ANTITRUST AND INEFFICIENT JOINT VENTURES: WHY SPORTS LEAGUES SHOULD LOOK MORE LIKE MCDONALD'S AND LESS LIKE THE UNITED NATIONS

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Antitrust law generally favors joint ventures that allow separate firms to integrate economic functions while continuing to compete as independent entities. In evaluating the risks to competition that joint ventures could pose, insufficient attention has been paid to the risk that joint ventures with market power may be structured so that the parties, acting in their independent self-interest, will prevent the venture from providing innovative goods and services responsive to consumer demand. In these cases, it may be better if a single firm provided services rather than having them provided jointly.

We illustrate this problem by challenging the conventional wisdom that sports leagues must be organized and run by clubs participating in the sporting competition. The fastest-growing competition in the United States is organized by NASCAR, a distinct business entity that is not controlled by the drivers who participate in stock car races. We suggest that the club-run sports leagues in the major North American sports impose significant costs on sports fans in a variety of markets. If, instead, relevant rules were decided by an independent Board of Directors of "NFL, Inc.," "MLB, LLC," or the like, we suggest that franchise allocation, broadcast rights, effective club management, marketing and sponsorship, and labor markets would be regulated more efficiently and more responsively to consumer demand.

Our analysis blames significant transactions costs for the inability of club owners who run leagues to reach efficient, consumer-responsive results. These same transaction costs may prevent an efficient restructuring of sports leagues. Thus, we apply conventional antitrust doctrine in innovative ways to argue that courts could view the current structure as an unlawful refusal of club owners to participate in a sporting competition that they themselves cannot control, which we argue unreasonably restrain trades and unlawfully maintains monopoly power.

I. INTRODUCTION

For some time now, antitrust law has generally looked kindly upon joint ventures—when separate firms combine to perform some kind of economic activity.[1] The law has strived mightily to distinguish joint ventures from cartels, the latter being condemned as involving agreements to restrain trade and serving no other legitimate purpose.[2] It would be difficult to find those

1. *See* Robert Pitofsky, *A Framework for Antitrust Analysis of Joint Ventures*, 74 GEO. L.J. 1605, 1606-7 (1986); Joseph F. Brodley, *Joint Ventures and Antitrust Policy*, 95 HARV. L. REV. 1521, 1525 (1982).

2. *See, e.g.*, ROBERT PITOFSKY, ET AL., TRADE REGULATION: CASES AND MATERIALS 378 (5th ed. 2003) ("[A] joint venture carries the positive connotation of cooperation among firms, usually accompanied by some actual integration of managerial or production resources, to achieve some

who would not prefer a joint venture of firms that combine for limited purposes, even if they comprise most of the firms in the market, to a merger that eliminated all competition between the formerly separate firms.[3]

To be sure, courts and commentators have recognized that some joint venture agreements can have significant anticompetitive effects, and antitrust law should intervene to protect the market and consumers from such effects. The leading commentaries synthesize the cases and the literature to focus on whether a joint venture could harm competition by (1) reducing potential rivalry between the parties to the venture, (2) facilitating collusion relating to other aspects of competition between the parties, or (3) excluding or hampering rivals to the venture parties in their access to an essential product or service necessary to compete.[4] Much less attention has been paid to another important risk of joint ventures that do not face vigorous rivalry in the marketplace—that the venture is structured so that the parties, acting in their independent self-interest, will prevent the venture from providing innovative goods and services responsive to consumer demand. In such cases, consumers and society may be better served if a single firm provided certain services instead of having them provided jointly. For example, a baseball competition would be organized by Major League Baseball, Inc. rather than participating clubs; a commodities exchange would be organized by Chicago Board of Trade, LLC rather than by participating brokers; an oil field would be operated by a single company rather than jointly by mineral rights owners.

To be sure, Judge Richard Posner has sagely cautioned that "[i]t does not follow that because two firms sometimes have a cooperative relationship there are no competitive gains from forbidding them to cooperate in ways that yield no economies but simply limit competition."[5] Yet in *National Collegiate Athletic Ass'n v. Board of Regents*,[6] the Supreme Court appears (albeit in dicta) to have overlooked the significant antitrust risks from the parties' conscious decision to operate a member-run venture; instead, the Court assumed that this choice was an indispensable part of the parties' pro-competitive cooperation. Speaking for the Court, Justice John Paul Stevens declared that the marketing of contests between competing clubs or teams "would be completely ineffective if there were no rules *on which the competitors agreed* to create and define the competition to be marketed" and

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useful business objective more efficiently than either (or any) could alone. It is thus distinguished from a cartel or price-fixing arrangement, for example.").

3. SCFC ILC, Inc. v. Visa USA, Inc., 36 F.3d 958, 963 (10th Cir. 1994).

4. *See* Pitofsky, *supra* note 1, at 1608; Brodley, *supra* note 1, at 1530-32. *See also* Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy,* 1995 COLUM. BUS. L. REV. 1, 4.

5. Gen. Leaseways, Inc. v. Nat'l Truck Leasing Ass'n, 744 F.2d 588, 594 (7th Cir. 1984).

6. 468 U.S. 85 (1984) [hereinafter *NCAA Case*].

that agreements among rival firms were "essential if the product is to be available at all."[7]

As a matter of antitrust doctrine, the Court's precise holding was that the degree of cooperation among those who jointly organize and participate in sporting competitions is sufficiently extensive that their agreements should not be formulaically condemned as per se illegal.[8] Thus, the Court's embrace of the conventional wisdom that it is *essential* to permit collusion among clubs who compete both on the field/court/ice in a sporting competition, and off the field/court/ice for talent and revenue, was not required for the Court's holding.

It is our thesis that this conventional wisdom is wrong. Entertainment in the form of competitive sports leagues can be produced through a structure in which coordination of the particulars of the competition (playing rules, distribution of revenues, terms for competition for players' services) is provided by a separate entity that is distinct from the clubs participating in the competition. In the United States, the fastest growing sports competition exists among stock car drivers, who not only compete in individual races but whose success in races over the course of a season determines the winner of the lucrative Nextel Cup. Here, the competition organizer is not a venture of competing drivers, but rather a separate, for-profit entity, the National Association for Stock Car Auto Racing (NASCAR), controlled by the family of Bill France, who founded the competition.[9] NASCAR, and not the participating drivers, determines the rules of competition and the location of premier races. Moreover, when the National Basketball Association (NBA) created a women's league, they did so by explicitly giving majority control of the Women's National Basketball Association (WNBA) board of directors to owners and league executives who did *not* operate clubs in the new competition.[10] Elsewhere, Australian antitrust law has recognized that leagues and clubs are not inherently one and the same, the former competing in a

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7. *Id.* at 101 (emphasis added) (quoting ROBERT H. BORK, THE ANTITRUST PARADOX 278 (1978)). A sports league is a leading example of a business activity that "can only be carried out jointly." 468 U.S. at 101.

8. *Id.* at 103. Because of the procompetitive potential of the challenged joint selling arrangement as well as the plaintiffs' concession that the great majority of the NCAA's rules enhanced competition, a judgment about the competitive significance of the restraint required a fuller consideration of the defendants' justifications.

9. *See* Koszela v. Nat'l Ass'n of Stock Car Auto Racing, 646 F.2d 749, 750 (2d Cir. 1981) (stating that anyone wishing to participate in stock car racing must "join" NASCAR; however, this does not give right to participate in control of organization but merely to participate in its sanctioned events); Michael A. Cokley, *In the Fast Lane to Big Bucks: The Growth of NASCAR*, 8 SPORTS LAW. J. 67, 70-71 (2001).

10. *See* Larry Lebowitz, *Leagues are Forming as 'Single Entities' Where Decision and Profits are Shared by All Owners,* FT. LAUDERDALE SUN-SENTINEL, Apr. 20, 1997, at 1F.

distinct market for "competition organizing services."[11]

Properly recognizing that the decision to form a joint venture is a conscious rejection of alternative forms of inter-firm organization, such as merger or contract, Professor Joseph Brodley has observed that firms would not need to form joint ventures if significant transactions costs did not prevent them from reaching agreement with those with whom they need to cooperate to conduct their business.[12] Thus, for example, McDonald's Corporation is vertically separate from its franchised restaurant outlets, who do business pursuant to a detailed franchise agreement.[13] Although joint ventures allow for the reduction of transactions costs without the disadvantages of mergers, the problem of serving multiple masters raises potential problems.[14]

The traditional structure of club-run leagues imposes significant costs on consumers/sports fans in a variety of markets where sports leagues operate. Consider the following:

- Why would Major League Baseball (MLB) for years deny a team to fans in the national capital area, largely because a single owner of a neighboring franchise objected?
- Why would the NBA try to limit the number of times that the Michael Jordan-led Chicago Bulls could be shown on a national superstation, when the Bulls were willing to pay the league all revenues attributable to showing the game outside of Chicago?
- In light of the recognized interdependence of sports franchises, why do leagues tolerate years of gross mismanagement by particular owners, subjecting local fans to years of unnecessary mediocrity that would never be tolerated in a competitive business

11. In *News Ltd. v. Australian Rugby League*, 139 A.L.R. 193, 338 (Full Fed. Ct. 1996), the court recognized a market for "competition organizing services" where two rival leagues sold these services and clubs participating in competitions were buyers. *See also* S. Sydney Dist. Rugby League Football Club Ltd. v. News Ltd., 200 A.L.R. 157 (H.C. 2003) (holding wher a merged league excluded the plaintiff from the receipt of competition organizing services, but exclusion did not meet specific standards for per se illegality under the Australian Trade Practices Act).

Indeed, the evolution of a national rugby league competition in Australia demonstrates the distinct functions of clubs and leagues. The traditional competition was organized by the Australian Rugby League, an entity controlled by a board of directors representing clubs participating at the top level of competition as well as a variety of other clubs and individuals involved in the sport; the courts determined that clubs competed among themselves for the right to participate in the annual top-tier competition. *News Ltd.*, 139 A.L.R. at 318 ("the clubs were not members of the League"); *Id.* at 338-42 (detailing competition for competition organizing services).

12. Brodley, *supra* note 1, at 1527.

13. *See, e.g.*, Marane, Inc. v. McDonald's Corp., 755 F.2d 106 (7th Cir. 1985). In rejecting antitrust and tort claims by former franchisee, court describes initial grant of franchise by defendant to plaintiff and its termination under terms of the agreement.

14. Brodley, *supra* note 1, at 1528-29.

environment?

- Why do North American sports leagues centralize virtually all aspect of the marketing of team merchandise (other than retail sales), when individual owners want to pursue innovative ideas to add revenue (and in contrast, the top English soccer league seems unable to offer any significant collaborative effort in merchandising)?
- Why do sports leagues subject fans to the risk or reality of strikes and lockouts, and impose competitive restraints that actually harm competitive balance, in order to lower team payroll costs? (For example, although significantly increased in the seven years after the lifetime "reserve clause" was abolished in baseball in 1976, and competitive balance had actually improved during that time period, owners were not happy because salaries more than tripled![15])

The reason for these woes, in our view, is that club-run leagues forego attractive business opportunities because they are unable to overcome the significant transactions costs involved in agreeing on how to distribute the proceeds from the opportunity. Contrary to conventional wisdom, club owners need not insist on collectively controlling the sporting competition in which they participate. If, like NASCAR, relevant rules were decided by an independent Board of Directors of "NFL, Inc.," "MLB, LLC," or the like, we suggest that (a) franchises will be more likely to be located in a manner responsive to consumer demand; (b) broadcast rights will be sold in a manner to maximize overall revenues, which often means increased viewership; (c) incompetent ownership would be more likely to be replaced; (d) marketing and sponsorship opportunities would be divided between the league and local clubs based on which entity can most efficiently sell rights and products; (e) collective bargaining agreements will be easier to reach (no approval of a super-majority of owners) and more likely to be designed in a manner to enhance the consumer appeal of the sport.

Although reorganizing sports leagues from an inefficient joint venture structure to one featuring a single firm organizing a competition among participating clubs would increase efficiency, benefit fans, and increase total profitability, there are significant reasons why sports league owners may not support such a change. All of the problems identified above exist only because transactions costs prevent agreement on side payments that would make all concerned better off. Absent transactions costs, MLB would have

15. Stephen F. Ross, *Monopoly Sports Leagues*, 73 MINN. L. REV. 643, 676 (1989).

expanded years ago into Washington, D.C. and provided a lump-sum compensation for the Baltimore Orioles; Michael Jordan's exposure to a national television audience would have been maximized with proceeds shared between his team and the NBA; incompetent owners would have been paid off to either sell their team or place club operations in skilled hands; clubs with new ideas for marketing or sponsorship revenue would pursue them with an agreed-upon share of proceeds going to the league; players, leagues and clubs would easily agree on a scheme to maximize revenue and then share it among league stakeholders. Suppose, echoing this Article, an investment banker were to present a league with a proposal to acquire all assets necessary to organize the competition from the clubs. Even if the offer exceeded the aggregate value of all clubs, owners may well be unable to agree on how to divide the proceeds. Indeed, news reports have concluded that the biggest obstacle to the National Hockey League (NHL) owners' consideration of a $3.5 billion offer from investment bankers for all league assets is "disagreements among owners over how much their individual franchises are worth".[16]

Antitrust law provides a remedy for these transaction cost problems. Despite a historic preference for joint ventures as a means to maintain the independence of separate firms, courts have long implicitly recognized that joint ventures may act in ways that are less efficient than a single firm. Thus, the competing pipe manufacturers found to have engaged in per se illegal price fixing in the landmark 1899 *Addyston Pipe* decision were allowed to merge into a single entity.[17] The Supreme Court has held that an agreement by rivals not to compete in each other's geographic markets is illegal, even though an agreement by a supplier firm that its retailers would not compete might not be.[18] Consistent with the analysis presented in this Article, the Court also rejected the proposition that there is no difference between a joint venture's decision to bar intra-brand competition in a local area and the decision of a major national supermarket chain to only have one of its stores in the area.[19]

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16. *See, e.g.*, Stefan Fatsis & Dennis K. Berman, *Puck Plan: NHL Explores Sale To Cure a Troubled Sport*, WALL ST. J., Mar. 4, 2005, at B1.

