

Antitrust Insights


 Fall 2009

From the Editor

In January 2010, the Supreme Court will hear arguments in *American Needle*. On the surface, the case is about the way sports leagues may be organized and managed, but there is much more at stake. At issue is the antitrust treatment of joint ventures and other collaborations among competitors. The central legal question is whether the NFL and its member teams operate as a “single entity.” If they do—as claimed by the NFL—the League’s conduct may be beyond the reach of Section 1 of the Sherman Act. This is clearly a matter of law and how it is applied, but do economists have something to say about this, too?

In this issue of *Antitrust Insights*, Greg Leonard and Steve Schwartz discuss the economic implications of *American Needle* and their views on how economic analysis can help us evaluate the competitive effects of a legitimate joint venture that has multiple core functions and activities. Both Greg and Steve agree that an economic approach would focus on an “output test,” which would provide a way of assessing the competitive impact of the venture. The analysis would require an inquiry into the restrictions that may affect the ways in which the joint-venture partners compete and, potentially, a weighing of the benefits of the venture in one area against the detrimental effects of the venture in another area.

Greg Leonard is a Senior Vice President in NERA’s San Francisco office. His areas of expertise are applied microeconomics and econometrics. He consulted for the plaintiffs in *Chicago Professional Sports Limited Partnership and WGN v. National Basketball Association* and for the defendants in *Kentucky Speedway LLC v. NASCAR, et al.* Greg’s publications include an article on the value of superstars to sports leagues.

Steve Schwartz is a Senior Vice President in NERA’s White Plains office. He has directed and performed numerous economic analyses in connection with merger reviews, private antitrust litigation, and complex commercial litigation. This includes consulting for a professional sports team in a dispute with its League over restrictions related to the team’s media operations and licensing.

I hope you enjoy this issue.

—Lawrence Wu, Editor

The Economic Implications of *American Needle* on Joint Ventures and Other Collaborations

A roundtable discussion with Gregory Leonard and Steven Schwartz

Lawrence Wu: *Twombly* and *Leegin* are widely viewed as Supreme Court decisions that have significant implications for not only the legal analysis, but also the economic analyses that are likely to be required.¹ Is *American Needle* a case that also will go down in history as having important economic implications?²

Steven Schwartz: It could well be such a case. Much depends on how the Court chooses to decide it. If it decides, for example, to rule narrowly and limit its decision to the specific facts of the case, then the impact may be relatively insignificant. However, both sides to this dispute are begging the Supreme Court to make a broad ruling. The National Football League (NFL) is asking for a blanket ruling that actions by a sports league—which it characterizes as a joint venture—should be *per se* legal, as a practical matter, under Section 1. In the same spirit, *American Needle* seems to want a blanket ruling that *everything* that a sports league does is subject to review under Section 1. If the Court agrees with the NFL and rules broadly, the implications will be far-reaching.

Wu: What are the implications?



If the Supreme Court rules that the NFL is a single entity with respect to its marketing of trademarked goods (which is clearly not necessary for the NFL to exist), then the decision would open the door to joint ventures doing just about whatever they wanted.

Schwartz: Suppose the Court decides that sports leagues are joint ventures and that they are immune from Section 1 scrutiny based on the reasoning in *Copperweld*.³ Other sports leagues and joint venturers may use the ruling to argue that immunity applies to *all* of their activities. In this way, the ruling could potentially redraw the boundaries of Section 1 in a meaningful way. It is worth noting that among the *amici* in the case supporting the NFL's position are sports leagues such as the National Basketball Association and the National Hockey League. I think they clearly recognize the opportunity that a sweeping win for the NFL presents for them.

Gregory Leonard: That's right. If the Supreme Court rules that the NFL is a single entity with respect to its marketing of trademarked goods (which is clearly not necessary for the NFL to exist), then the decision would open the door to joint ventures doing just about whatever they wanted. If that happened, it could have substantial implications for the way that the Department of Justice (DOJ) and the Federal Trade Commission (FTC) analyze joint ventures and other collaborations between competitors.

Wu: What would be the implications if the DOJ and FTC were to analyze all joint ventures in the way you just described?

