply not substitutable for those of banded players.[57]

The market for 'rights to premier rugby union player services' was evidenced in *Decision No 281* by actual and potential transactions between provincial unions for the sale and purchase of rights to utilise the services of premier rugby union players.[58] The Commerce Commission was satisfied in *Decision No 281* 'that there is a field of potential transactions between provincial unions for the rights to player services',[59] though in *Decision No 580* the NZRU successfully argued that there was no market between provincial unions for rights to utilise player services distinct from the market for players' services. In essence, the Commission appears in *Decision No 580* to have viewed player transfers as transactions between players and unions, rather than as transactions between two unions.[60] The Commission also considered it plausible that a separate market might exist for the service of organising rugby competitions but considered it unnecessary to resolve this question for the purposes of the determination.[61]

In *Decision No 580*, the Commerce Commission again found there to be three relevant markets, though these were not identical to those defined in *Decision No 281*. The Commission defined:

- A national market for the provision and acquisition of premier rugby player services;
- A national market for the provision and acquisition of non-premier rugby player services; and
- A national market for the provision and acquisition of sports entertainment services.

While determining that a 'premier rugby player services' market continued to be appropriate, the Commerce Commission identified premier players as 'all players, whether contracted to the NZRU or not, participating in the new NPC [National Provincial Championship] competition, and in all higher levels of competition,'[62] rather than 'banded players' as in *Decision No 281*. Although there was only one independently contracted player in this market at the time *Decision No 580* was under consideration, the Commerce Commission

[57] Ibid [71].
[58] Cf *Adamson v West Perth Football Club (Inc)* (1979) 27 ALR 475; 39 FLR 199; ATPR 40-134; *Adamson v New South Wales Rugby League Ltd* (1991) 27 FCR 535.
[59] *Decision No 281*, [77].
[60] 'A provincial union cannot sell a player to another provincial union. It is the transferring player who initiates the transaction': *Decision No 580*, [482] and see [360]–[367].
[61] Ibid [376]–[378].
[62] Ibid [350] (footnote omitted).

considered there to be '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'[63] and was fortified in this view by the fact that the Collective Employment Agreement permitted independent contracting and by evidence from some industry participants that indicated 'there are a number of 'superstar' players who could conceivably become independent contractors in future.'[64]

This reasoning is undoubtedly right in principle,[65] though the fact that the market was in actuality small in scope entailed a slender basis for the analysis of benefits and detriments that followed. That is, the fact there was one independent contractor player and the possibility of more was sufficient in law to conclude that a 'market' existed in terms of the *Commerce Act*, yet the volume of services actually transacted in that market must be considered quite small. The Commerce Commission was of the view that 'the fact that little or no trade presently occurs in this market [for premier player services] does not obviate the need to analyse the impact of the proposed arrangements on competition in that market.'[66]

A market for 'non-premier rugby player services' comprised the services of rugby union players competing in the new Modified Division One and in A and B level club sides.[67] Definition of this market was necessary for assessment of the competitive effects of the Proposed Arrangements on affected players outside the 'premier' category. Although salary caps applied in respect of premier division players' remuneration, non-premier division players were potentially affected by the transfer period and transfer fee rules.

Definition of markets for the provision and acquisition of premier and non-premier rugby player services required analysis of the effects of the proposed arrangements for the relevant players who would be directly affected by them. The definition of, additionally, a 'sports entertainment services' market required consideration of the possible effects of the proposed arrangements in the broader market in which sports and non-sports entertainments are provided and acquired, including the effects for spectators and television audiences.

In the 'sports entertainment services' market, rugby union was found in *Decision No 281* to compete with other forms of sporting entertainment (for example, rugby league, cricket, netball) and, to a lesser extent, with non-sporting entertainments (for example, theatre, barbeques).[68] A 'sporting entertainment market' had also

[63] Ibid [337].
[64] Ibid [339].
[65] '[A] market can exist if there be the potential for close competition even though none in fact exists': *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Company Ltd* (1989) 167 CLR 177, 196 (Deane J).
[66] *Decision No 580*, [57] (Executive Summary).
[67] Ibid [358].
[68] *Decision No 281*, [79]–[84].

been defined in *Decision No 242*, where the Commerce Commission considered that 'the public has a wide choice of forms of entertainment on which to spend its money', such that speedway racing was in competition 'against other forms of sporting entertainment such as other motor sports, horse racing, rugby, etc.'[69] In *Decision No 580* the Commission again found there to be a relevant market for 'sports entertainment services', in which rugby union competed with other forms of sporting entertainment. The proposed arrangements were unlikely to lessen competition in this market, however, given its breadth.

The effect of the proposed arrangements on competition

Before analysing the detriments and benefits associated with proposed arrangements, the Commerce Commission must first be satisfied that those arrangements would result in a lessening (not necessarily a 'substantial lessening'[70]) in competition in a relevant market. Since rugby players working under contracts of service (that is, as employees) had to be regarded as not providing 'services', the Commission restricted its attention in *Decision No 580* to effects in markets for non-employee players (that is, independent contractors) and their playing services.[71]

The Commerce Commission considered the effect on competition in each of the three markets of the particular features of the Proposed Arrangements likely to affect that market. In relation to the 'sports entertainment' market, the Commission considered sections 29 and 30 to have no application and observed that, having regard to the 'expansive scope' of the market, the Proposed Arrangements would need to have 'a clear negative impact … on the attractiveness of rugby union as a whole'[72] before competition could be regarded as lessened in more than a minimal way. The Commission did not find evidence of a lessening of competition in the broad 'sports entertainment' market. The following paragraphs therefore focus on effects in the premier player services market and non-premier player services market.