17. *See* John Shepard Wiley Jr., *Antitrust and Core Theory*, 54 U. CHI. L. REV. 556, 564 (1987) (citing the discussion by George Bittlingmayer, *Price-Fixing and the* Addyston Pipe *Case*, 5 RES. L. & ECON. 57, 90 (1983), of *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899), and its aftermath, including the defendants' merger into the United States Cast Iron and Foundry Company).

18. United States v. Gen. Motors Corp., 384 U.S. 127, 140 (1965) (distinguishing joint action by rival dealers to exclude rivals from action General Motors might take unilaterally pursuant to franchise agreements). This distinction was reaffirmed in *Cont'l T. V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 59 n.28 (1977).

19. *See* United States v. Topco Assocs., Inc., 405 U.S. 596 (1972) and *id.*, 405 U.S. at 623 n.11 (Burger, C.J., dissenting). One of us has previously detailed an application of our theory that single

The logical implication of these decisions, we suggest, is that antitrust doctrine needs to look more critically at joint ventures that possess economic power to determine whether consumer welfare is being harmed by a structure that inhibits efficient business opportunities. Our principal application of this argument is that the best way to organize and market a sporting competition is to separate the entity (we call it "The League") that organizes a sporting competition, and the clubs participating in the competition, where responsibilities are assigned in well-drafted franchise agreements between The League and each club.

In light of the importance of sporting competitions to millions of sports fans, determining the proper legal response to the choices about industry structure made by participants in major North American sports leagues has independent significance. We offer this analysis as part of a larger project on the structure of sports leagues in the United States.[20] More concretely, the issues raised by this Article also have immediate implications for non-sports industries. Currently, a variety of stock and commodity exchanges are exploring whether their control by member-brokers may lead to inefficiencies that would be avoided by placing ownership in an independent, for-profit entity.[21] The development of antitrust and intellectual property doctrines relating to technology standards may be influenced by insights that help identify when collectively-determined standards may be inefficient.[22] Efficient operation of an oil field is likely to be impaired where mineral rights are vested in different owners, and public policy that facilitates the field's unitary operation by a single operator on behalf of all owners may be welfare-enhancing.[23] Where beneficial ownership of assets is divided between a life estate and a remainder interest, trust instruments may overcome transaction costs that prevent parties with conflicting interests from agreeing on an

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firms are likely to make more efficient decisions about where to permit intra-brand competition, in the context of the *Topco* case. *See* STEPHEN F. ROSS, PRINCIPLES OF ANTITRUST LAW 152 (1993).

20. We are currently researching a book-length comparative review of the structure of a variety of sports around the world and the appropriate governmental/regulatory response to problems raised by these structures. The general topic is one we have tackled before. *See, e.g.*, Stefan Szymanski, *The Economic Design of Sporting Contests*, 56 J. ECON. LIT. 1137 (2003); Stephen F. Ross & Stefan Szymanski, *Open Competition in League Sports*, 2002 WIS. L. REV. 625.

21. *See, e.g.*, Roberta S. Karmel, *Turning Seats Into Shares: Causes and Implications of Demutualization of Stock and Futures Exchanges*, 53 HASTINGS L.J. 367 (2002).

22. *See, e.g.*, Mark A. Lemley, *Antitrust and the Internet Standardization Problem*, 28 CONN. L. REV. 1041 (1996).

23. For a helpful discussion, see Gary D. Libecap, *Contracting for Property Rights*, in PROPERTY RIGHTS: COOPERATION, CONFLICT, AND LAW 156-65 (Terry L. Anderson & Fred S. McChesney eds., 2003).

efficient utilization of the assets.[24]

This Article critically analyzes the legal and economic implications of the prevailing choice of sports league design and suggests an alternative more likely to promote efficiency and to avoid cartel-like inefficiencies. Our central theme is that even a single-firm monopoly may be more efficient than a joint venture when bargaining costs prevent participants, keen to pursue their own self-interest at the expense of the group's profits or consumer appeal, from agreeing on efficient, welfare-enhancing strategies that even a monopolist would adopt. Part II details our concern that bargaining costs among league members lead to inefficiencies in the determination of the number and location of franchises, the sale of broadcast, marketing, and sponsorship rights, the effective oversight of club management, and the efficient allocation of players among teams. If these key decisions were instead made by an economic entity independent of the participating clubs, a more efficient organization and marketing of the competition is likely to result. Part III notes the significant legal advantages that a vertically separate league would enjoy in operating more flexibly than club-run leagues. Part IV examines obstacles to the proposed restructuring. The same transactions costs that preclude efficiencies among club-run leagues may also inhibit the member clubs' willingness to adopt a more efficient structure. Specifically, owners may well reject a profitable restructuring because of an inability to agree on how to distribute the gains. Thus, Part V argues that proper application of antitrust principles justifies the involuntary restructuring of sports leagues along the lines discussed in this Article.

To be sure, when a joint venture faces significant inter-brand competition, it can be expected to strive mightily to overcome any transaction costs that cause it to operate inefficiently. If it fails to do so, "market retribution will be swift."[25] But we assume for purposes of this Article that the major North American sports leagues face neither product market competition nor a viable entry threat sufficient to force them to avoid the inefficient practices we discuss herein.[26] Thus, this Article accepts the continuing ability of leagues to

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24. *Compare* Brokaw v. Fairchild, 237 N.Y.S. 6 (N.Y. Sup. Ct. 1929) (inflexible law of waste governing relationship between life tenant and remaindermen prevented efficient use of real property), *aff'd*, 177 N.E. 186, 1931 N.Y. LEXIS 1272 (1931), *with* Baker v. Weedon, 262 So.2d 641 (Miss. 1972) (court employs its equity powers in the best interests of both the life tenant and the remaindermen). Recent changes in the Uniform Principle and Income Act recognize the need to place greater discretion in the hands of a single entity capable of efficiently utilizing assets to craft a portfolio that maximizes total return on investment. *See* JESSE H. DUKEMINIER, ET AL., WILLS, TRUSTS AND ESTATES 828 (7th ed. 2005).

25. Valley Liquors, Inc. v. Renfield Importers., Ltd., 678 F.2d 742, 745 (7th Cir. 1982).

26. At the same time, we assume that each league's insulation from rivalry is not subject to imminent threat from antitrust intervention. One of us has previously suggested that the government

exercise market power, but suggests ways to facilitate greater efficiencies within that context.[27] In short, we suggest that both profitability and the provision of services responsive to consumer demand would improve if sports leagues looked more like McDonald's and less like the United Nations.

II. THE PROBLEM WITH VERTICAL INTEGRATION IN DOMINANT SPORTS LEAGUE JOINT VENTURES

In this section, we adopt the approach of Australian courts[28] and think of a sports league as product created by the combination of upstream competition organizing services and downstream clubs participating in the competition. Upstream services are those which enable the competition to take place, but do not necessarily have to be provided for by the competitors themselves. Sports leagues have conventionally recognized that the function of enforcing league rules is best done by investing broad authority with regard to "integrity of the game" issues in an independent entity—the league commissioner.[29] At the same time, common sense suggests that certain functions are best fulfilled by participating clubs, including organizing the team, training the players, organizing spectator services in the form of seating and ticketing, providing refreshments and other stadium amenities, and similar activities. The focus of this Article is the myriad activities that traditionally have not been performed by a commissioner or by individual clubs, but rather by a governing body composed of a representative from each club, with a super-majority required for major changes or initiatives.[30] These services include the determination of

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intervene to require a divestiture of monopoly sports leagues into competing entities. Ross, *supra* note 15, 733-53. We have also discussed ways that league power could be restrained through intervention to facilitate new club entry. Ross and Szymanski, *supra* note 20, 639.

The focus of this article is on promoting efficiency and not reducing the market power of dominant sports leagues. Economic reasoning suggests that these other proposals would be likely to have a greater effect in enhancing overall welfare and in reducing wealth transfers from consumers to sports fans. There are costs and risks of any reform proposal, and we believe even a "second-best" alternative that significantly improves the efficiency of an important industry merits serious consideration.

27. Although more than one vertically-separated leagues are possible, we assume that the ability of any dominant sports league to exercise market power makes it unlikely that multiple leagues will develop absent antitrust intervention.

28. *See supra* note 11.

29. *See, e.g.*, Milwaukee Am. Ass'n v. Landis, 49 F.2d 298, 299 (N.D. Ill. 1931). With regard to enforcing baseball's code, the parties clear intent was "to endow the commissioner with all the attributes of a benevolent but absolute despot and all the disciplinary powers of the proverbial *pater familias*." *Id.* at 299.

30. *See, e.g.*, Chicago Nat'l League Ball Club v. Vincent, No. 92 C 4398 (N.D. Ill. 1992), *excerpted in* PAUL C. WEILER & GARY R. ROBERTS, SPORTS AND THE LAW 28-32 (3d ed. 2004) (holding Commissioner's broad power did not extend to alignment of clubs within league divisions,

the number of teams admitted to the league, the determination of player contract and trading rules, stadium facility standards, the sale of broadcasting rights, the extent of revenue sharing, and the allocation of shared revenues.

The decision to have these important business decisions be determined jointly by the participating clubs—to have, in our parlance, a "club-run league"—is, in economic terms, a conscious decision to vertically integrate. That is, clubs have decided to provide their own competition organizing services, rather than allow a separate entity, like NASCAR, run the competition. Economic theory supports the argument that decisions made by a club-controlled body subject to super-majority voting requirements are unlikely to be optimal. In any partnership where profits are shared, the marginal benefit to each partner accruing through the sharing arrangement is smaller than the total benefit, and therefore no partner has the incentive to vote in ways which maximize total payoffs.[31] Efficient allocation of resources requires the services of a "residual claimant," a separate economic actor who has the incentive to make optimal decisions, pay each member of the "team" their opportunity cost, and then retain the surplus.[32]

Sports leagues' unique features make the absence of a residual claimant (i.e., an independent competition organizer) particularly problematic. In order to preserve the integrity of the competition, an actual or potential competition organizer possesses a unique disincentive to integrate forward into the operation of participating clubs—NASCAR cannot own all the participating race car teams. (As a European court noted, the integrity of the competition is impaired if even a few of the teams are owned by the same corporation.[33]) Club-run leagues will necessarily make decisions about how to organize the league that limit the extent of economic competition; these decisions may simultaneously enhance the overall quality of league play (acceptable under antitrust law) and simply increase profits (unacceptable under antitrust law).[34]

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based on specific provisions of the league Constitution limiting power in that manner), *decision withdrawn and vacated at request of the court,* 1992 U.S. Dist. LEXIS 11033 (July 23, 1992) (following settlement by parties).

31. *See, e.g.*, Bengt Holmstrom, *Moral Hazard in Teams,* 13 BELL J. ECON. 324 (1982); Armen Alchian & Harold Demsetz, *Production, Information Costs and Economic Organization,* 62 AM. ECON. REV. 777 (1972).

32. Holmstrom, *supra* note 31, at 327 (Theorem 2).

33. AEK Athens and Slavia Prague v. Union des Associations Europeenes de Football, CAS 98/200 (Aug. 20, 1999), *reprinted in* XXV YEARBOOK OF COMMERCIAL ARBITRATION 393, 395-97 (2000).

34. Antitrust decisions generally treat restraints imposed by pressure from downstream firms more harshly. *See, e.g., Gen. Motors Corp.*, 384 U.S. 127 (agreement imposed on GM by a conspiracy of dealers held illegal *per se*); Cont'l T.V., Inc. v. G.T.E. Sylvania, Inc., 694 F.2d 1132, 1137 (9th Cir. 1982) (under rule of reason, significant that vertical restraint imposed by manufacturer

Moreover, unlike a more typical vertical integration of a single upstream firm and a single downstream firm, the "backward integration" of clubs into competition organizing services cannot resolve many of the problems that economists have identified when economic functions are performed by contract rather than integration, such as double marginalization,[35] free riding,[36] opportunistic behavior,[37] and costly contracting.[38] Because vertical integration

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and not at the request of other dealers). However, intra-league sports restraints are often tolerated because of the clubs' unique interdependence. *See, e.g., NCAA Case*, 468 U.S. at 103 (most agreements enhance competition); *id.* at 117 (acknowledging that rules that promote competitive balance can enhance public interest and thus be procompetitive); United States v. Nat'l Football League, 116 F.Supp. 319 (E.D. Pa. 1953) (interdependence of strong and weak football teams justified protections to preserve viability of weak teams).

Tribunals around the world that have invalidated sports league restraints have acknowledged that some restraints were necessary but the challenged one was overly restrictive. *See, e.g.,* Los Angeles Mem'l Coliseum Comm'n v. Nat'l Football League, 791 F.2d 1356, 1369 (9th Cir. 1986) (league oversight of franchise relocation permissible but rejection of specific proposed relocation found unreasonable); Mackey v. Nat'l Football League, 543 F.2d 606 (8th Cir. 1976) (restraints on competition for players to promote competitive balance permissible but existing plan overbroad); *Nat'l Football League*, 116 F. Supp. 319 (restraints on competition in sale of broadcast rights permissible to protect live gate but not to facilitate higher returns in rights sales); Union Royale Belge des Sociétes de Football Association v. Bosman, [1996] 1 C.M.L.R. 645 (E.C.J.) (restraint on movement of players throughout Europe could be subject to reasonable restraints to promote competitive balance and to recoup investment in players but mandatory payment of transfer fee unreasonable); Buckley v. Tutty, 125 C.L.R. 353 (H.C. 1971) (some restraints on competition for player services in Australian rugby league permissible but complete ban unreasonable); Eastham v. Newcastle United Football Club, [1963] 3 All E.R. 139 (Ch.) (same re English soccer).