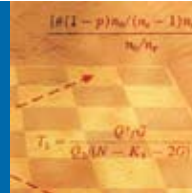
Leonard: Right now, the agencies can require a joint venture to be structured to avoid anticompetitive aspects that are not necessary for the formation of the venture. This could change if the Supreme Court rules broadly in favor of the NFL in a way that makes the decision applicable to other joint ventures. For example, if there is a pro-NFL ruling by the Supreme Court that is not restricted to sports leagues, we may have to wrestle with a host of new questions. Could potential joint venture partners argue that the agencies cannot require any changes in the structure of the venture because it is a single entity? Will the agencies therefore be required to analyze the joint venture as a yes/no choice, that is, either procompetitive as a whole or anticompetitive as a whole, under the assumption that the joint venture will adopt the most profitable (and possibly most anticompetitive) structure? If a joint venture is viewed as a single entity, will it be able to do whatever it wants?

Schwartz: That is another interesting aspect of *American Needle*. The NFL wants the ability to do two things. It wants to be the licensor of products that have the NFL and team logos, and it wants the right to have an exclusive licensing arrangement with Reebok. In other words, the conduct at issue involves both collective licensing and exclusivity. What is the conduct that should be allowed—collective and exclusive licensing? Or collective, but not exclusive,

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licensing? I would think that if the Court were to allow collective licensing behavior, they might well set the constraint by subjecting that collective judgment to potential rule of reason analysis—that would probably make American Needle happy and disappoint the sports leagues.

The “output test” provides a way to assess the consumer welfare effects of the restriction: did the restriction lead to higher or lower levels of output? A consumer welfare-enhancing restriction will generally lead to higher output.

Wu: In evaluating the competitive effects of a joint venture or an organization like the NFL, should the focus be on the overall product that is produced by the organization or joint venture? Or should the focus be on specific elements or “core functions” of the organization or venture?

Leonard: While the restriction at issue will generally involve one of the “elements” or “core functions” of the joint venture, what we care about is whether the restriction increases or decreases consumer welfare. The “output test” provides a way to assess the consumer welfare effects of the restriction: did the restriction lead to higher or lower levels of output? A consumer welfare-enhancing restriction will generally lead to higher output. This was the standard that was applied in *Chicago Professional Sports Limited Partnership and WGN v. National Basketball Association*.⁴

Schwartz: I also think that the output test is key here. But the question in *American Needle* is this: what output is relevant? If we are talking about the production of professional football games or entertainment, then there is no real doubt that the teams need to coordinate and function jointly. A league would

facilitate scheduling and organization. But, does coordination really need to extend to the production of licensed clothing items? That is a tougher call, and one that requires a careful analysis of the consequences of joint, exclusive licensing versus individual team licensing of their own marks. To me, the essence of the debate is whether the output gains are so obvious that *per se* legality under Section 1 is warranted. I also think that the question of “what output is relevant” leads us into a debate about whether there ought to be a “core functions” test or some other test that can be used to evaluate the benefits of and need for coordination.

Wu: Both of you agree that the output test is the right approach, but what are we measuring? For example, in the case of *American Needle*, should we look at the production of NFL football games, the licensing and distribution of team products with NFL and team logos, or both?

The question in *American Needle* is this: what output is relevant? If we are talking about the production of professional football games or entertainment, then there is no real doubt that the teams need to coordinate and function jointly.

Leonard: In general, application of the output test should focus on the product or products that are affected by the restriction at issue. For example, in *American Needle*, the competitive effects analysis should look at the sales of goods that have the NFL trademark. Of course, if there is more than one product affected by the restriction, the output test can become more complicated because an increase in the output of one product may have to be weighed against the decrease in the output of another product. In any event, the product should be the primary focus of the analysis.



But I should stress that the analysis could be complex because one must understand the restrictions and how they affect the operation of the organization in order to perform the output test.

The essence of the debate is whether the output gains are so obvious that *per se* legality under Section 1 is warranted.

Wu: Does an output test also help us evaluate whether an organization or joint venture is a single entity or not?

Leonard: Isn't the determination of "single entity" status a matter of "what should be?" rather than "what is?" In other words, while the NFL effectively controls the sale of trademarked goods as a "single entity," isn't the antitrust question whether single entity behavior by the NFL should be allowed, as opposed to a marketplace in which the NFL teams compete against each other in the provision of trademarked goods?

Wu: That's one way to look at it. But others suggest that we focus on ownership and control.