Table 1 summarises the Commerce Commission's conclusions in *Decision No 580* as to whether the proposed salary cap, transfer fee and transfer window would have, or would be likely to have, or should be deemed to have the effect of lessening competition in each relevant market.

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[69] *Decision No 242*, [74]

[70] *Commerce Act 1986* (NZ), s 61(6A). See also Commerce Commission, *Streamlined Authorisation Process Guidelines* (May 2009) [2.2], [3.6] <http://www.comcom.govt.nz/assets/Business-Competition/Mergers-and-Acqusitions/Streamlined-AuthorisationProcess-Guidelines-May-2009.pdf>.

[71] *Decision No 580*, [382].

[72] Ibid [533].

Table 1

	Premier player services market	Non-premier player services market	Sports entertainment market
Salary cap	Would have effect/ likely effect of lessening competition (s 27); Would control prices so deemed to lessen (s 30).	No potential effect.	No material effect.
Transfer fee	Would not have effect/ likely effect of lessening competition (s 27); Would control prices so deemed to lessen (s 30).	Would not have effect/ likely effect of lessening competition (s 27); Would control prices so deemed to lessen (s 30).	
Transfer period	Would not have effect/ likely effect of lessening competition (s 27); (s 30 not applicable).	Would not have effect/ likely effect of lessening competition (s 27); (s 30 not applicable).	

In particular, the object of the enquiry into the effects of the proposed arrangements on competition is not to determine effects on the NPC rugby competition but rather the effects of the arrangements 'in terms of their impact on the *competitive process* in the *markets* for player services and sports entertainment'.[73] In accordance with its usual practice,[74] the Commission adopted a counterfactual analysis to assess the impact on competition of the proposed arrangements, in *Decision No 281*[75] and *Decision No 580*, and to assess the effect of the variation applied for in *Decision No 601*. Fixing, controlling or maintaining prices is deemed to lessen competition,[76] so the counterfactual need not be considered in such cases.

Effects of salary caps on competition

The Commerce Commission assessed the effect of the salary cap on competition by comparing the likely future state of competition *with* the proposed arrangements against the likely future state of competition under 'a realistic

[73] Ibid [383] (emphasis in original).
[74] Commerce Commission, *Guidelines to the Analysis of Public Benefits and Detriments* (October 1994, Revised December 1997) 10 <http://www.comcom.govt.nz/assets/Imported-from-old-site/Publications/ArchivedPublications/ContentFiles/Documents/comcom-guidelinestotheanalysisofpublicbenefits.pdf>.
[75] On appeal, the High Court of New Zealand rejected an argument that the Commerce Commission had applied an incorrect counterfactual: *Rugby Union Players' Association Inc v Commerce Commission (No 2)* [1997] 3 NZLR 301.
[76] *Commerce Act 1986* (NZ), s 30.

counterfactual situation which reflects what the Commission considers is likely to happen *without* the practice … taking place'.[77] The relevant comparison is forward-looking, examining the future with the provision in question compared to the future without it.[78]

The NZRU initially proposed a counterfactual involving no salary cap but a continuation of the existing Player Transfer Restrictions. The NZRU acknowledged difficulties with that counterfactual, due to the likely unsustainability in the medium or long term of those relatively restrictive rules. Ultimately, the Commission compared the 34-week player transfer window under the proposed arrangements with a counterfactual involving a player transfer window briefer than 34 weeks but 'significantly wider' than the fortnight allowed under the existing Player Transfer Regulations. The Commission also considered player transfer fees would be payable where negotiated and in circumstances 'maybe to some degree wider' than if the salary cap arrangements were authorised.[79] These conclusions appear to reflect a pragmatic assessment of the likely future arrangements, absent authorisation of the proposed arrangements.

Applying section 27 of the *Commerce Act* to the premier player services market (since the arrangements were designed to constrain the premier division provincial unions), the Commission concluded, first, that the proposed salary cap would lessen competition in this market relative to the counterfactual, since under the arrangement each premier division provincial union's total spending on players' salaries would operate at least *some* of the time to constrain unions' acquisitions of player services, relative to a market with more relaxed player transfer restrictions and no salary cap. Logically, competition in the premier player services market should be lessened, since the aim of the salary cap was 'to constrain the larger-resourced unions' ability to compete for rugby player services.'[80] If the wealthier unions were not constrained in their ability to acquire player services, the cap would apparently be ineffective in its intended role.