35. Double marginalization occurs in some cases where both firms have market power, because the downstream firm's effort to achieve its own monopoly price will result in the price to consumers being higher than is optimal for profit maximizing by both parties. JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 174-76 (1988). For example, where a league adopts a revenue sharing plan that requires one-third of revenues from live gate be shared with the league as a whole, the result will be higher ticket prices for fans than if (a) all ticket revenues went to the league or (b) no revenue was shared.

36. Free riding problems occur when firms under-invest in promoting a product because of a desire to free-ride on promotional efforts of others. *Id.* at 185. For example, teams could spend less on payroll, or avoid costly public relations activities like community outreach, confident that the general appeal of their club is significantly affected by the general goodwill generated by the efforts of league officials and other clubs.

37. In some contexts, a club-run league may be thought to be less likely to engage in opportunistic behavior vis-a-vis the downstream clubs that control it. However, where opportunistic behavior can be directed at a minority of clubs, the majority could well vote to engage in such behavior. Certainly, individual clubs have ample incentive to engage in such behavior vis-a-vis their league "partners" in a club-run league. A franchise agreement between a vertically separate competition organizers and club/franchisees can be designed to eliminate foreseeable opportunistic behavior, so it is difficult to conclude that club-run leagues offer significant advantages in this regard.

38. Any significant policy requires league officials to navigate a costly minefield to get the requisite approval of a majority or super-majority of owners interested primarily in their own club's profitability. NASCAR can easily negotiate a new enhanced broadcast rights deal featuring greater national telecasting of its races; and opportunity for MLB to sign a lucrative national rights contract

appears less likely to achieve these predicted efficiencies in the sports context, and because of the particular potential for vertical integration to cause a welfare-reducing relaxation in inter-club competition, the general Chicago School presumption that vertical integration is efficient[39] is particularly unwarranted with regard to sports leagues.

In this part, we seek to demonstrate that significant inefficiencies in the operation of club-run leagues result from the tendency of these leagues to put the interests of individual clubs above the interest of the league as a whole, and that substantial transaction costs prevent optimal results. Not only does this reduce the potential profits available to providers of sports entertainment, but—because sports leagues lack effective product market competition—this results in output that is reduced and unresponsive to consumer demand compared to that which would be provided by a sports league owned by an entity separate from participating clubs.

Consider the alternative of a vertically separate entity (The League) that would organize the competition and determine which functions are best carried out at the club or league level. This new entity would then contract with separate firms (the clubs) as franchisees, granting clubs the right to participate in the competition that The League will organize. Franchise agreements would set forth conditions for termination, rules of the game, revenue streams that would be retained by the franchisees, and revenue streams that would be reallocated by The League back to franchisees (as revenue sharing or as prizes for competitive success). Thus, well-drafted franchise agreements would assign to The League those marketing activities that can most be efficiently performed centrally, while preserving incentives for club innovation in any markets where such innovation is foreseeable. Our analysis of five important sports markets concludes that, in comparison with The League, collective action problems are likely to lead club-run leagues to adopt practices that result in a smaller "pie," because of the clubs' inability to agree on how to share the proceeds of profit-enhancing initiatives. As a result, club-run monopoly leagues are likely to produce (a) fewer franchises, (b) fewer opportunities for broadcasting or web-casting of games, (c) less effective licensing of merchandise, (d) greater tolerance for inefficient front-office management, and (e) a less efficient allocation of players among teams. As a result, consumers will benefit from receiving an entertainment product delivered more efficiently and responsively to their demand, and investors

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reducing the number of games available for sale by each club would require complex negotiations among owners.

39. *See, e.g.*, ROBERT H. BORK, ANTITRUST PARADOX 225-31 (1978). This approach and the competing theories discussed in text are outlined in JEAN TIROLE, *supra* note 35, 90-106.

should also see profits increase from these realized efficiencies.

A. *Optimal Number and Location of Franchises*

Sports leagues that do not face competition from close substitutes will artificially suppress the number of franchises in the league.[40] Club-run leagues will necessarily reduce output by even more than a profit-maximizing single-firm monopolist would, and will avoid placing franchises in locations that, while more efficient, may hurt individual club owners' interests.

The optimal number of clubs within a league typically depends on the revenue expected from creating additional clubs, the additional costs associated with additional clubs, and any lost revenue that arises because of reduced demand for games involving existing clubs.[41] An additional club is likely to increase revenue because new fans will be attracted. At the same time, costs increase due to the overhead involved in supplying an additional team to the league, and any increase in operating costs due to an increase in the number of players hired and greater competition for services of players. Revenues to existing clubs may potentially fall, because either (a) fans will substitute watching games involving the new club for those involving an existing club, (b) the total quality of the league may be diminished by the addition of a club (e.g., because talent becomes spread too thinly and the overall quality of each game declines),[42] or (c) the number of games between popular teams is reduced by the need for these teams to also play against expansion clubs (i.e., to make room for games with the Tampa Bay Devil Rays, the New York Yankees play fewer games against the Boston Red Sox).

A league designed to maximize overall profits will increase the number of clubs, as long as the revenues from expansion outweigh increased costs plus lost revenues to existing clubs. A club-run league, however, will not expand unless a super-majority of clubs are compensated for any lost revenue, even though the league as a whole might benefit from expansion.[43] To illustrate,

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40. *See* Roger G. Noll & Andrew Zimbalist, *Build the Stadium–Create the Jobs!*, *in* SPORTS, JOBS, AND TAXES 1-54 (Roger G. Noll & Andrew Zimbalist eds., 1997); Ross, *supra* note 15, at 656.

41. This Article assumes the existence of a monopoly league facing no serious threat of entry, whose teams cover the geographic breadth of the relevant market. Strategic considerations may cause a league to expand to forestall entry. Operational considerations may cause a league to decline to expand to new geographic areas if travel costs significantly increase.

42. We suspect—in the context of a modest expansion — that the "dilution" effect of league expansion is overstated—in market terms—by the general sports media. Consumers most sensitive to perceiving the reduced quality of play that comes from expansion are likely to be "hard core" fans who are not likely to significantly reduce their patronage of their favorite sports teams, much as they might like to complain about it over a beer in their favorite drinking establishment.

43. For a mathematical demonstration, see Ross and Szymanski, *supra* note 20, at 630-31 n.21.

any expansion in the National Football League (NFL) will modestly expand television ratings, and each club's pro-rata share of broadcast revenues is likely to shrink, even if the expansion would be profitable from a league perspective. Because each club's representative votes for the amount of expansion that maximizes *its own club's* profits, there will be fewer clubs in club-run leagues.

Depending on its strategic goals, The League might continue the practice of reaping significant monopoly profits by reducing the number of clubs and demanding public subsidies for stadia, which could be recovered by The League in the form of an entry fee. Alternatively, The League might subsidize franchisees located in under-developed areas to promote the sport and deter potential entry. Still, club-run leagues are likely to under-expand to a greater degree, as part of explicit or implicit agreements to protect local markets from competition. Many suggested, for example, that MLB's reluctance to expand to the Washington, D.C. area for many years was solely due to vigorous opposition from the Baltimore Orioles.[44] Of course, if transactions costs were zero, the members of the league would be able to agree to a set of side payments that ensured efficient expansion, because the precise cost to the Orioles from expansion could be quickly ascertained and an agreed-upon lump-sum payment would remove any objections. However, because transactions costs are not zero, efficient contracting often fails to occur.[45]

In contrast, The League would have an incentive to draw up franchise agreements that preserve the flexibility to add or relocate teams when the trade-off is favorable. We would expect that, like any other franchisor, The League would determine the number and location of franchises authorized to participate in the competition. In light of the dynamic nature of demand for a sport, we predict that The League would follow the now-typical franchisor practice of granting non-perpetual franchises, with specified terms for non-renewal,[46] and flexible provisions rather than guarantees of geographic

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There is a close analogy between a sports league and a labor-managed firm that will choose to produce less output than a profit maximizing firm. Benjamin Ward, *The Firm in Illyria: Market Syndicalism*, 48 AM. ECON. REV. 566 (1958).

44. Mark Asher, *Expos' Relocation In 2004 Is '50-50'*, WASH. POST, Apr. 16, 2003, at D7. A jury similarly found that the National Football League had blocked the relocation of the Oakland Raiders to Los Angeles principally to protect the incumbent Los Angeles Rams from competition. Los Angeles Mem'l Coliseum Comm'n v. National Football League, 726 F.2d 1381 (9th Cir. 1984).

45. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 85, 111-12 (3d ed. 2000).

46. *See* Andrew A. Caffey, et al., *Structuring the Franchise Relationship*, *in* FUNDAMENTALS OF FRANCHISING 47, 61 (Rupert M. Barkoff & Andrew C. Selden eds., 1997).

In the food service industry, newer companies may grant greater protection for franchisees than well established firms. For example, neither Taco Bell nor Subway grants any exclusive territories, while the newer Jimmy John's firm states that it "usually" will not grant competing franchises and allows

exclusivity.[47]

To illustrate, suppose that reliable market research were to demonstrate that overall baseball profits would increase if the Montreal Expos were relocated to the Washington, D.C. area and two expansion teams were added in suburban New Jersey and Connecticut:[48] that is, the sum of increased revenues from entry fees paid by new owners to the league, live gate and stadium related revenue at these three new locations, and increased revenues from broadcasting, licensing, and merchandise, exceeds lost revenue from Montreal-based sources, marginally lost revenue from the New York and Baltimore teams in close proximity, and increased costs of operating two new teams. The League would be expected to proceed with the expansion after compensating existing clubs for losses pursuant to carefully drafted provisions of the franchise agreement. However, under current rules the rest of the clubs would not agree unless the expansion fees exceeded the reduction in their pro-rata proportion of shared revenues from 1/30 to 1/32. Moreover, the New York Mets, the New York Yankees and the Baltimore Orioles could plausibly lobby a significant minority of owners to block the expansion out of fear that future expansion or relocation might be adverse to their interests. Thus, although absent product market competition, The League will still have an incentive to reduce the number of franchises below the optimal number in order to obtain stadium subsidies.[49] We predict that it would likely increase the number from that which prevails in most club-run leagues.[50]

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franchisees to purchase "development territories." *See* World Franchising, *Franchise Directory*, http://www.worldfranchising.com/ (last visited Mar. 6, 2006). Unlike food service, of course, preserving the integrity of on-field competition would not allow the NFL, for example, to give the Chicago Bears the right to own a second franchise in Chicago if market circumstances warranted.

47. For truly national leagues unconcerned by the threat of entry, our prior research suggests that overall consumer appeal would be maximized by the creation of a multi-tiered competition, with entry into the major league the result of promotion from a lower tier and league size maintained by the relegation of unsuccessful clubs into lower-tiered competition. *See* Ross and Szymanski, *supra* note 20.

48. Although this assumption is purely illustrative, we note that this would give the New York metropolitan area four of thirty-two major league teams. In the English Premier League, by contrast, where market forces determine entry into the top-tier league (because good teams are promoted from lower tiers and bad teams are relegated), between five and six London-based clubs regularly participate in the twenty team elite competition.

49. Ross, *supra* note 15, at 649-66.

50. It is theoretically possible (and plausible within the context of the NHL) that a club-run league may have over-expanded due to misplaced optimism about the ability of a sport to expand into untraditional areas of fan support. A club-run league may be reluctant to contract, because owners would not want to risk having their colleagues vote to eliminate *them*, and because clubs could not agree on compensation for excluded clubs. The League is more likely to reach an efficient result, taking into consideration the likelihood that accommodations with the players' union to preserve major league jobs may lead to the preservation of these clubs.

B. Sale of Broadcast Rights

Transactions costs also inhibit club-run leagues from maximizing profits from the sale of broadcast and internet rights. Owners have passed up profitable opportunities because, unable to agree among themselves on how to divide the proceeds, a requisite super-majority cannot agree to proceed with a valuable rights sale. In the English Premier (soccer) League, for example, rights have traditionally been sold collectively. In reviewing a government challenge to an agreement to sell television rights for only sixty of the league's 380 possible games, a tribunal found that the league's limitation on television sales actually reduced revenues.[51] However, the clubs could not agree on how to share revenue gained from additional sales, whether negotiated individually or collectively.[52] Unlike English soccer, television rights to NBA games not collectively sold by the league may be sold by each club within a team's assigned territory. However, the NBA sought to prevent the then-popular Chicago Bulls, featuring superstar Michael Jordan, from carrying their games on a leading Chicago free-to-air channel (WGN) that was shown outside of Chicago as a "superstation" by cable and satellite distributors, although the trial court found no evidence of substantial injury to the ratings or the value of broadcast rights elsewhere.[53] The league could have permitted the Bulls games to be shown on WGN and taxed the Bulls for any excess profits,[54] but the owners were unable to agree on a formula for doing so.

Club sales of broadcast rights involve significant externalities. Clubs do not operate in completely independent broadcast markets. All broadcast revenues are partly attributable to individual team effort and party due to the league's overall appeal. Some out-of-market sales may harm other clubs' ratings,[55] while other sales may not.[56] Competition can be distorted because of

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51. In re Football Ass'n Premier League Ltd., 1996 No. 1, ¶313 (E&W) (Restrictive Practices Court, 28 July 1999), (noting that Sky Sports, the holder of the rights to broadcast sixty matches per season, had manifested a willingness to purchase ninety matches, but was turned down).

52. Stefan Szymanski & Stephen F. Ross, *Necessary Restraints and Inefficient Monopoly Sports Leagues*, 1 INT'L SPORTS L. REV. 27 (2000).

53. Chicago Prof'l Sports Ltd. v. Nat'l Basketball Ass'n, 874 F.Supp. 844, 861 (N.D. Ill. 1995), *vacated and remanded on other grounds*, 95 F.3d 593 (7th Cir. 1996).