Leonard: An organization is formed by combining assets and putting them under common control. Whether those assets are contributed by individual agents in exchange for ownership in the organization, or purchased by the organization (i.e., an acquisition),

strikes me as largely irrelevant from an economic point of view. The question from an economic and antitrust perspective is whether the organization should be allowed to exercise control over those assets. It is entirely possible that an organization should be allowed to control certain assets and not others. Thus, the organization may be treated as a single entity for some purposes and not a single entity for others. The output test could be used to determine which purposes qualify for single entity treatment, or which assets the organization should be allowed to control.

The NFL defends its single entity status with respect to club-branded merchandise licensing by arguing that the league is an integrated entity that has to exist for the participating teams to produce output: professional football games.

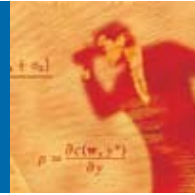
Wu: How would you do this in practice?

Leonard: In principle, one could seek to identify a group of assets such that, if operated by a "hypothetical profit maximizing single owner," the act of either adding or subtracting one asset (or a group of assets) would reduce output (appropriately defined). Such a group of assets would define the appropriate scope of a single entity from an economic point of view. In this sense, the output test could be used to

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define what the organization should be allowed to control as a single entity when the assets are in fact owned by firms that are otherwise competitors. In practice, it might often be difficult to identify this “optimal” group of assets. However, one could still determine whether a given asset should be accorded single entity status using the output test.

Schwartz: Greg’s approach has real intellectual appeal, but my concern is that I don’t see how this can be implemented when it comes to a multiproduct joint venture like the NFL unless there is an analysis of single entity status for each category of output produced by the joint venture.

Wu: Do you have an alternative approach?

Schwartz: The NFL defends its single entity status with respect to club-branded merchandise licensing by arguing that the league is an integrated entity that has to exist for the participating teams to produce output: professional football games. They try to make the logical extension of that necessity to say that, consequently, the league is a single entity for all purposes. To me, that argument invites a test that has multiple prongs. The first—and I know that some think this is a slippery slope—is a core functions test: is the activity at issue either one of the core functions of the league (i.e., setting rules or scheduling games) or required by one of the core functions (e.g., hiring officials)? If it does, I think it is presumptively *not* anticompetitive. If it is not, then the other prongs of

the analysis become relevant. We would then be in a rule-of-reason world and we would assess the behavior in the same way that we would analyze any other behavior under the rule of reason. We would define markets, look for procompetitive benefits, consider price and output effects, and other such familiar elements. Also, here is where Greg’s output test becomes the centerpiece of the antitrust analysis.

That argument invites a test that has multiple prongs. The first is a core functions test: is the activity at issue either one of the core functions of the league? If it is not, then we would then be in a rule-of-reason world.

Wu: Wouldn’t a core functions test also be difficult to implement?

Schwartz: I realize that a core functions test is a bit difficult to define in the abstract. But it seems to me that we can more easily get our hands around the concept of what a single entity is if we ask the question than if we avoid the question. And it is preferable, in my view, to deal with that question than to grant the sort of blanket blessing that the NFL seeks. Surely, there are some things we can clearly identify as core functions: rule-making, scheduling, hiring officials. Others are less clear: negotiating national television and radio contracts. In practice, I think that the issue

Contributors

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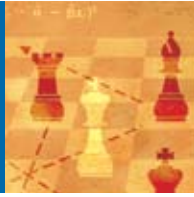
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in *American Needle* will come down a judgment on whether collective brand building is a core function for a league.

Leonard: It seems to me that the core functions test Steve is suggesting can be nested within the output test framework I described. If a function or asset is indeed “core” or “necessary” for the organization to exist, then its removal from the organization’s control will cause the organization’s output to be reduced to zero. In that case, the output test would suggest that the organization should be considered a single entity with respect to that function or asset.

Wu: That is probably a good way to wrap it up. On the surface, *American Needle* seems to be a case that rests on legal issues, but there is clearly an important economic aspect to the debate. Thank you for your views and for the discussion today.

NOTES

- 1 The cases are *Bell Atlantic Corporation et al. v. William Twombly et al.*, 127 S Ct. (2007) and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S Ct. (2007).
- 2 *American Needle, Inc. v. National Football League, et al.*, 538 F.3d 736 (7th Cir. 2008), cert. granted, 77 U.S.L.W. 3708 (U.S.29 June 2009) (No. 08-661).
- 3 *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).
- 4 *Chicago Professional Sports Limited Partnership and WGN v. National Basketball Association*, 95 F.3d 593 (1996).

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