Secondly, the Commerce Commission applied section 30 of the *Commerce Act*, concluding that the salary cap arrangement must also be *deemed* to have the purpose, effect or likely effect of substantially lessening competition for the purposes of section 27, because the arrangement involved 'controlling or maintaining' prices. The salary caps would interfere with competitive determination of prices in the player services market where the provincial union who values most highly a particular player's services must decline to acquire

[77] Commerce Commission, *Guidelines*, above n 74, 10 (emphasis added).
[78] 'When considering the effect of the provision, the Commission considers what would or would likely result from the provision if it were to be put into effect. It then compares these effects to what would happen under the counterfactual. In relation to the salary cap, the counterfactual is no salary cap but more relaxed transfer arrangements than the existing transfer regulations': *Decision No 580*, [420].
[79] Ibid [236]–[263].
[80] Ibid [418].

him (or must release him) in order to avoid paying an amount for his salary that would put the union in breach of its cap.[81] Accordingly, the salary cap's imposition of a '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'.[82]

Thirdly, applying section 29 of the *Commerce Act*, the Commerce Commission concluded that the salary cap would result or be likely to result in a lessening of competition, 'by the giving effect to an exclusionary arrangement amongst provincial unions competing for player services.'[83] The Commission considered the salary cap arrangement necessarily involved parties who were competitive with each other (since all provincial unions would be parties to the salary cap arrangements, by virtue of the NZRU Constitution) and had the purpose of restricting acquisition by at least some of the unions of player services.[84] Notwithstanding that the premier division player services market was then small, and the actual impact of the effects in the marketplace correspondingly small, the Commission must be considered right in principle in these conclusions as to effects on competition, and bound to consider these effects, the question having been placed before it by the NZRU's application.

In the entertainment services market, the Commerce Commission considered that the proposed arrangements affecting the premier division competition 'will not likely be sufficient to lessen competition in the wider sports entertainment market'.[85] The Commission noted that any diminution in performance of constrained unions would be counterbalanced by likely improved performance by unconstrained teams, so that 'the entertainment provided by watching NPC and therefore rugby union *as a whole* would not be negatively impacted in the sports entertainment market.'[86]

Effects of transfer fees and transfer period on competition

The NZRU's Player Movement Regulations, containing provisions limiting transfer fees and prescribing a player transfer period, potentially affected competition in the markets for both premier and non-premier player services. While recognising that these provisions 'might be exclusionary', the Commerce Commission did not pursue section 29 analysis in respect of the transfer fee and transfer period: the proposed players transfer period was significantly less restrictive than that applying under the extant Player Transfer Regulations and was regarded as not resulting in a lessening of competition relative to

[81] Ibid [446]–[453].
[82] Ibid [445] (emphasis added).
[83] Ibid [527].
[84] Ibid [525].
[85] Ibid [537].
[86] Ibid [535].

the counterfactual.[87] Nevertheless, the Commission considered that the transfer period (together with transfer fees) required authorisation as part of the proposed Player Movement Regulations which, considered together with the proposed Salary Cap Arrangement would have or be likely to have 'the combined or likely combined effect' of lessening competition and controlling or maintaining prices in the premier player services market.[88]

The Commerce Commission determined that the transfer fee provisions of the Player Movement Regulations would not result or be likely to result in a lessening of competition under section 27 in either the premier or non-premier player services markets,[89] relative to a counterfactual in which the extant Player Transfer Regulations (which were more stringent than those proposed under the factual) would continue to apply.[90] Similarly, the Commerce Commission considered the proposed transfer period would not result or be likely to result in any lessening of competition in terms of section 27 in the markets for either premier or non-premier player services, relative to the counterfactual.[91]

Section 30, however, required that setting maximum transfer fees must be deemed to lessen competition for the purposes of section 27 of the *Commerce Act*. Unlike players' salaries, which are payable by unions to their contracted players, transfer fees are payable by a 'receiving union' to a 'releasing union' when a player transfers to the former from the latter and are intended to compensate the releasing union for costs incurred by it in development of the player concerned.[92] The Player Movement Regulations proposed to cap fees for transfers of players moving up from 'Modified Division One' to the Premier Division at NZD10,000-20,000[93] and set all other transfer fees, including for transfers between provincial unions, at zero. Although transfer fees would in practice, therefore, be payable in respect of relatively few player transfers, the Commerce Commission identified a relationship between transfer fees and the levels of salaries that players would be likely to receive:

> A provincial union is likely to be prepared to pay a certain amount for a player's services, inclusive of any applicable transfer fee. This is supported by the [Rugby Players' Collective] which has submitted

[87] Ibid [495], [514], [521].
[88] Ibid [504], [505].
[89] Ibid [479], [510].
[90] The Commerce Commission was forced to revise its counterfactual between the draft determination and final determination stages, when advised that the extant Player Transfer Regulations would be suspended for one year if the proposed arrangements were not authorised. The change did not affect the result of the Commission's reasoning, since the Commission considered it 'unlikely' that any new Player Movement Regulations that would be negotiated would be as restrictive as the previous Player Transfer Regulations: Ibid [467].
[91] Ibid [495], [515].
[92] Ibid [622].
[93] Ibid 37, Table 4.

> that it sees any transfer fees as par of the amount assigned/budgeted to that player – and an unfair limitation on his pay packet.[94]

Imposing a ceiling on transfer fees was regarded by the Commerce Commission as interfering with the free market levels of transfer fees and, in turn, 'it can be said that an agreement to fix a maximum transfer fee will control the level of salaries paid to transferring players.'[95] The transfer fee arrangements were therefore held to amount to a 'controlling' of prices for player services, which, under section 30, must be deemed to lessen competition for the purposes of section 27, in both the premier and non-premier player services markets.[96] The Commission determined that in the sports entertainment market competition would not be affected to an appreciable degree by either the proposed Player Movement Regulations or the proposed salary cap arrangements.