54. Chicago Prof'l Sports Ltd. v. Nat'l Basketball Ass'n, 961 F. 2d 667, 675 (7th Cir. 1992).

55. *See, e.g.*, Richard Sandomir, *Just How Super Are These Stations*, N.Y. TIMES, Sept. 1, 1992, at B13. Neilsen ratings dropped 30% for Cardinals games broadcast in St. Louis on same night as Cubs games broadcast on WGN superstation and 20% for games broadcast on same night as Braves games on WTBS, while ESPN ratings were 69% higher when not competing against any other games.

56. The *Chicago Bulls* litigation, which produced numerous trial court opinions and two opinions from the court of appeals, can perhaps be explained by the significant discrepancy between the NBA's position that the Bulls' superstation telecasts significantly affected other rights sales and evidence put forth by the Bulls that it did not.

revenue disparities based not on performance but on the relative size of local media markets.[57] These issues would be internalized if all television revenues flowed to The League as the residual claimant. Because different packages of rights can be sold at different prices (enabling rights sellers to price discriminate between different buyers), The League would have little incentive to reduce output. Currently, most clubs sell local broadcast rights to two or three programmers, so the need to identify the best local broadcaster is not a task that The League's officials will find difficult (and, indeed, since the vast majority of local cable rights in the United States are currently purchased by a handful of companies,[58] there may be efficiencies in a single negotiation).[59] The result, we predict, would be increased output in terms of number of games, and a greater responsiveness of output to consumer demand.

C. Licensing, Merchandise and Sponsorships

The design and licensing of professional sports merchandise—jerseys, hats, jackets, etc.—would appear to include some functions most efficiently done on a league-wide basis and others best done by individual clubs. There are obvious economies of scale in granting licenses for a particular item to one or a few manufacturers. At the same time, merchandise design and local promotion would also appear to be essential in maximizing a product's appeal. Economists suggest that decisionmaking in this context should be left to those who have the best information.[60] Thus, one would expect that an efficient league would divide merchandising responsibility and income, "selling" those parts of the merchandising activities that the teams understand best back to them. Yet, virtually all licensing in North America is done centrally, while soccer clubs in the English Premier League offer little cooperative licensing of merchandise.[61] Revenue sharing could address any problems with individual

57. Although the ability to recoup quality investments through higher fees is lost if The League captured all broadcast revenue for local broadcast rights, The League can create appropriate incentives through the prize mechanism we discuss at text accompanying note 66 *infra*.

58. *See* R. Thomas Umstead, *Going to the Net Isn't Always Easy; Sports Teams' Start-Up Cable Channels Face Hurdles,* MULTICHANNEL NEWS, Apr. 29, 2002, at 36 (three networks controlled twenty-seven local markets).

59. In contrast, there may be marketing efficiencies in allowing clubs to sell radio rights for play-by-play of their games, building a network with a flagship local station and various other stations in smaller towns where demand warrants.

60. *See, e.g.,* Sanford Grossman and Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Lateral and Vertical Integration*, 94 J. POL. ECON. 691 (1986).

61. For example, the league website, www.premierleague.com, features a "Shop" page that simply provides links to each club's "team shop." *F.A. Premier League Welcome Page,* http://www.premierleague.com (last visited Mar. 6, 2006). In contrast, www.mlb.com directs the consumer to a fully-integrated website where each club's products are available. *MLB Welcome*

club promotional activities that might free-ride on league promotion efforts or distort competitive balance, assuming that clubs could agree on the appropriate sharing formula. The inability to reach agreement has led to disputes and litigation in the United States,[62] and the lack of any central licensing in England. Thus, collective action problems on both sides of the Atlantic seem to explain the unwillingness of club-run sports leagues to achieve a balance of cooperation and local promotion that The League could achieve.

D. Accountability of Club Executives

Profit-maximization at the club level requires considerable business acumen in varied tasks. The owner must assemble a staff to effectively deal with stadium utilization issues (including either construction or rental of facilities and management and marketing of luxury suites), marketing and promotion of local live gate, local broadcast rights, and sponsorships, not to mention the organization of on-field playing talent. Because each club's success is tied to some degree to the success of fellow owners, it is critical that the league hold each owner accountable for the stewardship of her franchise. However, in a club-run league, the club owners rarely hold a fellow owner accountable for the poor stewardship of a club. Indeed, although league officials may have privately orchestrated some ownership transfers to bring in new management, we are unaware of any cases where a league has disciplined owners for mismanagement. Despite their inter-dependence, owners would rather allow their joint venturers to modestly reduce their own profits rather than allow themselves to be judged. It is clear that incentives for efficient management are significantly reduced when we consider that owners do not face vigorous competition from substitute products, and that many clubs are owned by wealthy entrepreneurs, or corporations investing in clubs to pursue strategic advantages with affiliated businesses,[63] who are not likely to be subject through a market for corporate control to a hostile take-over by investors who believe they can improve corporate management. In a true franchise relationship that would exist between The League and club franchisees, we would not expect The League to grant a perpetual franchise, and the franchise agreement can specify standards that franchisees must

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Page, http://www.mlb.com (last visited Mar. 6, 2006).

62. For example, the New York Yankees were anxious to enter into a lucrative shoe contract while Major League Baseball was taking years to collectively sell this sponsorship opportunity. The lawsuit is described in Joshua Hamilton, Comment, *Congress in Relief: The Economic Importance of Revoking Baseball's Antitrust Exemption*, 38 SANTA CLARA L. REV. 1223, 1235 (1998).

63. *See* ANDREW ZIMBALIST, MAY THE BEST TEAM WIN 55-74 (2003).

achieve.[64]

E. Competition for Players

Like all for-profit organizations, professional sports leagues seek to maximize revenues and minimize costs. With regard to structuring the market for players, this requires a series of extremely complex trade-offs. Collective action problems severely impede the ability of club-run leagues to achieve an efficient structure for labor market competition.

As applied to labor markets, revenues are maximized when the market is structured to present fans with a level of absolute quality and competitive balance that will have the greatest appeal. Costs are minimized in complex negotiations with well-organized players' unions, often incorporating revenue sharing and other agreements that significantly affect labor market competition. Determining the optimal structure is quite a tricky business.[65] A league that simply uses its muscle to negotiate the lowest cost agreement with the players' union may produce a structure that results in too much competitive imbalance (driving down overall fan interest) or a league with too much parity (losing revenues otherwise available to large market or popular teams).

The most efficient way to structure a labor market would be to calibrate the appropriate economic reward for clubs that win (in the terminology of the relevant economic literature, adjusting the "prize").[66] This calibration can be

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64. It is unlikely that The League (or its shareholders) will be content to allow revenues to suffer because of chronically poor stewardship of any of The League's valuable franchises. Even when a commissioner tries to get an under-performing owner to sell, the result can be complicated litigation on peripheral issues. Accountability would significantly increase if a clearly drafted franchise agreement set forth minimum goals for a club. *See* Caffey, et al., *supra* note 46, at 47, 61.

65. Economists and judges have long accepted that labor relations in sports raise unique issues because, unlike other industries, a competitive balance among clubs in a league makes the product more attractive. *See, e.g., Nat'l Football League*, 116 F. Supp. 319; Walter C. Neale, *The Peculiar Economics of Professional Sport*, 78 Q. J. ECON. 1 (1964). The different markets in which clubs operate, and the tendency for successful teams to generate more income, suggests that a completely unrestrained labor market will result in reduced consumer appeal. *See, e.g.*, PAUL WEILER, LEVELING THE PLAYING FIELD 189 (2000) (noting the "externality" that all other clubs suffer if dominant team signs star); Ross, *supra* note 15, at 687-88 (same). *But see* Szymanski, *supra* note 20. Literature review finds mixed support for hypothesis that promoting contest or seasonal uncertainty – i.e., competitive balance – increases popularity.

66. A sports league fits naturally into models of economic contests. The original notion of an economic contest was developed in Gordon Tullock, *Efficient Rent Seeking*, *in* TOWARD A THEORY OF RENT SEEKING SOCIETY 97 (James Buchanan, Gordon Tullock, & Robert Tollison, eds., 1980) (suggesting that competition for political favors could be characterized as rent-seeking contests, where different lobbyists invest (e.g., time, effort, bribes) in winning a prize (e.g., the location of a new public facility such as a military base)). This model has since been applied to a number of contexts, including labor market tournaments (contests between workers for promotion), *see* Edward

complicated, for if the prize is set too high, clubs potentially may bid themselves into bankruptcy; if the prize is based on localized revenues, teams with built-in advantages (such as large market size or a traditionally large fan base) may become so strong as to reduce the overall appeal of the league. If the prize for winning is too small, clubs lack the incentive to improve the absolute or relative quality of their rosters. Handouts to poor team owners will simply make those poor team owners richer without necessarily increasing investment in success on the field. The critical insight of contest theory is that equality of outcomes will be promoted if every contestant has an equal probability of winning the prize for a given level of effort (equality of opportunity). To optimize the investment, then, requires careful selection of the prize.

Selecting the best plan, and then negotiating a deal with the players' union that minimizes costs as well as deviations from the ideal structure, is significantly distorted when the league is run by participating clubs. To determine how to structure a prize, a league needs to determine how much locally-generated revenue clubs will be permitted to keep, how much to share, and how centrally-generated revenue will be distributed. In a club-run league, however, each club is primarily concerned with whether a proposed prize structure will be in its own interests, not whether the structure will maximize overall fan appeal for the entire league through improved competitive balance and by increasing club incentives to improve performance within the competition. For example, wealthier clubs are likely to block sharing of locally-derived revenues like ticket sales, even if they were revenue-maximizing (and, by enhancing consumer appeal, welfare-enhancing).[67] Especially because most leagues require these arrangements to be approved by a super-majority, a minority of owners could veto a proposal that demonstrably increases fan appeal.[68] Similarly, the necessary trade-offs to secure union approval may not affect clubs equally. A trade-off may minimize

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Lazear & Sherwin Rosen, *Rank Order Tournaments as Optimal Labor Contracts*, 89 J. POL. ECON. 841 (1981), patent races (R&D spending aimed at a monopoly rent granted by the patent), *see* Glenn Loury, *Market Structure and Innovation*, 93 Q. J. ECON. 385 (1979), and competition for research contracts, *see* Curtis Taylor, *Digging for Golden Carrots: An Analysis of Research Tournaments*, 85 AM. ECON. REV. 873 (1995).

67. *See* Stefan Szymanski & Tommaso M. Valetti, *Promotion and Relegation in Sporting Contests* (Imperial College Working Paper June 2003), *available at* http://www.nhh.no/omnhh/organisasjon/fag/sam/stabssem/2003/szymanski.pdf.

68. Clubs will often find it most profitable to minimize their investment in player talent and resulting roster quality, accomplished by creating a "prize structure" (i.e. revenue distribution) that minimizes the economic reward for winning. As Rosen and Sanderson observe, "All schemes used in the United States [major leagues] punish excellence in one way or another." Sherwin Rosen & Allen Sanderson, *Labour Markets in Professional Sports*, 111 ECON. J. 469, F47-F68 (2001).

overall labor costs while maximizing fan appeal, yet be contrary to the interests of a significant minority of clubs. Of course, skilled league executives may be able to overcome these objections by side payments to adversely affected clubs, but this process is not costless – especially because it is never precisely clear *how much* any club is adversely affected – and thus there is a substantial likelihood of sub-optimal behavior.[69]

The dynamics of collective bargaining present further problems for club-run leagues. A successful team with a strong fan base, an inferior large-market team, and a struggling small-market team will each have different incentives in labor negotiations: the effects of minimizing labor costs, restraining a club's ability to improve quickly, and losses caused by strikes or lockouts vary widely from team to team. Often, the most difficult task for league officials is securing owners' agreement on a bargaining offer.[70] The inability of club-controlled management negotiators to present a united front often makes it easier for union leaders to assume that management will not remain firm; in other cases, the union's perception that it needs to create a sufficiently credible threat of disruption to persuade the most militant minority of the owners to reach a compromise may result in miscalculations that also lead to inefficient labor disruptions.

Club owners—most of whom come to the sports having accumulated their wealth elsewhere—appear to be keen on attaining "cost certainty" with regard to the labor market. This seems to mean that they place a high value on avoidance of the economic consequences of making good or bad front-office player personnel decisions—even if the result is reduced fan appeal.[71] Avoiding the rigors of competition allows the owner the ability to enjoy the "quiet life,"[72] and increases the franchise's value, by making the club a potentially profitable investment for a wide variety of wealthy investors who would be unlikely to profitably operate a club where profitability turned on the owners' business acumen. From either an efficiency or consumer-welfare

69. For example, the Kansas City Royals will receive over $18 million from the league as part of new revenue sharing. If they wisely invest $10 million in increased payroll and the resulting improvement in the team's quality produces $12 million in additional revenue to the club, their revenue sharing transfers would be reduced by $9 million, resulting in a net loss to the club of over $3 million. This is illustrated in ZIMBALIST, *supra* note 63, at 103-07.

70. *See, e.g.*, Don Pierson, *Tagliabue Urges 'New' Tactics With Union*, CHI. TRIB., Mar. 22, 2005, at C4 (detailing obstacles to NFL owners' internal agreement).

71. *See generally* Stephen F. Ross, *The NHL Labour Dispute and the Common Law, the Competition Act, and Public Policy*, 37 U.B.C. L. REV. 343 (2004). *See also* Nat'l Baskeball Ass'n v. Williams, 857 F. Supp. 1069, 1072 (S.D.N.Y. 1994) (NBA Deputy Commissioner justified salary cap in part on grounds of "cost certainty").

72. *See* John Hicks, *Annual Survey of Economic Theory: The Theory of Monopoly*, 3 ECONOMETRICA 1, 8 (1935) ("best of all monopoly profits is a quiet life").

perspective, this emphasis on cost certainty is not desirable.

