Sports Economics

Professor Simon Bowmaker
Lecture 7: Economic Organization of Sports Leagues
Roadmap

- Sports league organization
- The American Needle v NFL case
  - Background
  - The Single Entity Argument
  - Likely outcome
Sports League Organization

- Teams in sport must make at least five decisions about league structure:
  - Format
  - Hierarchy
  - Multiplicity
  - Membership
  - Governance
American Needle v. NFL: Background

- Is the NFL as we know it about to come to an end?
- The United States Supreme Court case called American Needle, Inc. v. National Football League, et al., Docket No. 08-661
American Needle v. NFL: Background

In 2000, NFL authorized NFL Properties to solicit bids from companies who wished to obtain an exclusive headwear license.

Reebok won the bid and won a 10-year exclusive license to make hats and other headwear featuring NFL team logos.

Because of this exclusive license, NFLP refused to renew American Needle’s (and all other headwear vendors’) licenses.
American Needle v. NFL: Background

- American Needle filed a lawsuit against the NFL, NFLP, the 32 NFL teams separately, and Reebok, claiming that such an exclusive license violated Section 1 of the Sherman Antitrust Act
- Section 1 prohibits any “contract, combination...or conspiracy, in restraint of trade.”
- NFL and other respondents argued that the NFL was immune from antitrust liability because it is a “single entity.”
American Needle v. NFL: Background

- In short, single entity argument states that the NFL and its teams are really just one business for the purposes of the Sherman Antitrust Act.
- This is important as Section 1 explicitly requires an agreement between entities and a single entity could not reach an agreement with itself.
- U.S. District Court for Northern District of Illinois ruled that “the NFL teams act as a single entity in licensing their intellectual property” and were therefore immune from an antitrust lawsuit under Section 1.
American Needle v. NFL: Background

- The Court of Appeal for the Seventh Circuit explicitly accepted the single entity rationale.
- American Needle petitioned the U.S. Supreme Court, asking them to grant *certiorari* and hear the case.
- NFL and the other respondents took highly unusual step of filing a brief with the Supreme Court urging them to hear the case.
- Respondents’ position is that Court should rule, once and for all, whether the NFL is a single entity for purposes of Section 1.
- Court agreed to hear case and oral arguments began on January 13, 2010.
American Needle v. NFL: Single Entity Argument

• The NFL Respondents characterize the issues before the Court as follows:
  • “Whether, under the standards articulated in Copperweld, a professional sports league and its separately owned member clubs, which collectively produce an entertainment product that no member club could produce on its own, constitute – or at least can function as – a single entity for Section I purposes.”
American Needle v. NFL: Single Entity Argument

- NFL Respondents seek a determination that they should be regarded as a single entity with respect to their “core venture functions” of the NFL.

- Core functions include:
  - “where to locate its clubs..., rules governing ownership qualification..., how to present its integrated entertainment product to viewers on a national basis, rules concerning the equipment that may be used by players in games, and terms and conditions of player employment, as well as the trademark licensing activities that are the subject of this lawsuit”.
American Needle v. NFL: Single Entity Argument

- So, Respondents seek a blanket exemption from antitrust liability for acting collaboratively in all important markets for both inputs (including players, stadia, and game equipment) and outputs (including product licensing, local marketing of games, and broadcasts and other reproductions of games that may not be covered by the *Sports Broadcasting Act*)

- Respondents seek a ruling that would reverse numerous antitrust decisions in which the NFL and its member teams were found to have violated antitrust laws
American Needle v. NFL: Single Entity Argument

- Petitioner American Needle characterizes the issues to be decided as:
  - “Are the NFL and its member teams a single entity that is exempt from rule of reason analysis under Section I of the Sherman Act simply because they cooperate in the joint production of NFL football games, without regard to their competing economic interests, their ability to control their own economic decisions, or their ability to compete with each other and the league?”
American Needle v. NFL: Single Entity Argument

• What can economists contribute to debate?
  • Research by sports economists bears directly on arguments and assertions by Respondents
  • “professional sports leagues...produce a product that no member club could produce on its own”.
  • “The NFL produces an entertainment product known as ‘NFL Football’, an annual, highly integrated series of professional football games”

• So one question, for example, is whether there are efficiency benefits derived from a league’s functions such as creating a schedule of matches or standardizing rules of conduct
American Needle v. NFL: Single Entity Argument

- Economists argue that a group of competitors (whether football teams or tennis players) can add value if they collaborate to adopt standards of play.
- Standardization function of NFL adds to value of products of 32 member clubs in same way that other standards organizations add to value of products that make use of them.
- But it would seem foolish to expose NFL team members to antitrust liability for meeting to develop playing rules or to select the date and location of the Super Bowl.
American Needle v. NFL: Single Entity Argument

- Delegation of all scheduling to a league can be inefficient.
- Centralized control of all scheduling by a single league eliminates the possibility for creating other events that consumers value.
American Needle v. NFL: Single Entity Argument