In summary, the Commerce Commission determined that the transfer fee (but not the transfer period) pursuant to the proposed Player Movement Regulations would lessen competition in terms of section 27 by reason of the deeming provision of section 30; and the proposed salary cap arrangements would have the effect or be likely to have the effect, or should be deemed to have the effect, of lessening competition in the market for premier player services (but not in the market for non-premier player services). It followed that the Commission had jurisdiction to determine the application in respect of both the proposed salary cap arrangements and Player Movement Regulations and was required to assess the benefits and detriments that were likely to result from entering into and giving effect to the arrangements proposed. The Commission sought to quantify those benefits and detriments, to the extent feasible.

IV Commerce Commission's analysis of benefits and detriments

The Commerce Commission's analysis of the benefits and detriments expected to flow from the arrangements proposed by the NZRU provides a valuable insight to the Commission's approach to the identification, quantification and balancing of benefits and detriments in authorisation proceedings generally. Its approach to modelling viewer enjoyment of televised rugby, in particular, is likely to have further application in other sports settings.

The focus of the enquiry into the benefits and detriments that are likely to flow from conduct is on the effects of the conduct on economic efficiency, in the interests of promoting the optimal use of society's resources.[97] It is efficiency

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[94] Ibid [483].
[95] Ibid [487].
[96] Ibid [488], [512].
[97] *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352, 358. See also *Goodman Fielder Wattie Industries Ltd – Wattie Industries Ltd* (1987) 1 NZBLC (Com) 104, 108.

gains or losses in domestic markets to which the Commerce Commission directs its attention:

> 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.[98]

Such net gains or losses under the factual must be considered relative to the state of welfare under the counterfactual. The Commission's focus on net efficiency effects and exclusion of redistributive effects from the balance, are both apparent in *Decision No 580*.

Finally, the Commerce Commission recognised that it is necessary to consider welfare effects over a period of time. Since efficiency gains (and losses) will often take time to accrue, it is important to have regard to the flow of such effects over a period of years but it is also necessary to limit the period over which such gains or losses are counted. In *Decision No 580* the Commission had regard only to benefits and detriments anticipated to accrue within five years following authorisation.[99] While the benefits (and detriments) might not be exhausted within that period,[100] the Commission was of the view that 'forecasting the magnitude of any such benefits [beyond year five] with a reasonable degree of confidence is very difficult.'[101] In fact, it transpired that the proposed arrangements would have an operational lifespan of slightly less than five years.[102] Quantifiable future gains were discounted to their net present value.[103]

Court of Appeal's support for quantitative analysis

The Commerce Commission's *Decision No 580* on the NZRU's application for authorisation is noteworthy for the extent of quantitative analysis undertaken in support of the Commission's assessment of the benefits and detriments likely to flow from the proposed conduct. No quantitative analysis is evident in the 1989 determination which denied authorisation to the Speedway Control Board but, following judicial dicta in the Court of Appeal's 1994 *Telecom Corporation*

[98] *Decision No 580*, [543].
[99] Ibid [546].
[100]
[101] Ibid [547].
[102] Authorisation for the arrangements considered in *Decision No 580* was granted on 2 June 2006 and the authorisation was revoked by *Decision No 721* on 31 March 2011.
[103] The Commission applied a real discount rate of 6.8 per cent per annum, assuming a nominal discount rate of 10 per cent and inflation of 3 per cent per annum: *Decision No 580*, [562].

of New Zealand Limited v Commerce Commission[104] decision, quantitative analysis of benefits and detriments has quickly come to be fundamental to the Commission's approach to authorisation proceedings. Clearly, the Commission's quantitative analysis was considerably more extensive in its 2006 NZRU determination than in its 1996 NZRU determination.

In *Telecom,* Richardson J stressed the vital role of economics in competition law, observing that '[w]hile it would be naive to think that economics furnishes a body of settled conclusions dispositive of any particular factual circumstances, economists can assist the commission and the Courts in identifying, explaining and debating economic theory including rival theories and their applicability in particular circumstances.'[105] In the context of a difference of views as to the magnitude of efficiency gains, Richardson J approved of efforts being made by the Commission to quantify benefits and detriments to the public:

> The third is the desirability of quantifying benefits and detriments where and to the extent that it is feasible to do so. … [T]here is in my view a responsibility on a regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.[106]

Following the *Telecom* decision, the Commerce Commission has in practice sought to quantify benefits and detriments where and to the extent that it is feasible. The Commission often utilises modeling methods to quantify the effects of conduct. The Commission explained its views on the use of economic modelling in its decision on Qantas's proposal to acquire 22.5 per cent of the voting equity in Air New Zealand:

> With respect to the use of models, the Commission considers that these are useful to the degree that they focus the parties' attentions on key assumptions regarding characteristics of the market. The Commission's view is that the value of a model is in its ability not to produce 'proof' of a substantial lessening of competition, nor to supplant the Commission's exercise of judgement, but rather in providing support to the Commission's deliberations by:
>
> - focusing parties' attentions on verifiable economic arguments;
> - making transparent the values of the key parameters and assumptions in the analysis; and

[104] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429.
[105] Ibid 441.
[106] Ibid 447. See also *Ravensdown Corporation Ltd v Commerce Commission* (High Court, Wellington AP 168–96, 16 December 1996, Panckhurst J and Professor R G Lattimore) 47.

- producing quantitative estimates of the results of a given transaction or arrangement.[107]

The uses of economic modelling in *Decision No 580* served to focus the parties' attention on verifiable economic arguments and to make transparent the values of key analytic parameters and assumptions. These merits strongly commend the use of modelling, notwithstanding that the quantitative estimates of the results of the proposed arrangements in *Decision No 580* did not indicate an overwhelming preponderance of benefit over detriment or vice versa.