In our model, The League will select a prize structure designed to create incentives for clubs to succeed in a manner that creates the level of competitive balance that maximizes fan appeal, without driving teams into bankruptcy. The League will design its revenue sharing to induce clubs collectively to make an investment in talent equal to the aggregate return, measured by a league-awarded prize and any local revenues clubs are permitted to retain.[73] The more the league-awarded prize dominates the income stream of the teams, the more balanced the outcome of the contest is likely to be. If the only reward were a prize, every contestant would have an equal incentive to win. (Thus, if all baseball revenues were shared and the World Series champion received a $40 million prize, New York teams would have no long-term advantage over clubs from Pittsburgh or Kansas City.) Although the prize thus can correct for club dependence on local revenues, with their inevitable asymmetry, this need not imply that The League should aim to achieve a perfectly balanced contest. Because fans in each franchise location are unlikely to derive an equal amount of utility for a given level of success, and because in some instances competitions featuring dynastic teams increase fan appeal, a scheme is likely to maximize revenue and welfare if certain clubs (with a larger fan base, or where fans respond to wins by significantly greater attendance) won disproportionately, while all clubs had a reasonable opportunity to be competitive.[74] This is likely to reflect some mix of local revenue and prize money.

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73. *See* Tullock, *supra* note 66. The optimal contribution to effort depends on the "discriminatory power" of the contest: the degree of sensitivity of success to effort. If discriminatory power is high, it means that if one contestant supplies only a small amount of effort more than the others, then that contestant is highly likely to win; if discriminatory power is low, then a contestant has to put much more effort in than anyone else in order to achieve a high probability of winning. If discriminatory power is high then the optimal prize may be quite small, since even this small prize will elicit enormous effort to win. By contrast, if discriminatory power is low, then the prize will need to be quite high in order to extract effort.

74. A classic argument in this vein is RICHARD C. LEVIN, GEORGE J. MITCHELL, PAUL A. VOLCKER, & GEORGE F. WILL, THE REPORT OF THE INDEPENDENT MEMBERS OF THE COMMISSIONER'S BLUE RIBBON PANEL ON BASEBALL ECONOMICS (July 2000), http://www.mlb.com/mlb/downloads/blue_ribbon.pdf, attributing baseball's woes to an increasing disparity in local revenues among clubs, which the Report blames for an increasing inability of well-run "small market" clubs to have a "regularly recurring reasonable hope of reaching post-season play." *Id.* at 8. The effect of asymmetric local revenue bases on local revenue should not be overstated, however. Using the Report's data, among the top six clubs are teams located in the relatively small markets of Atlanta, Denver, and Phoenix, while Detroit and Montreal are in the bottom quartile; indeed, if half the population size for each club in metropolitan areas with two clubs are assigned to each team, the statistical correlation between media market rank and local revenue based on Report data is a modest 0.58. *Id.* Stephen F. Ross, *Light, Less-filling, It's Blue-ribbon!*, 23 CARDOZO L. REV. 1675, at 1685-86 & n.38.

Labor relations executives from The League will be able to agree on a collective bargain with the union to implement the most efficient and revenue maximizing structure for labor market competition, without the additional need to ensure that the agreement makes a super-majority of clubs better off. They will be able to offer the union incentives to agree to such a structure, or to minimize any departures from this ideal competition design.[75] Relatedly, The League will present a united front that avoids costly misjudgments concerning the resolve of management as well as the need to craft a proposal acceptable to a minority of "hard line" owners. Helpfully to the union (and to fans seeking to avoid industrial disruption), assuming a mature well-run league that can attract competitive levels of investment,[76] The League has no particular incentive to reduce competition player services in ways that the union is likely to oppose solely give owners "cost certainty" to shield them from the risk that bad personnel decisions will require increased spending because of their club's poor record in prior seasons. We note that in the one major North American league not run by clubs, NASCAR, there are no serious restraints on the compensation provided by participating racing teams for drivers, crew chiefs, or other skilled personnel.[77] Although the actual effect on player salaries is uncertain and subject to collective bargaining, we predict that The League would likely recognize that competition in the marketplace is usually the best means of allocating resources (here, players) among teams.

F. Summary of Economic Comparisons Between Club-run and Vertically Separate Leagues

The industrial organization of a sports competition is a complex endeavor, requiring those who develop the product for sale to fans to account for many different considerations. More franchises increase national television audiences and attract new fans, while modestly diluting playing talent and reducing the number of games between highly attractive clubs. More telecasts

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75. To the extent that across-the-board salary caps improved competitive balance to such an extent that overall league revenues were really maximized, The League and the union can be expected to reach an agreement. However, salary caps often reduce consumer appeal by prohibiting inferior clubs from quickly improving by increasing payroll through the infusion of new talent. Stephen F. Ross, *The Misunderstood Alliance Between Sports Fans, Players, and the Antitrust Laws*, 1997 U. ILL. L. REV. 519, 567-77. Moreover, the need for salary caps to address revenue disparities among clubs is reduced where The League is setting the prize.

76. A fledgling or flailing league that requires additional incentives to attract investors to operate clubs may find cost certainty to be a legitimate priority. Indeed, this was the basis on which the NBA persuaded the players' union to agree to a salary cap in return for a guaranteed share of hopefully-growing revenues in 1982. *See Interview with David Stern, NBA Commissioner*, ANTITRUST, Summer 1987, at 27.

77. Scott Warfield, *NASCAR Rules*, SPORTS BUS. J., May 23, 1994, at 20.

or webcasts increase revenues from rights purchasers and sponsors, but may affect live gate or ratings from other telecasts currently under contract. Merchandise often is sold because of league rather than club popularity and can often be efficiently sold collectively, yet individual club initiatives might allow for localized opportunities that league marketers will miss. Determining an optimal level of competitive balance and devising a mechanism to efficiently allocate players among clubs to maximize consumer appeal is enormously difficult. These trade-offs are challenging enough for skilled professionals to accomplish. However, executives of club-run leagues must not only develop a business model that optimizes these trade-offs in a way that maximizes profits for the sport; they must also obtain approval from owners whose votes are cast based on their own long-term, short-term, or other strategic interests. Although in theory side payments can be made to any owners adversely affected by a model that maximizes league profits, the difficulty in agreeing on these payments can lead to inefficient rules that reduce consumer appeal as well as league-wide profits. These problems are exacerbated in cases where a super-majority of individual clubs must approve any proposal.

Our predictions about how The League might implement its authority to maximize profits and consumer appeal are primarily illustrative. What is critical is that The League, unlike the clubs acting collectively, has the incentive to determine efficiently how sporting competitions are conducted and the business of sport is run.

III. ANTITRUST TREATMENT OF SPORTS LEAGUES: SINGLE ENTITIES CONTRACTING WITH CLUBS VERSUS CLUB-RUN LEAGUES

Contracts in restraint of trade violate section 1 of the Sherman Act.[78] The Supreme Court held almost a century ago, however, that the statute's broad language precluded only agreements that unreasonably restrain trade.[79] More recently, in the *NCAA Case*,[80] the Court provided guidelines to determining unreasonableness in the sports context. Because of the cooperation among clubs required to organize a sporting competition, agreements among participating clubs are evaluated under the rule of reason. According to the *NCAA Case*, a "hallmark antitrust violation" occurs when these agreements result in higher prices, lower output, or output unresponsive to consumer

78. Section 1 of the Sherman Act, 15 U.S.C. §1 (2000), declares unlawful every "contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations."

79. Standard Oil Co. v. United States, 221 U.S. 1 (1911).

80. 468 U.S. 85 (1984).

demand compared to what would "otherwise be,"[81] even where some agreements among the defendant-rivals are considered necessary for the product to exist at all.[82]

Although this reasonableness inquiry does not apply to intra-firm agreements within a single business entity,[83] courts have overwhelmingly rejected efforts by club-run leagues to be treated as single entities.[84] Indeed, one of the principal doctrinal insights to be gleaned from Part II of this Article is that the significant economic difference in the way that a club-run league operates, compared to a league controlled by a single entity acting as "residual claimant" for profits not distributed to clubs, provides a persuasive justification for continued close scrutiny of the former.[85] While Part II demonstrated the economic advantages of organizing a sporting competition through a single business entity, The League, this Part suggests that there are significant legal advantages to organizing a vertically-separate business entity

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81. *Id.* at 107.

82. *Id.* at 101.

83. Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984).

84. Earlier cases are catalogued in Stephen F. Ross, *Antitrust Options to Redress Anticompetitive Restraints and Monopolistic Practices by Professional Sports Leagues*, 52 CASE W. RES. L. REV. 133, 146 n.35 (2001). For academic commentary in favor and opposed to the single entity defense as applied to club-run leagues, see Ross, *supra* note 75, at 549 n.136. *Cf.* Fraser v. Major League Soccer, L.L.C., 284 F.3d 47 (1st Cir. 2002) (the district court's rejection of an antitrust claim based on the single entity argument was criticized and the result affirmed on other grounds.)

85. *See* Chicago Prof'l Sports Ltd. v. Nat'l Basketball Ass'n, 95 F.3d 593, 603 (7th Cir. 1996) (Cudahy, J., concurring) (sports leagues can make inefficient decisions where individual teams can gain at the expense of the league).

Even Professor Gary Roberts, the principal academic advocate for treating club-run leagues as single entities, has recognized that:

> there is a legitimate concern that the structure of a league, unlike that of other business organizations, may cause, albeit infrequently, individual club economic interest to be contrary to the interests of the league as a whole. While it is unusual for partnerships or corporations to be organized such that a proposal enhancing the efficiency or profitability of the firm as a whole is contrary to the economic interest of any partner or shareholder, the universal sports league practice of allocating all or most of the nontelevision, game-generated revenues to the home club makes the potential more likely in some sports league contexts.

Gary R. Roberts, *Sports Leagues and the Sherman Act: the Use and Abuse of Section 1 to Regulate Restraints on Intraleague Rivalry*, 32 UCLA L. REV. 219, 295 (1984). Our principal difference is with Roberts' belief that "in the overwhelming majority of instances, the interests of the league will coincide with those of individual clubs." *Id.* at 295 n.261. Rather, we have identified a wide variety of areas where we believe that club-run leagues will behave differently than a league controlled separately. In suggesting that club-run leagues enjoy single-entity status unless a plaintiff shows that a minority of clubs actually vetoed a proposal that would benefit the league and the majority of clubs. *Id.* at 296. Roberts also ignores the distinct possibility that a majority of club owners will engage, over time, in a tacit agreement to adhere to policies that benefit each of them as club owners even if the league as a whole will suffer, or the alternative scenario where the majority agree not to pursue an efficient innovation because of an inability to agree on the distribution of profits.

as an independent organizer of sporting competitions. As explained below, The League would enjoy much greater flexibility than a club-run league in (1) the sale of broadcast rights, (2) decisions relating to entry and franchise relocation, (3) the creation of balance-enhancing or otherwise efficient rules governing clubs' competition for the services of players, and (4) the implementation of regulations relating to the structure of club ownership.

A. Sale of Broadcast Rights

Under the common law, the home team has the right to telecast a ball game.[86] Thus, any rights sales by a club-run league constitutes an agreement among competing clubs to jointly sell valuable rights, which is subject to rule of reason analysis under the *NCAA Case* standard. Any sale that demonstrably raises prices, reduces viewership, or renders output unresponsive to consumer demand would be unlawful.[87]

Where sports competitions are organized by The League, we envision that the clubs' common law television rights would be transferred to the League as part of the franchise agreement. The franchise agreement's provision initially granting all rights to The League would be scrutinized under the *NCAA Case* test. However, in light of the significant pro-competitive benefits to vesting control of broadcast revenues in The League, this transfer should be upheld as reasonable because it is likely to enhance viewership and the overall appeal of the sport. Allowing The League to distribute all broadcast rights avoids the significant collective action problems when clubs individually sell rights and then—to pursue legitimate goals like competitive balance—agree among themselves as to how revenue is shared. Moreover, centralized rights sales' provide The League with a critical base of revenue that can be used to achieve the level of competitive balance designed to maximize consumer appeal, through outright redistribution or through competitive prizes.[88] Once the

86. Pittsburgh Athletic Co. v. KQV Broad. Co., 24 F. Supp. 490 (W.D. Pa. 1938).

87. *NCAA Case,* 468 U.S. at 107 (1984). *See also* Stephen F. Ross, *An Antitrust Analysis of Sports League Contracts with Cable Networks*, 39 EMORY L.J. 463 (1990). A major exception is if a league sells a package of games to a free-to-air television network. Congress has passed a specific and limited exemption from antitrust scrutiny for such sales. Sports Broadcasting Act, Pub. L. No. 87-331, 75 Stat. 732 (1961), *codified at* 15 U.S.C. §§ 1291-94 (2000).

88. *See supra* text accompanying notes 73-74. The downside to this legal advantage that The League would have over club-run leagues is that the ongoing evolution of the market for pay television could lead The League to shift many games now shown on free-to-air television to a more expensive medium. Shifts away from free-to-air are becoming more prevalent in club-run leagues, *see* ZIMBALIST, *supra* note 63, ch. 7, but may be inhibited by the inability of clubs to agree on how to divide the proceeds from collective rights sales to pay programmers. While an agreement among rivals to collectively shift the sale of their rights to more expensive tiers may constitute an unreasonable restraint of trade, Ross, *supra* note 87, at 481, the unilateral sale by The League to a

initial common law rights have been vested in The League, all subsequent rights sales to programmers or networks would no longer be viewed as a collective sale for purposes of the Sherman Act. Thus, absent a demonstrable anticompetitive effect in another market (for example, if a contract with a dominant purchaser had the effect of foreclosing competition from other broadcast companies, harming competition in the broadcast market),[89] The League would be free to do as it chose.