- England provides a useful comparison because popularity and financial success of top English soccer teams and top NFL teams are similar
- Teams in the English Premier League (EPL) play each other twice to determine a league champion
  - Also enter the Football League Cup and Football Association Cup
  - Top four EPL teams qualify for the European Champions League in the following season and fifth, sixth, and seventh best EPL teams normally qualify for the Europa League competition
    - Both competitions organized by Union of European Football Associations (UEFA), the governing body for soccer in Europe
American Needle v. NFL: Single Entity Argument

- NASCAR is an example of how a league can be separated from teams
  - Commercial entity that establishes standards for stock car racing and stages a championship series of races
  - Teams that compete are separate entities, and compete with each other for prize money in races, corporate sponsorships, drivers, race cars, and pit crews
  - NASCAR competes with other entities that organize races for teams, fans and TV rights
- Examples suggest that NFL teams do not have only two options: not to play at all or to play in NFL
American Needle v. NFL: Single Entity Argument

- But even if NFL as currently structured is an efficient way to organize pro football, that’s not the issue....
- Issue is whether efficient standardization by a league requires centralization of all core business activities
- Success of other leagues that are much less centralized than NFL (and much less centralized than NFL proposes that it should be allowed to become) demonstrates that centralization of all core business activities is not essential for a successful league
American Needle v. NFL: Single Entity Argument

- Sources of value for NFL teams
  - Respondents claim all of economic value of major league pro football is due solely to the existence of NFL – a false claim?
  - Popularity of football creates a core demand that would be instantly satisfied if the NFL joint venture were to disband, leaving 32 solitary teams without a league
American Needle v. NFL: Single Entity Argument

- Value of pro sports team derived from demand for games and demand for games determined primarily by identities and qualities of team, not the fact that the game is associated with the NFL brand name.
- Studies show that variation in attendance is explained primarily by characteristics of the city and stadium in which game is played and quality of teams.
- Variation in TV ratings explained primarily by quality of teams.
  - Cities differ in degree to which team revenues depend on team quality, and these differences help explain team relocation decisions.
American Needle v. NFL: Single Entity Argument

- Teams would have several options available if they left the NFL:
  - Schedule games through a series of bilateral negotiations
  - Create a few new, smaller leagues
  - Contract with an entrepreneur who sees a business opportunity in the absence of a tournament that leads to Super Bowl
  - 32 teams could apply to join the new United Football League
- Those alternatives are neither implausible nor valueless
  - Remember also that 12 of the 32 teams operated in other leagues before joining the NFL
American Needle v. NFL: Single Entity Argument

- Respondents claim that the NFL is a single entity in product licensing
- Essence of efficiency claim is that collective product licensing by NFL Properties has extensive economies of scale that make licensing a natural monopoly
  - Refer to the quality of the marks and logos, implying that NFL Properties is necessary for assuring high quality
  - By how can competition be bad for product design?
    - Inconsistent with economics research on the role of competition in fostering innovation
- In any case, there is no necessary connection between setting standards for the design of marks and logos, and reviewing them before they are used and licensed, and the subsequent activity of licensing them
American Needle v. NFL: Single Entity Argument

- Respondents claim that natural monopoly argument is valid for other core business activities.
- Economies of scale argument for pooled product licensing is not transferable to other business activities.
- E.g. the role of the NFL as a standards organization is separable from core business activities of the teams.
American Needle v. NFL: Single Entity Argument

- There appears to be no basis in economics for deciding that the NFL should be regarded as a single entity for any business activity of member teams that it decides to centralize.
- Single entity concept is useful when applied to the divisions of a corporation because corporations are not joint ventures of independent firms that are or can be horizontal competitors.
- Flynn and Gilbert (2001) concluded that sports leagues can be analyzed as single entities when “there is no relevant competition among the member teams in the absence of the league.”
American Needle v. NFL: Single Entity Argument

- Most useful way to view sports leagues is as a joint venture among entities that in some respects are horizontal competitors, but in other respects are not.
- In areas where they are not competitors, treatment as a single entity is not harmful because their collaboration has no anticompetitive effect.
- In other cases, a rule-of-reason analysis allows comprehensive balancing of the anticompetitive effects and the efficiency benefits of collaboration.
  - In these circumstances, the designation of a league as a single entity should occur only after complete consideration of the relevant evidence.
American Needle v. NFL: Likely Outcome

- A litany of legal heavyweights and virtually every sports entity in the U.S. has lined up on the side of the NFL
- Believed that four justices (Roberts, Alito, Scalia and Thomas) will likely embrace the NFL’s position and the NFL needs only one other justice to join them...
- So NFL likely to come out on the winning end of the underlying ‘cap’ controversy
- But how broadly will the Supreme Court’s decision go toward validating the single-entity theory, or will it be narrowly tailored to the area of licensing and properties?
American Needle v. NFL: Likely Outcome

- If NFL gets (broader) single-entity status that it seeks, league could do anything it wanted on its own, provided that action did not run afoul of other laws
  - One specific concern is whether there would be a significant shift in the leverage of NFL over player union
- Yes, there are caveats to the idea of it “doing want it wants”, but a broad decision in favor of the NFL would alter the NFL product to some unknown extent
- If so, there are possible repercussions for other major sports leagues too
Required Reading