Assessment of detriments

The Commerce Commission identified five kinds of detriments as potentially arising from the proposed arrangements: allocative inefficiency; productive inefficiency; loss of player talent; reduction in player skill levels; and innovative inefficiency. Of these, the Commission was able to reach quantitative estimates of the first three and formed the view that the extent of detriment under the last two heads would be 'small,' relative to the magnitude of the quantified detriments.

Allocative inefficiency was identified as resulting from 'a "misallocation" of players between unions compared to the unrestrained "free market" allocation.'[108] Such 'misallocation' would result where a player moved to (or remained with) a union which is unconstrained by the salary cap but which values him less than a different union which, though it values him more highly, is constrained by the cap from paying his free market salary. In estimating the quantum of the loss caused by allocative inefficiency, the Commerce Commission recognised limitations in the data available to it and protected the confidentiality of many of the quantities.[109] A 'necessarily very rough' estimate was made of allocative inefficiency losses as totalling NZD133,000 over five years, at present value.[110]

Productive inefficiencies were identified by the Commerce Commission as arising from the incentives of constrained unions to cheat on the salary cap regime and to seek loopholes and exceptions from it.[111] Costs of the following kinds were treated as productive inefficiencies: initial set-up costs; NZRU annual operating costs (including a premium for the first year of operation); breach investigation and enforcement costs, to both NZRU and unions; and annual compliance costs. Cost estimates were based on estimates of resource requirements and costs associated with the Australian NRL's comparable salary cap regime.[112] The Commission estimated that productive inefficiency costs

[107] Commerce Commission, *Decision No 511* (23 October 2003), [909].
[108] *Decision No 580*, [565].
[109] Ibid [569]–[572].
[110] Ibid [574].
[111] Ibid [576].
[112] Ibid [104], [137], [183], [577], [585].

could total between NZD2.1 million and NZD2.458 million over five years, at present value.[113]

The extent to which the proposed arrangements would result in a decline in average player salaries and loss of player talent overseas was 'difficult to foresee,' particularly as many significant changes were occurring contemporaneously in the domestic competition.[114] To derive an estimate of the detriment caused by loss of talent, the Commerce Commission used high and low projections of players lost (for example, three or six players in year 1, six or twelve players in year 2, et cetera)[115] and took their domestic salaries as the measure of the productivity lost to New Zealand during those players' absence overseas.[116] Departing players were assumed to remain away for the whole of the five year period under assessment.[117] These calculations resulted in estimates of detriment due to loss of player talent of NZD948 000 at the lower bound to NZD1 895 000 at the upper bound, discounted to present values.

Two further categories of possible detriment were identified by the Commerce Commission but found not to be susceptible to quantification. First, the Commission considered arguments as to whether the proposed arrangements could adversely affect players' morale, training and skill levels. The Commission found a 'consensus of views' that the proposed arrangements would include 'some restriction on player movements' but the admission to Premier Division of four new teams would increase the opportunity for players to participate at the highest NPC level.[118] The Commission's conclusion, after canvassing a range of 'countervailing views and arguments'[119] was that the effect 'if it exists, is likely to be small.'[120] Secondly, the Commission considered whether innovative efficiency might be lost due to diversion of unions' energies from enhancing their teams' competitiveness to circumventing the salary cap or lobbying for its change. The detriment due to this loss of innovative efficiency was held to be 'small'.[121]

In aggregate, detriments associated with the proposed arrangements were quantified as being in the range of NZD3.2 million to NZD4.5 million, plus the unquantified but 'small' detriments in relation to possible decline in players' skills and possible loss of innovative efficiency. While this level of detriment seems slight relative to the likely value of the rugby 'industry' overall and

[113] Ibid [593].
[114] Ibid [608].
[115] Ibid [609] and Table 9.
[116] Ibid [612].
[117] Ibid [610].
[118] Ibid [623]. The Commerce Commission noted that the expansion of NPC opportunities would occur under both the factual and counterfactual, so could not be counted as a benefit of the proposed arrangements: Ibid.
[119] Ibid [624].
[120] Ibid [627].
[121] Ibid [632].

while significant informational constraints surround the quantifications of detriments (as the Commission itself acknowledged), undertaking the exercise of quantifying estimates of losses to the domestic economy appears to have served well the purposes referred to by the Commission of focusing attention on verifiable claims and making transparent key parameters and assumptions. The efforts made to estimate the costs caused by 'misallocation' of players; set-up, administration and compliance with the proposed regime; and loss of player talent, for example, appear to have focused stakeholders' attention closely on the likelihood of such effects, possible countervailing effects, relevant causalities, and outcomes under the counterfactual conditions. In this way the quantification exercise appears to have disciplined the analysis and prompted a deeper exploration of the effects of the proposals than would have been likely if only qualitative claims had been considered.

Claimed benefits and their nexus to the proposed arrangements

The NZRU claimed a variety of benefits would flow from the proposed arrangements, which were categorised either as direct (if arising within New Zealand) or 'indirect' (if international in origin). The Commerce Commission faced two challenges at this stage of its determination: first, to identify a 'nexus' between the arrangements the NZRU proposed and the benefits it claimed would flow from those arrangements; and secondly, to quantify those benefits, so far as possible.