B. Franchise Entry and Relocation

The specter of antitrust liability poses perhaps the greatest concern for club-run leagues with regard to franchise entry and relocation. The collective refusal of current clubs to permit new entry or to approve a relocation opens club-run leagues to lawsuits challenging these decisions as unreasonable trade restraints among competitors.[90] As the Supreme Court noted in the *NCAA Case*, horizontal restraints among competitors are generally treated with suspicion under the antitrust laws.[91] In contrast, there will be minimal antitrust

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satellite or pay programmer would not. We do not believe that this concern outweighs the benefits in allowing The League to control broadcast rights, but if this shift is socially undesirable Congress can follow the pattern of many other developed countries that have enacted "Listed Events" legislation that specifies that key events (championships, late playoffs, a game of the week) must be on free-to-air television. *See, e.g.*, Broadcasting Act, 1996, ch. 55, §§ 97-105 (Eng.); Broadcasting Services Act, 1992, (Austl.) (authorizing minister to list events required to be available on free-to-air television).

89. *See, e.g.*, Henderson Broad. Corp. v. Houston Sports Ass'n, 541 F. Supp. 263 (S.D. Tex. 1982) (plaintiff claimed exclusive contract monopolized competition for radio in Houston-Galveston area). *See also* MONOPOLIES AND MERGER COMMISSION, BRITISH SKY BROADCASTING GROUP PLC AND MANCHESTER UNITED PLC: A REPORT ON THE PROPOSED MERGER (Apr. 9, 1999), *available at* http://www.competition-commission.org.uk/rep_pub/reports/1999/426sky.htm (blocking acquisition of leading British soccer team by leading pay television programmer in part based on concerns that acquisition would distort competition for lucrative soccer television rights between acquiring firm and its rivals).

90. *See, e.g.*, St. Louis Convention & Visitors Comm'n v. Nat'l Football League, 154 F.3d 851 (8th Cir. 1998) (league requirement that Rams pay a fee for permission to relocate to St. Louis was reasonable; allegations that league agreed that Rams would be only team to negotiate with St. Louis unproven); Nat'l Basketball Ass'n v. San Diego Clippers Basketball Club, 815 F.2d 562 (9th Cir. 1987) (league relocation rules are not per se illegal but must be evaluated on a case by case basis); *Los Angeles Mem'l Coliseum Comm'n*, 726 F.2d 1381 (affirming jury verdict that NFL refusal to allow Oakland Raiders relocation to Los Angeles was unreasonable effort to protect Los Angeles Rams franchise from intra-league competition); San Francisco Seals v. Nat'l Hockey League, 379 F. Supp. 966 (C.D. Cal. 1974) (no claim of any injury to competition from bar on relocation of franchise to Vancouver); State v. Milwaukee Braves, 1966 Trade Cas. ¶ 71,738 (Wis. Cir. Ct., Milwaukee Co.) (National League's approval of Braves' relocation to Atlanta and refusal to expand to Milwaukee constituted monopolization in violation of state antitrust statute), *rev'd on other grounds*, 144 N.W.2d 1 (Wis. 1966) (application of state antitrust statute to league rules requiring uniformity constituted an unconstitutional burden on interstate commerce).

91. *NCAA Case*, 468 U.S. at 100.

scrutiny of The League's entry and relocation decisions.

Even for club-run leagues, courts are generally deferential on questions of entry,[92] and there is even less risk if, as we predict, The League will allow entry where market dynamics so indicate.[93] As a matter of legal doctrine, while the NFL's refusal to allow the Oakland Raiders to move to Los Angeles was viewed as a restraint among competitors, any decision by The League would be considered a vertical restraint and a plaintiff would have a heavy burden under the rule of reason to show that The League's interest was not the same as fans. As noted earlier, decisions by a single firm as to where to sell its product raises fewer competitive problems and warrants less antitrust scrutiny than a collective decision by rivals.[94] As a matter of substance, it is unlikely that The League would block a relocation that enhanced overall fan appeal simply because of increased intra-league competition might result; at the same time, relocations that reduce fan appeal by trampling on fan loyalty (such as the Cleveland Browns' relocation to Baltimore or the Baltimore Colts' relocation to Indianapolis) would be less likely to be permitted by The League on business grounds, and The League's commissioner would not have the same antitrust worries that the NFL Commissioner now faces.

C. Labor Restraints

In most instances, labor restraints no longer present significant antitrust concerns to any league, club-run or not. The Supreme Court has held that any restraints primarily affecting the labor market that occur in an industry where there is ongoing collective bargaining between management and a is immune from worker challenges under a judicially-created exemption to the antitrust

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92. In *Mid-South Grizzlies v. Nat'l Football League*, 720 F.2d 772 (3d Cir. 1983), the court rejected an antitrust suit by a would-be entrant to the NFL. The court reasoned that, unlike the *Raiders* case, there was no serious claim that a Memphis entrant into the league was rejected by an inefficient monopoly venture in order to protect an existing rival (the closest other franchise, the then-St. Louis Cardinals, was over 250 miles away), and that leaving markets such as Memphis open actually encouraged new inter-league rivalry by promoting entry.

93. *See supra* text accompanying notes 46-50.

94. *Compare Cont'l T.V., Inc. v. GTE Sylvania*,433 U.S. 36 (1977) [hereinafter *Sylvania*] ("vertical" territorial restraint imposed by television manufacturer on locations where its product could be sold at retail subject to rule of reason) *with Gen. Motors Corp.*, 384 U.S. 127 ("horizontal" territorial restraint imposed by auto manufacturer at behest of organized group of retailers held illegal *per se) and* United States v. Sealy, Inc., 388 U.S. 350 (1967) (territorial restraint imposed by trademark owner on licensees considered "horizontal" where licensees controlled the corporation owning the trademark). This distinction was reaffirmed in *Sylvania.*, 433 U.S. at 58 n.28.

Even if The League did not permit efficient entry in order to add to its monopoly profits, this conduct by a single dominant firm would not violate the Sherman Act. The League's liability as a single firm for monopolization is discussed *infra* at note 105.

laws.[95] However, in the context of club-run leagues, players retain the option of decertifying their union as their bargaining representative, ceasing collective bargaining, and filing an antitrust suit to challenge jointly-adopted labor market rules, alleging that clubs competing among themselves for players' services were illegally restraining trade.[96] The League would face no such threat if it centrally controlled all labor relations.[97]

As with the initial grant of television rights in the franchise agreement, the provisions granting The League central control over player assignment would initially be subject to Sherman Act scrutiny. To be sure, if the result was a centralized allocation of players among teams, eliminating any competition for players' services, this decisions would raise serious risks of antitrust liability. However, for the same reason that the most brilliant planners that Lenin could assemble were unable to centrally plan an economy, we believe that a centralized labor market is unlikely to maximize fan appeal. Whereas a club-run league may not care about maximizing fan appeal if the harm is outweighed by significant savings on salaries, The League's management will not be spending any money on player salaries: the club-franchisees will be. Just as NASCAR has no reason to limit the salaries participating racing teams pay their drivers,[98] The League is likely to create rules designed to optimally allocate players among teams via a generally free labor market.[99] For these reasons, perhaps the best solution for The League would be to assure players of their fair share of the benefits from this competition through a collective bargaining agreement, thus minimizing an antitrust challenge to the initial grant of control to The League. Indeed, the ability of The League's organizers to attract capital and investment is probably enhanced by initially securing a long-term collective bargaining agreement with the union.[100] Moreover, such

95. Brown v. Pro Football, Inc., 518 U.S. 231 (1996).

96. Indeed, this is exactly what the NFL players did over a decade ago. *See, e.g.,* Powell v. Nat'l Football League, 764 F. Supp. 1351, 1359 (D. Minn. 1991).

97. Although centrally-controlled labor relations were subjected to close antitrust review in *Fraser*, 284 F.3d 47, the league was not found to be independent of rival clubs but rather was controlled by the club owners. *Id.* at 57, 57 n.5.

98. *See supra* note 77.

99. *See supra* text accompanying notes 70-77.

100. One way for current owners to profit from the restructuring we propose would be to create The League as a separate business entity and sell stock in that entity, either as an initial public offering or as a private sale to selected investors. The value of that sale would be maximized by creating The League prior to issuance of public stock, establishing a highly regarded Board of Directors and executive team, and securing a collective bargaining agreement with players. *Cf.* Taylor Milk Co. v. Int'l Brotherhood of Teamsters, 248 F.3d 239 (3d Cir. 2001) (describing merger where acquiring firm desired to have new collective bargaining arrangement secured before closing deal).

bargaining may well be necessary under federal labor law, to the extent that the restructuring of a league would be considered to have such a significant effect on player wages and working conditions as to constitute a mandatory subject of bargaining.[101]

D. Policies Concerning Ownership

Finally, leagues have faced antitrust litigation concerning the creation or application of policies concerning ownership. For example, applying the rule of reason under Section 1, courts have found the National Football League's rule against corporate ownership of its clubs to unreasonably shield owners from competition from more efficiently-structured entities,[102] while the NBA's rejection of a particular buyer was upheld.[103] Antitrust liability for ownership rules are more likely when a league is club-run: plaintiffs will allege that club owners are trying to hamper rival clubs by precluding more efficient ways of organization or of obtaining capital. If The League unilaterally imposed its own rules on franchisees, it would be difficult to construct a theory of competitive harm.

Any league can persuasively argue that the overall league appeal can be affected by the ownership structure of participating clubs. Club-run leagues face a disadvantage in devising optimal policies however, because it is in the interest of each owner to tacitly agree that virtually any high bidder seeking to purchase a club from an existing owner should be able to do so, even if such an owner would not be an effective steward of the sports in their local market. Alternatively, a club-run league may prefer a less-effective steward precisely because a rival bidder may increase competition in various markets in which owners compete.[104] In contrast, The League would be much more likely to

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101. *Cf. Mackey*, 543 F.2d at 615 (league rules restricting inter-club competition for players affects salaries so that they constituted mandatory subject of bargaining under § 8(d) of the National Labor Relations Act, 29 U.S.C. § 158(d) (2000)). If the restructuring is the result of legislation or court order, the fact of restructuring would not, of course, be a mandatory subject of bargaining. Obviously, The League would then need to enter into a new collective bargaining agreement with the players.

102. Sullivan v. Nat'l Football League, 34 F.3d 1091 (1st Cir. 1994).

103. Levin v. Nat'l Basketball Ass'n, 385 F. Supp. 149 (S.D.N.Y. 1974).

104. Some have suggested that the recent highly-leveraged sale of the Los Angeles Dodgers was approved, notwithstanding a fiscally-superior offer in the wings from a wealthy local philanthropist, because other owners wanted a major-market team to be saddled with less aggressive ownership. Thomas S. Mulligan, *McCourt Teams Up on Land Use,* L. A. TIMES, Mar. 17, 2005, D1 (purchase featuring little cash and unusual seller financing raised questions about whether buyer's pockets were deep enough to keep the Dodgers competitive). The jury in *Sullivan* was persuaded that the fear of competition from clubs owned by publicly traded corporations was more important to league owners than the chance to maximize their franchise resale opportunities. 34 F.3d at 1100.

prevent clubs from being operated by those whose ownership structure was inimical to the league's best interests.

In sum, an independent entity organizing a popular sporting competition is likely to enjoy significant legal advantages over traditional club-run leagues.[105]

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105. Because The League would likely be the dominant provider of competition organizing services in each sport, it would potentially remain liable for attempted or actual monopolization under Section 2 of the Sherman Act, 15 U.S.C. §2. Courts have generally found that the dominant league in a major sport possesses monopoly power. *See, e.g.*, Ross, *supra* note 84, at 140 n.16 (citing cases). However, The League's liability would be no greater than that faced by club-run leagues today. Antitrust law does not forbid the exercise of monopoly power, only its illegal maintenance. *See* United States Football League v. Nat'l Football League, 842 F.2d 1335, 1361 (2d Cir. 1988) (upholding jury verdict that a monopolist "is free to set as its legitimate goal the maximization of its own profits so long as it does not exercise its power to maintain that power"). To prove illegal monopoly maintenance, a plaintiff must establish not only that rules are exclusionary, but also that they are unnecessarily so – that is, that they are inefficient. Rules designed to promote consumer appeal or to achieve efficiencies are lawful. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985).

Like current club-run leagues, The League could not engage in blatantly anticompetitive acts without violating §2, nor could it foreclose rival leagues from essential inputs; thus, The League could neither tie up every television network (this was a principal, albeit unproven, theory in *United States Football League*, 842 F.2d 1335), nor structure its player contracts so that in any given year it would not be feasible for a rival to have access to a sufficient number of players to viably compete. *See* Philadelphia World Hockey Club, Inc. v. Philadelphia Hockey Club, Inc., 351 F. Supp. 462, 508 (E.D. Pa. 1972) (provisions reserving all major and minor league players to NHL clubs or affiliates for three years constituted monopolization by precluding rival league from entry.)

Likewise, The League might be required, in the interest of maintaining the potential threat of competition, to permit clubs to retain control of their trademarks. Allowing clubs to keep their trademarks (subject to a limited assignment to The League for licensing purposes that now occurs) if they choose to join another league would enhance the opportunity for rivalry in competition-organizing services and the possibility of The League's displacement by a more efficient rival. In similar fashion, although franchise agreements can reasonably be set for a sufficient duration to allow for long-term planning, unduly long franchise agreements could operate to monopolize if they precluded any ability to lure existing clubs to a new league. *See* XI HERBERT HOVENKAMP, ANTITRUST LAW ¶1802g (1998).

Because even in natural monopoly markets antitrust laws favors competition for the monopoly, it could be argued that the best way to promote competition in the market for competition organizing services is to prohibit The League's control of player contracts. If players were contracted to individual clubs, then a new entrant could compete by simply attracting the club owner, rather than develop a league of minimum viable scale by individually signing players. We do not believe that The League's control of players – assuming that after any given season a reasonable number of player contracts will expire – is sufficiently anticompetitive to constitute monopolization. There are significant efficiencies in allowing The League negotiate as a single entity with the players' union to devise an optimal scheme to allocate players among clubs participating in its competition. Collective action problems make such an agreement with club employers more difficult. Moreover, The League might allocate a player to a particular club precisely because this allocation is efficient in the context of the club's participation in the competition organized by The League. If The League feared that an individual club might take all its players and participate in another competition, The League might allocate players differently, and less optimally in the short-run. Foregoing clear benefits to The League's competition in the short-run, because of the possibility that entry into the presumptively natural monopoly market for competition organizing would be marginally facilitated if clubs

The competition is more likely to be designed to enhance consumer appeal and operated in a manner to maximize overall profits. Because The League's business decisions will either be unilateral or "vertical" agreements with independent clubs, The League will enjoy significant legal flexibility to make decisions that would otherwise risk serious antitrust liability. The result should be greater profitability as well as greater responsiveness to consumers.