The claimed direct benefits were summarised as 'a more attractive domestic provincial competition for spectators and television viewers' and 'enhanced domestic sponsorship and broadcasting interest and funding'.[122] To explain how redistribution of players could be expected to result in net benefits of these kinds, the NZRU largely relied, in its application and in later submissions, on the UOH. Proponents of the UOH argue that spectators and television viewers generally wish to see their team win close encounters against rival teams, where both teams are evenly matched, or nearly so, and the outcome of the encounters is uncertain.[123] According to this hypothesis, spectators and viewers will lose interest when the encounters are less balanced and hence less uncertain of outcome. Increasing unevenness among premier division provincial union teams and declining game outcome uncertainty were identified by the NZRU as motivating it to introduce the proposed salary cap and relaxing the player transfer restrictions.

[122] Ibid [709].

[123] Above n 17, 240–4. See also, Walter C Neale, 'The Peculiar Economics of Professional Sports: A Contribution to the Theory of the Firm in Sporting Competition and in Market Competition' (1964) 78 *Quarterly Journal of Economics* 1; Mohamed El-Hodiri and James Quirk, 'An Economic Model of a Professional Sports League' (1971) 79 *Journal of Political Economy* 1302; Rodney Fort and James Quirk, 'Cross-subsidization, Incentives, and Outcomes in Professional Team Sports Leagues' (1995) 33 *Journal of Economic Literature* 1265.

The Commerce Commission found significant controversy within relevant economic literature regarding the degree to which UOH holds true in relation to overseas sporting codes and found little economic evidence in support of UOH in relation to rugby in New Zealand.[124] The Commission responded in three ways. First, at the Draft Determination stage, the Commission proposed to view 'conservatively' benefits claimed to arise as a result of increased uncertainty of outcome. Secondly, the Commission had regard to two econometric studies which were, so far as the Commission was aware, 'the only pieces of empirical work to date that test the UOH in relation to rugby union in New Zealand',[125] though it received and considered critiques of that work by the NZRU's expert advisors.[126] Thirdly, the Commission undertook its own modelling work, leading it to place very little weight on benefits claimed to result from uncertainty of outcome but more weight on 'quality of contest' (measured by the number of star players in a game) as a source of public benefits.

In conducting its own empirical work, the Commerce Commission sought to understand better the drivers of spectator attendance at matches and television viewership, respectively. The Commission first used a panel data model to examine attendance at NPC matches as a function of various factors including uncertainty of a union's performance in a season and a union's previous success or lack of success in reaching semi-finals.[127] The Commission considered critiques of this work, but determined to place 'some weight' on its finding that 'there was no evidence in the data to suggest that a more balanced competition (over successive seasons) would lead to stronger crowd attendance'.[128]

The Commerce Commission's second empirical study, which was ultimately of key importance to its decision to grant authorisation, responded to the lack of empirical investigation of the impact of competitive balance on audience size. For that study:

> The Commission's approach involved econometrically estimating a demand equation for televised 1st Division NPC matches, which was specified as a function of outcome uncertainty and contest quality, as well as a number of other control variables. The estimated model

[124] *Decision No 580*, [661].
[125] *Decision No 580*, [661], referring to P Dorian Owen and Clayton R Weatherston, 'Uncertainty of Outcome and Super 12 Rugby Union Attendance: Application of a General-to-Specific Modeling Strategy' (2004) 5 *Journal of Sports Economics* 347; P Dorian Owen and Clayton R Weatherston, 'Uncertainty of Outcome, Player Quality and Attendance at National Provincial Championship Rugby Union Matches: An Evaluation in Light of the Competitions Review' (2004) 23 *Economic Papers: A Journal of Applied Economics and Policy* 301.
[126] *Decision No 580*, [650] referring to critiques provided to the Commission in submissions made by Professor Fort, Mr Copeland and Dr Adolph Stroombergen.
[127] *Decision No 580*, [665], Appendix 3, Appendix 4.
[128] Ibid [666].

> was a random effects panel model using data on four NPC seasons (2001 to 2004), each containing 45 round-robin matches.[129]

Match-specific television ratings data provided by the applicant served as a proxy for television demand for NPC rugby. A key finding of this work was that 'none of the uncertainty of outcome variables specified were statistically significant in explaining the variation in television demand between NPC matches over the four seasons studied.'[130] Rather than being driven by uncertainty of outcome, viewer demand was positively affected by household income, prime-time scheduling, 'spectacle' matches and match quality – particularly, the number of Super-12 'star players' involved in a match.[131] Results of regression analyses[132] suggesting that an increase in the number of Super players involved in a match would increase viewer ratings became significant to the Commission's analysis.[133]

Redistribution of players under the influence of the proposed arrangements might not make rugby union more attractive to television viewers by reducing the predictability of match outcomes (since uncertainty of outcome appeared *not* to drive higher viewership ratings) but seemingly could increase the game's attractiveness where it resulted in a broader distribution of the most talented players. Addressing the requirement that to constitute 'benefits' changes must result in net economic gains, not merely redistributions, the Commission envisaged scale economies resulting from redistribution of the most talented players to weaker unions:

> The transfer of a Super player from a strong contest to a weak contest results in an increase in the combined television audience, because the loss of audience in the first is more than offset by the increase in the second. Hence, player redistribution policies, such as a salary cap scheme, may increase viewer demand not because of a more even competition, as proponents of the UOH would claim, but rather because of an increase in the average quality of games.[134]

Thus, the Commerce Commission did not place weight on the UOH as a nexus between the proposed arrangements and claimed public benefits but considered instead that enhanced game quality (in terms of star player participation) provided a nexus to support the conclusion that benefits could result from the proposals. In this respect the Commission's investigations supported the NZRU's

[129] Ibid [671]. For further detail, see Commerce Commission, 'What Drives Television Demand for NPC Rugby Matches'(15 May 2006), <http://www.comcom.govt.nz/new-zealand-rugby-union-2007>.
[130] *Decision No 580*, [674].
[131] Ibid [674].
[132] Ibid Appendix 5.
[133] Ibid [675].
[134] Ibid [675].

claim and were consistent with testimony by the NZRU's expert advisors and with other empirical studies.[135]

In relation to NZRU's claim that public benefit would result from provincial unions being able to achieve a stronger financial performance, as a result of a more attractive domestic competition, the Commerce Commission was wary that such results 'may not necessarily represent net public gains' but might rather involve redistribution, at the expense of another group. It nevertheless recognised that some resources could flow to enhancing the attractiveness of the domestic competition.

The NZRU also claimed the following 'indirect benefits' (that is, public benefits generated overseas), would result from the proposed arrangements:

- 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.[136]

The NZRU did not endeavour to quantify these claimed indirect benefits and the Commerce Commission formed the view that 'these effects are likely to be weak', because they would arise only 'indirectly' and would be subject to offsetting factors.[137]

Quantification of direct and indirect benefits

Having concluded that there was a basis (in its 'match quality hypothesis') to believe the proposed arrangements would lead to public benefits, the Commerce Commission next sought to quantify those benefits, in accordance with Richardson J's injunction to do so 'where and to the extent that it is feasible'.[138]

In *Decision No 281* the Commerce Commission had developed a simple demand model of demand for rugby union and other sports entertainments.

[135] Ibid [691].
[136] Ibid [710].
[137] Ibid [707].
[138] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429, 447.

For the purposes of *Decision No 580*, the NZRU's expert recalibrated the model with more recent data, to estimate net public benefits from the proposed arrangements in the range NZD105 000–NZD420 000 annually.[139] The Commission supplemented the model using simple econometric techniques, to derive estimates of public benefits over a range of possible changes in rugby demand.[140] On this basis the Commission estimated net public benefits over five years in the range NZD0 – NZD1.1 million (in net present value terms).[141] The Commission recognised that increasing the attractiveness of rugby for spectators and viewers would count as a public 'benefit' but that the intangible nature of this benefit made it 'difficult to quantify'.[142]

The second category of claimed 'direct' benefits was increased enjoyment of rugby by television viewers of the game. Again, the Commerce Commission adapted its demand model from *Decision No 281* to model the benefits flowing to television viewers from the more even distribution of star players across teams. The Commission identified the range of possible increase in viewer demand for rugby as 0 per cent (if contest quality did not improve) to 18 per cent,[143] then calculated the change in consumers' surplus (surplus gained by increased demand for NPC rugby less surplus lost by decreased demand for other sports entertainments).[144] After scaling for the time profile and discounting to net present value, net public benefit in the range of NZD0–NZD10.8 million was identified.[145]

The third category of claimed 'direct' benefits was increased broadcasting and sponsorship revenue to the NZRU and provincial unions. As in *Decision No 281*, the Commerce Commission noted that NZRU's revenues earned from selling broadcast rights to an overseas distributor could be counted as benefits but the expenditure by New Zealand broadcaster SKY to acquire the New Zealand rights must be netted off against those revenues. As a five-year broadcasting rights contract had been signed in December 2004, no increase in broadcasting revenues could be expected before 2010, the final year within the time-horizon of the analysis. In relation to growth in NZRU and provincial union revenues due to increased sponsorship, signage and advertising, and merchandising and royalties, the Commission applied a build-up profile (5 per cent in year one, 10 per cent in year two, et cetera) and assumed 10 per cent of the expected annual increase would represent net gain to the public, as opposed to transfers of wealth.[146] A net public benefit in the range NZD0–NZD360,000 was attributed

[139] *Decision No 580*, [716].
[140] Ibid [717]–[725].
[141] Ibid [725], 188, Table 11.
[142] Ibid [714], [715].
[143] Ibid [752]–[755].
[144] Ibid [756].
[145] Ibid [759], Table 12.
[146] Ibid [791]–[793].

by the Commission to increased NZRU and provincial union funding as a result of the proposed arrangements.[147]

Finally, the 'indirect' benefits claimed by the NZRU as being generated overseas by the proposed arrangements were each determined by the Commerce Commission to be weakly linked to the proposed arrangements and, in total, of 'small' public benefit. It remained, as the final stage of its analysis, for the Commission to weigh the benefits and detriments estimated to result from implementation of the proposed arrangements.