IV. WHY CURRENT OWNERS MAY BE UNWILLING TO RESTRUCTURE EVEN IF IT IS EFFICIENT TO DO SO

In a well-functioning market, no one would design a league that resulted in a sub-optimal number and location of franchises, a sub-optimal exploitation of broadcast rights, inefficient marketing of sponsorship and licensing, labor markets that are neither cost-minimizing nor efficient in allocating players among clubs, and lack of effective oversight of each club's stewardship of its valuable franchise. Absent transaction costs, of course, the assignment of rights to club owners would not affect the ultimate structure of a league: where a revenue-enhancing alternative is available, side payments can be made to assure the desired result.[106] However, where transaction costs are significant, the allocation of control rights to club owners can significantly affect the distribution of resources.[107]

Unlike most other businesses that could profitably restructure, neither actual or potential rivals, nor a market for corporate control, constrains individual club owners' pursuit of their own interests at the expense of an

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employed players, would not seem to be reasonable.

At the same time, the Sherman Act should properly constrain clubs' ability to jointly negotiate with The League and rival competition organizers. If a rival can organize a competition more efficiently than The League, it is free to bid for individual teams to compete in its competition. A rival league could conceivably pursue a strategy of attracting clubs by offering them greater power and authority, similar to that now enjoyed in club-run leagues, and that such competition will result in a structure no different than currently exists. We believe that such a strategy is unlikely to succeed. Precisely because club-run structures are less efficient, it is difficult to see how a new entrant could make an offer sufficient to attract so many clubs that The League would not remain viable. To use two simple examples, if a new entrant made an offer aimed at attracting small-market clubs, The League would remain viable on a smaller basis focusing on its large markets; if a new entrant made an offer aimed at the top clubs in major cities, The League with its preexisting brand loyalty and infrastructure could add additional franchises in these major markets, which are likely to be capable of supporting additional teams. If we assume that The League will remain as a viable entrant in the market, then clubs considering jumping to a rival will have to weigh the more attractive package offered against the lost profits because of the usually fierce inter-league rivalry that will follow. On the other hand, a rival that develops a model that really is more efficient than The League's should be able to attract almost all the clubs through individual negotiations.

106. *See* Ronald H. Coase, *The Problem of Social Cost,* 3 J. L. & ECON. 1 (1960).

107. *See* COOTER & ULEN, *supra* note 45 at 111-12.

efficient league operation. The same transactions costs that prevent current leagues from achieving efficient results may prevent current club owners from voluntarily embracing an efficient re-structuring of the league in which their club competes. Although a solid promise of cash today and the opportunity to share in the gains from an even more profitable business operation in the future provides a significant incentive for parties to overcome transactions costs, the existence of such costs means that the inability of a league to restructure does not necessarily mean that the current system is efficient.

This part explores why vertically separate leagues have not been established already if, as we claim, the idea is so efficient. Then, this part details the transactions costs that must be overcome to achieve restructuring on a voluntary basis.

A. Why Leagues Have Not Done This Already if It is Such a Good Idea

Each major North American professional team sports league has always been vertically integrated. We do not believe, however, that vertical integration is inherently required in order to maximize consumer appeal or efficiently operate a team sport competition. Rather, vertical integration is the result in part of the dynamic economics of fledgling sports leagues that lack market power, and in part is due to historic accident.

Vertical integration was a necessity when the first club-run league—baseball's National League—was created in 1876.[108] This model emerged as a consequence of two factors. First, interest in the rapidly growing sport was being undermined by the free-for-all existing in baseball at the time, characterized by (a) barnstorming teams attracting support as long as they were winning and then collapsing when they lost, (b) team owners dissipating profits in competing to hire the best talent, and (c) opportunities for gambling that led to significant match fixing. Second, almost all the revenues associated with baseball in the late 19th century were generated locally by clubs, principally through sales of admission tickets.[109] The founders of the significantly named "National League of Professional Baseball Clubs" set out to create a new kind of equilibrium: a league with stable membership. The new arrangement[110] invested members with a stake in its long-term success (to

108. The authoritative work on the origins of baseball, from which the textual narrative is derived, is HAROLD SEYMOUR, BASEBALL: THE EARLY YEARS 77-85 (1960).

109. *Id.* at 75-85.

110. To bring this about, the league's principal founder, William A. Hulbert of the Chicago Baseball Club (now the White Sox), assembled a talented team by raiding other clubs and then secured an agreement from leading clubs in a geographically-balanced group of eight cities from Boston to St. Louis. *Id.*, at 77-80.

combat short-run incentives for match fixing), granted exclusive territories guaranteeing a local monopoly (providing an incentive to invest in the local market), and established a reserve clause to eliminate competition for players (ensuring that the income stream from matches accrued principally to the owners). The extraordinary success of this model made it the basis for not only the national pastime, but also for the other North American team sports.

Although the founders of the National League deemed it natural to integrate governance functions with the supply of matches, this was not really necessary but rather a direct consequence of the lack of any alternative credible supplier of these services in 1876. In England, by contrast, the Football Association (FA), established in 1863, had successfully standardized rules and maintained oversight of the development of English soccer and had also developed two important forms of competition in its own right: the FA Cup, a knock-out competition including all members, and international representative football.[111] Thus, when leading English soccer clubs found the same need as American baseball teams for a fixed and reliable playing schedule and therefore created the Football League in 1888, they did not fully integrate the competition. Although in part this may have been due to the desire to continue participating in the FA Cup, the founders also believed that it would be both in their interests and in the wider interests of soccer to maintain an independent governing body at the head of the sport.[112] The English governance model has been adopted globally in soccer.[113]

Whether an organization created for other purposes exists to develop a league competition may be a historic accident, but where a sport is just developing in the relevant market, or where a new entrant is organized to

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111. The early history of the game is recounted in GEOFFREY GREEN, SOCCER, THE WORLD GAME: A POPULAR HISTORY ch. 3 (1956).

112. In the words of William McGregor, founder of the Football League:

> The League should never aspire to be a legislating body . . . by the very nature things the League must be a selfish body. Its interests are wholly bound up in the welfare of its affiliated clubs, and what happens outside is, in a sense, of secondary importance only . . . the League has its work to do; the [Football] Association has its work to do and there need be no clashing.

SIMON INGLIS, ENGLISH LEAGUE FOOTBALL AND THE MEN WHO MADE IT 11 (1988). *See also* GREEN, *supra* note 111, at 62 ("The FA on the one hand [is] the monarchy as it were, with its watchful care and authority over the whole of English football: on the other hand [there is] the Football League, with its narrower horizons, existing under the licence of the FA.")

113. Each country's domestic competition operates under the aegis of a national association modeled on the FA; an association of associations governs each continent. For example, Europe's governing body is the Union of European Football Associations (UEFA). *See UEFA Welcome Page*, UEFA.COM, http://www.uefa.com/ (last visited Mar. 7, 2006). An international federation, the The Fédération Internationale de Football Association (FIFA) is the world governing body. *See FIFA Welcome Page*, FIFA.COM, http://www.fifa.com/en/organisation/index.html (last visited Mar. 7, 2006).

challenge an established incumbent league, vertical integration can be extremely important. There is unlikely to be a credible supplier of competition-organizing services to clubs who might join such a league, and club owners may be reluctant to participate in such a risky venture without some role in controlling the fortunes of the new competition.[114] However, today's owner of the Chicago White Sox would not find, as his predecessor William Hulbert did, that there is no one willing and able to provide competition-organizing services. The explosion in revenues from broadcasting, merchandising, and sponsorships creates huge incentives for vertically separate firms to perform these services. Unlike those seeking to organize Major League Soccer,[115] and like NASCAR's owners, competition organizers would likely find many interested in participating in the dominant professional baseball competition in the United States, even if they lacked the ability to control the league. Once a league becomes sufficiently dominant so that vertical integration is no longer necessary to attract potential franchisees, it may well retain its traditional structure simply because the potential gains from an efficient restructuring are not large enough to justify the trouble. It is only recently that the revenues (primarily from broadcasting) have exploded to such a degree that the sort of restructuring proposed in this Article is worth the significant transaction costs involved in bringing it about.

Recent developments suggest a growing industry recognition of the benefits of vertical separation. Preventing owners from engaging in self-aggrandizing opportunistic behavior is seen as a serious problem: according to one sports executive, "if [NFL Commissioner] Paul Tagliabue could convert the NFL to a single entity, he'd do it tomorrow."[116] Although not formally as separated as The League we suggest in this Article, the WNBA is run by a Board of Directors with each club participating pursuant to an operating agreement that designates revenues and costs for which the club is responsible. While four of the nine directors come from the group of NBA owners who operate WNBA teams, the other five include four owners without WNBA franchises and the NBA Commissioner. The Board of WNBA, LLC is ultimately responsible to the WNBA's sole owner, a corporation named NBA Development, that in turn is owned by the twenty-nine NBA owners. Thus,

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114. Recently, the commercial power of English football clubs has expanded dramatically, resulting in greater deference to club interests by the FA resulting in some of the same problems that exist in North America. *See, e.g,* JOHN WILLIAMS, IS IT ALL OVER? CAN FOOTBALL SURVIVE THE PREMIER LEAGUE 53-60 (1999). This is due in large measure to the perceived threat of the top clubs to secede from the FA and organize their own competition. We discuss why we believe a concerted secession from a competition by the leading teams should violate the Sherman Act, *supra* note 105.

115. *See* WEILER & ROBERTS, *supra* note 30, at 495-97.

116. *See* Lebowitz, *supra* note 10, at 1F.

while some of the problems that plague club-run leagues could rear their head, the benefits of negotiating broadcast rights and sponsorship deals without the fear that clubs may undercut rights sold by the league is a major advantage, according to the WNBA's former chief executive.[117] As a result, while some club-run league constitutions have express terms to make clear the reality that club owners vote the interests of their own club rather than the league as a whole,[118] a WNBA owner serving on the WNBA board who put his club's interests ahead of the league's would arguably breach his fiduciary duty.

Just recently, two investment banking houses presented the NHL with an offer to acquire the entire league.[119] Although the initial proposal, unlike the proposal for The League contained in this Article, would retain the vertical integration of competition organizing and club participation by having a single entity own both the league and all clubs, its structure is designed to take advantages of the efficiencies here.

Finally, the strongest demonstration of the viability of vertical separation in sports leagues is the tremendous success and growth of NASCAR. Historically, this centrally-run giant was developed out of a chaotic industry where independent tracks set their own rules for the competition.[120] Of course, if today NASCAR were sold to a consortium of competing drivers, who agreed to henceforth operate the circuit by super-majority vote, and to limit entry to current Nextel Cup drivers and any qualified driver who bought the rights to participate, there would be a public uproar as well as an antitrust challenge, and properly so.

B. Transaction Costs Inhibit Efficient Restructuring

Corporate finance experts can offer myriad ways to implement the creation of The League as a separate business entity and the assignment of rights necessary for The League to organize a sports competition efficiently.

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117. *Id.* (citing Commissioner Val Ackerman). At the same time, several leagues that have adopted a "single entity" approach by completely integrating all competition organizing and club participation services (so the league owns all the franchises) have found the approach wanting. *See id.* (indoor lacrosse league needed to modify single-entity to attract local investors); WEILER & ROBERTS, *supra* note 30, at 496 (Major League Soccer could not find investors absent ability to have local rights).

118. *See, e.g.,* NATIONAL FOOTBALL LEAGUE CONST., Art. II, §2.1(a) (purpose of NFL is to "foster the primary business of League members, each member beidng an owner of a professional football club"), *excerpted in* PAUL C. WEILER & GARY R. ROBERTS, STATUTORY AND DOCUMENTARY SUPPLEMENT TO SPORTS AND THE LAW 42 (2d. ed. 1998).

119. *See, e.g.,* Stefan Fatsis & Dennis K. Berman, *Puck Plan: NHL Explores Sale To Cure a Troubled Sport*, WALL ST. J., Mar. 4, 2005, at B1.

120. *See NASCAR History*, http://www.nascar-info.net/nascar_history_1.html (last visited Jan. 20, 2006).

To create a separate business entity through a voluntary transaction will require organizers to overcome substantial transaction costs. Whether the organizers are current league owners or officials[121] or outside investors,[122] securing consent of a requisite super-majority of league owners to change the league constitution would involve the difficult task of distributing the proceeds among the current owners.

This is the very problem that causes current leagues to operate inefficiently. Owners will forego potential pareto-optimal opportunities because of an inability to agree on how to divide the spoils. To illustrate, suppose that the current aggregate value of all MLB franchises were $9 billion,[123] and that a vertical separation would result in efficiencies sufficient to increase the combined value of MLB and club assets to $10 billion. The

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121. To illustrate, current owners could create The League as a separate corporate entity ("NHL, Inc.") with a relatively small percentage of outstanding shares created as voting stock and most of the shares retained by club owners as preferred non-voting stock. The return on an initial public offering of voting stock would be maximized if The League had a high-profile board of directors independent of current club owners, and if it had already entered into a new collective bargaining agreement with the players and detailed franchise agreements with existing clubs. Under this scheme, current owners would profit by receiving cash from the proceeds of the offering and by realizing potential capital gains from the appreciation of their preferred shares. Owners would retain ownership in their clubs, although obviously the franchise value of the clubs would be substantially reduced under this restructuring. Although reaping the benefits of vertical separation requires that club owners' investment in The League be non-voting, to facilitate the marketability of the preferred stock it can be made immediately convertible to voting stock if acquired by anyone not involved with club operations. Thus, once the market price had been established after the initial public offering, club owners could gradually sell off their non-voting stock and thus capture almost all of the surplus from the restructuring. Alternatively, in light of the continuing growth of the value of sports franchises, club owners could hold onto their stock, which, along with the value of their franchise (which has tripled in the last decade, *see* Rodney Fort, *Major League Baseball Team Values*, http://www.rodneyfort.com/SportsData/BizFrame.htm (last visited Mar. 14, 2006)), could continue to appreciate. We thank Professor Cynthia Williams and investment analyst R. J. Bukovac for assistance regarding the mechanics of the restructuring.