Balancing benefits against detriments

Having quantified the benefits and detriments where feasible, the Commission had regard also to a qualitative assessment of those benefits and detriments that were found not susceptible to quantification, summarising both categories in table form.[148]

Table 2

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

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

Finally, the Commerce Commission was required to weigh the benefits and detriments associated with implementing the proposed arrangements, compared with the counterfactual. The Commission noted: '[t]he potential range of benefits and detriments encompasses the possibility that the Proposed Arrangements either have net benefits or net detriments'[149] and, that being the case, the decision to grant or decline authorisation required the 'exercise of finely balanced judgment'.[150] Taking into account all of the evidence and analysis before it, the Commission determined it should take the midpoint of the range as 'a reasonable estimate of the likely net public benefit' from the proposed arrangements, which

[147] Ibid [795].
[148] Ibid 208, Table 15.
[149] Ibid [137].
[150] Ibid. In *Rugby Union Players' Association Inc v Commerce Commission (No 2)* [1997] 3 NZLR 301 the appellant Association argued that in *Decision No 281* the Commission had not properly weighed the benefits and detriments. The High Court dismissed the appeal, finding that there was a sufficient evidential basis and 'it was open to the commission to conclude, as it did, that the benefits 'comfortably' outweighed the detriments': Ibid 326.

indicated a likely net benefit to the public of NZD2 million over five years, in present value terms.[151] Accordingly, the Commission granted the authorisation sought by the NZRU, attaching to it a set of conditions designed to ensure the benefits should in fact be realised. These conditions included measures intended to ensure the firmness of the salary cap, requiring monitoring and audit of salary cap compliance, and requiring the NZRU to fund an independent review of the operation of the authorised arrangements.[152]

V Conclusions

The Commerce Commission's decisions between 1996 and 2010 concerning the NZRU's salary cap and player transfer restrictions contain a number of lessons for sports organising bodies specifically, as well as for applicants for conduct authorisation more generally. First, in seeking to promote league balance or other objectives, sports organising bodies should be particularly wary of measures that affect players' remuneration.[153] Section 30 of the *Commerce Act* deems the fixing, controlling or maintaining of prices to have an anti-competitive effect.[154] Alternative measures addressing other variables that influence the distribution of players may still be subject to competition law scrutiny but provided they do not fix, control or maintain prices they will not normally be proscribed unless some anti-competitive purpose or effect, or misuse of market power, can be proved.

Secondly, a claim by a sports organising body that its conduct in relation to players is not subject to the *Commerce Act* is more likely to succeed where it can be supported by evidence that the arrangements fall within a specific statutory exemption (for example, because the players concerned are employees), than where the claim rests on the proposition that sports are not commercial in character. It is trite today that sports are 'big business'.[155] Commercial interests and incentives are extending their reach, e.g. into the broadcasting of schoolboy rugby. It seems most unlikely that competition agencies will find appeals to the supposedly distinctive character of sports activities persuasive in the future.

Thirdly, the trend of the Commerce Commission's decisions since the mid-1990s very clearly evinces an increasing emphasis on hard data and quantitative methods. This development has important implications for applicants for conduct

[151] Ibid.
[152] Ibid [852].
[153] Ibid [498]–[501] = 'minimum squad spend', for which NZRU did not seek authorisation.
[154] Cf *Competition and Consumer Act 2010* (Cth), s 44ZZRD. See also discussion in Brent Fisse and Caron Beaton-Wells, *Australian Cartel Regulation: Law, Policy and Practice in an International Context* (Cambridge University Press, 2011) 89–94.
[155] See, eg, AT Kearney: 'Today's global sports industry is worth between €350 billion and €450 billion ($480–$620 billion), according to a recent A T Kearney study of sports teams, leagues and federations. This includes infrastructure construction, sporting goods, licensed products and live sports events': Patrice Zygband and Hervé Collignon, *The Sports Market* (May 2011) AT Kearney <http://www.atkearney.com/index.php/Publications/the-sports-market.html>.

authorisations and for other parties to such proceedings. Since the Court of Appeal in *Telecom* endorsed the use of quantitative methods,[156] the Commission has quickly embraced such methods and carried out analyses of increasing sophistication.[157] Although the range of estimated benefits and detriments that were found by the Commission in *Decision No 580* 'encompasses the possibility … [of] net benefits or net detriments',[158] the process of quantifying those benefits and detriments appears to have substantially succeeded in focusing attention on verifiable economic arguments and making transparent the values of key parameters and assumptions in the analysis.[159]

Fourthly, there inevitably are limits to the extent to which the benefits and detriments associated with conduct can be quantified. Organised sports must be recognised as generating benefits which are not readily susceptible to quantification. As the Commerce Commission stated, gains or losses 'of an intangible nature, which are not readily measured in monetary terms, must also be assessed'.[160] It is essential that the Commission should continue to be vigilant against quantitative analysis assuming an unduly influential role and guard against any unconscious bias toward under-weighting unquantified benefits and detriments.

Finally, *Decision No 580* is important in demonstrating the depth of analysis the Commerce Commission will undertake in seeking 'so far as possible to quantify detriments and benefits'.[161] In particular, the Commission's development of the 'match quality' hypothesis might well prove to be a significant contribution. Further study and testing of the hypothesis in other sporting codes and jurisdictions appears warranted. As an alternative (to the 'uncertainty of outcome' hypothesis) in explaining the effect of player distribution in the attractiveness of games to spectators and audiences, the 'match quality' hypothesis might assist other sports organising bodies both to design beneficial player transfer rules and to explain their merits.

[156] Above n 104, and accompanying text.
[157] See, eg, Commerce Commission, *Decision No 511* (23 October 2003).
[158] *Decision No 580*, [137].
[159] Above n 107, and accompanying text.
[160] *Decision No 580*, [545].
[161] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429, 447.