122. If the initiative came from outside the league, a more effective approach would probably be for a relatively small group of investors to form a new entity, The League, which would initially be closely owned, combining those with sizable assets with those knowledgeable about the sports business. The League would then tender an offer to acquire those rights necessary to organize the competition from current club owners. If an initial offer was not accepted by the three-quarter super-majority required by most league constitutions, then The League's organizers could enter into separate negotiations with individual club owners in an effort to find the sufficient number to effectuate the purchase. Once the tender was accepted, The League could then enter into franchise agreements with clubs, and a collective bargaining agreement with the union. With the new structure in place, the owners could then turn to public equity markets, both to realize a gain on their successful organizational efforts and also to refinance debt or personal assets required to provide the initial cash payments to current owners.

123. According to Forbes magazine, in 2004 the average franchise value was $295 million, or a combined total of $8.85 billion. *See MLB Valuations* (Apr. 26, 2004), *available at* http://www.forbes.com/free_forbes/2004/0426/066tab.html.

current thirty owners would then realize an average profit (realized either in cash or through increased valuation of preferred stock in The League) of $33.3 million. Even George Steinbrenner would likely approve the concept if, say, $400 million of the $1 billion increase went to the New York Yankees. Of course, the owner of the Kansas City Royals would initially insist on a pro-rata distribution, which would never be accepted. Given the potential revenue growth from an efficient restructuring, perhaps a skilled investment banking firm would be able to overcome these obstacles and secure agreement to proceed with a lucrative initial public offering. Yet, on the other hand, if owners cannot agree on how to distribute the small amounts available from increased sale of rights to out-of-market broadcasts,[124] one cannot be too sanguine about the likelihood of voluntary restructuring.

Another reason why owners may choose not to voluntarily restructure is ego. Most owners have already succeeded in other businesses and are personally wealthy. Although they would likely retain the perquisites of ownership of a club/franchisee in a competition organized by The League (owners' box, accepting the presentation of the champions' trophy), they would have to give up the power to make the rules and instead would have to accept directives from others. Even if this Article is correct that restructuring leads to substantial efficiencies, ($1 billion in our illustration for an average payout of $33 million), those efficiencies may be insufficient when their value is divided among the owners.

Ultimately, the most important reason why club owners may choose not to surrender control of their club-run leagues to a more efficient centralized operation is that they do not have to.[125] Sports leagues do not face significant competition from actual or potential product market rivals.[126] As a result, market retribution will not be swift[127] should owners fail to achieve efficient

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124. *See* cases cited *supra* notes 53-54 and accompanying text.

125. *Cf.* SATURDAY NIGHT LIVE: THE FIRST 20 YEARS (Michael Cader ed. 1994) (famous line by telephone operator "Ernestine" popularized by Lily Tomlin: "Next time you complain about your phone service, why don't you try using two Dixie cups with a string. We don't care. We don't have to. (snort) We're the Phone Company.") The idea that firms with monopoly power have the luxury to conduct their affairs inefficiently is widely supported. *See, e.g.*, United States v. Aluminum Co. of America, 148 F.2d 416, 427 (2d Cir. 1945). Monopoly power "deadens initiative, discourages thrift and depresses energy . . . immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress" and competition "is necessary to counteract an inevitable disposition to let well enough alone." Aluminum Co., 148 F.2d at 427; Hicks, *supra* note 72, at 8 ("best of all monopoly profits is a quiet life").

126. *See supra* note 105.

127. *Cf. Valley Liquors, Inc.*, 678 F.2d at 745 (noting swift market retribution as a characteristic of firms lacking market power).

results.[128] Even club-run leagues might face pressure for greater efficiency, if a market for corporate control existed so that outsiders who believe that the business can be operated more profitably can acquire the firm's assets.[129] But sports clubs are not publicly traded in North America, and even where a club is a subsidiary of a publicly traded corporation, the parent often has sufficient strategic interests that efficient operation of the league is not a principal concern.[130] Thus, a series of hostile takeovers of clubs is not a feasible option.[131]

Part II of this Article lays out the argument why club-run leagues have incentives to perform inefficiently in the market vis-a-vis vertically separate leagues. This part has suggested that, while there may be growing industry recognition of the problems with club-run leagues, the transactions costs involved in dividing up the proceeds of a restructuring in a manner satisfactory to a super-majority of club owners may be too great to permit this development. If that is the case, legal intervention to effectuate an involuntary restructuring may be required. This option is considered below.

V. INVOLUNTARY RESTRUCTURING: MANDATORY DIVESTITURE UNDER ANTITRUST LAW

Government intervention is welfare-enhancing if it can reliably require an industry restructuring to eliminate collective action problems that cause inefficient and exploitive output reductions not likely to be subject to market correction. There are several ways that this welfare-enhancing restructuring could be required. Congress could mandate restructuring through legislation enacted pursuant to its power to regulate interstate commerce.[132] Perhaps

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128. The inefficiencies engaged in by monopoly sports leagues, and an explanation for how competition would eliminate these inefficiencies, is discussed in Ross, *supra* note 15.

129. *See generally* WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 191-94 (8th ed. 2002).

130. For a more detailed discussion of this point, see Ross, *supra* note 84, at 145-46.

131. Moreover, because of the strong public aversion to having different clubs owned by a single firm, the outside investors cannot realistically pursue a strategy of buying up individual teams until they can persuade the club-run league to restructure.

132. The Supreme Court's decision in *Flood v. Kuhn*, 407 U.S. 258 (1972), makes clear that all sports, including baseball, constitute interstate commerce subject to congressional regulation. Congress could enact special regulatory legislation prohibiting clubs from maintaining a voting interest in the operation of any league that does not face significant competition from rival leagues in the same sport. This regulatory legislation could legalize conduct that was efficient and enhanced consumer appeal while specifically prohibiting anticompetitive conduct by The League, clubs, or rivals. This would be analogous to the detailed provisions of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996), regulating the break-up of AT&T, which prohibited the "Baby Bells" (the local phone monopolies) from entering the market for long-distance phone calls

more controversially, Congress could use its eminent domain power to acquire from current club owners the property rights necessary to operate The League.[133] This part focuses on another alternative. By applying conventional antitrust principles in the unique context of sports, we justify structural antitrust relief mandating the divestiture by clubs of the competition-organizing function of a league.[134]

As noted above, the *NCAA Case* holds that club owners may not enter into agreements that result in higher prices, lower output, or output unresponsive to consumer demand compared to what would "otherwise be."[135] In this regard, one of Judge Richard Posner's most profound antitrust insights is particularly relevant: "[i]t does not follow that because two firms sometimes have a cooperative relationship there are no competitive gains from forbidding them to cooperate in ways that yield no economies but simply limit competition."[136]

We suggest that the relevant anticompetitive agreement is the agreement among competing clubs to arrogate to themselves control of the organization of their sport's dominant competition. The economic analysis set forth in this Article demonstrates that compared to what would "otherwise be" – a sporting competition organized by a separate entity – the vertical integration between competition-organizing and competition-participating raises prices, lowers output, and renders output unresponsive to consumer demand.

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unless the local telephone market was open to competition. *See* 47 U.S.C. § 271 (2000).

133. A full analysis of this issue is beyond the scope of this Article. In *Berman v. Parker*, 348 U.S. 26 (1954), the Supreme Court held that the power of eminent domain can be used not only to acquire property for future public ownership, but also for resale to a private party, where that sale would serve a public purpose. This holding was recently reaffirmed in *Kelo v. City of New London*, 125 S. Ct. 2655 (2005). In authorizing the use of eminent domain to acquire land for stadium construction, courts have recognized that the operation of professional sports competitions for the benefit of local fans constitutes a public purpose. *See, e.g.*, City of Los Angeles v. Superior Court, 333 P.2d 745 (Cal. 1959) (upholding use of eminent domain to construct a major league baseball stadium). A leading example of the use of federal eminent domain power to remedy inefficiencies caused by transactions costs is described in *Mfrs. Aircraft Ass'n v. United States*, 77 Ct. Cl. 481 (1933). The decision details the government's actions just prior to World War I to pay royalties to the Wright Brothers and other holders of conflicting patents regarding aircraft construction based on a conclusion that "various companies were threatening all other airplane and seaplane manufacturing companies with suits for infringements of patents, resulting in a general demoralization of the entire trade." *Id.* at 484.

134. Major antitrust suits seeking divestitures are expensive. Although a consumer class action by a private attorney is plausible, because of the difficulty of establishing consumer damages such a lawsuit is unlikely. Such litigation would most likely be brought by a federal antitrust agency, or a collection of state attorneys general, or by a private investor or a minority of league owners interested in using the litigation as a vehicle to force owners to overcome the transactions costs identified above to effectuate a reorganization.

135. 468 U.S. at 107.

136. *Gen. Leaseways, Inc.*, 744 F.2d at 594.

As noted above, club-run leagues distort competition in a number of relevant markets.[137] They are likely to set the number of teams participating in the competition at a sub-optimal level, fail to fully exploit the sale of broadcast or internet rights, and inefficiently market licensed merchandise, all of which result in reduced output that is unresponsive to demand. Compared to an entity solely concerned about the interests of the league as a whole, club-run leagues are more likely to allocate labor resources inefficiently,[138] and tolerate operational mismanagement of clubs,[139] which also results in output being unresponsive to consumer demand. As in the *NCAA Case* case, these are all hallmarks of antitrust violations.[140] The central thesis of an excellent book on the success of the National Football League is that its growth was the result of Commissioner Pete Rozelle's heroic efforts to persuade owners to engage in "League Think"—i.e., to put the interests of the league over the interests of their clubs.[141] Implicit in this analysis is the conclusion that, absent Rozelle's vision and talent, the NFL would not efficiently act to maximize league value or consumer appeal. If these leagues feared the swift retribution of the marketplace for these errors, they would not tolerate these inefficiencies.[142]

Of course, the claims made in this Article are subject to proof in a court of law. Evidence that the efficiency gains we discuss are insubstantial, or that club-run leagues possess efficient properties that our analysis has failed to account for, would obviously favor a judgment for the defendant owners; evidence that the gains are substantial and that transactions costs explain the owners' unwillingness to voluntarily restructure would obviously favor the plaintiffs.

In a related antitrust area—the analysis of territorial market division arrangements—the Supreme Court has carefully and expressly differentiated between schemes imposed by a vertically separate manufacturer and those

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137. *See supra* Part II.

138. For example, baseball fans have just witnessed the first collective bargaining agreement in thirty years that did not require industrial disruption to be achieved. For a detailed chronicle of the difficulties in securing workable collective bargains in light of management's obligation to secure agreement from owners acting in their own club's interests, see JOHN HELYAR, LORDS OF THE REALM (1994).

139. The National Basketball Association has done nothing to restrain the complete mismanagement of one of their two franchises in the huge Los Angeles market. *See, e.g.*, Richard Hoffer, *The Loss Generation*, SPORTS ILLUSTRATED, Apr. 17, 2000 at 58 ("[The Clippers'] helplessness, so practiced and so dependable, is clearly the work of just one man--we're thinking of Donald Sterling here.").

140. 468 U.S. at 107.

141. *See* DAVID HARRIS, THE LEAGUE: THE RISE AND DECLINE OF THE NFL (1986).

142. *Cf. Valley Liquors, Inc.*, 678 F.2d at 745 (noting this characteristic exists where firms lack market power).

agreed to by downstream competitors. This distinction supports mandatory vertical separation in the sports industry. The Court recognizes that vertical restraints insulating a reseller from intrabrand competition have complex effects, simultaneously shielding the firm from potentially beneficial rivalry from sellers of the same product, while creating desirable incentives for promotion, quality assurance, or other investment that might otherwise be subject to free riding by rivals, potentially enhancing the brand's consumer appeal and thus promoting interbrand competition.[143] When imposed by an upstream seller in the independent exercise of its own business judgment, the Court concluded that such a seller was sufficiently likely to balance intrabrand harm and interbrand benefit to reach a socially-optimal result that case-by-case antitrust scrutiny under the rule of reason was appropriate.[144] In contrast, an intrabrand restraint that is the result of horizontal agreement among downstream rivals carries too much risk that the restraint is intended to benefit the rivals' interest in reduced competition, and thus remains *per se* illegal.[145] The Court likewise condemned a venture that jointly promoted a single trademark and divided markets for the manufacture and sale of the trademarked product by separate firms, basing its decision on the critical fact that the so-called "principal" (the corporate entity that owned the national trademark) was controlled by the so-called "agents" (the individual manufacturing firms).[146] These precedents demonstrate why antitrust is so hostile to cartel behavior, in contrast to that of a fully-integrated firm. For the latter, the whole is greater than the sum of the parts. As to the former, activity will only occur if supported by a majority of the parts. These precedents therefore support the conclusion that an agreement to organize a vertically integrated club-run league with the anti-competitive effects noted in this Article constitutes an unreasonable restraint of trade in violation of Section 1.

Section 2's condemnation of monopolization provides an additional basis for a judicially-ordered restructuring of sports leagues. Leading precedents establish that competitors may not control a key upstream input where such control allows the maintenance of a monopoly and does not reflect efficiencies. Although to date the courts have not required that the upstream

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143. *Sylvania*, 433 U.S. at 51-52.

144. *Id.* at 54-56.

145. *Id.* at 57 n.27, citing *Topco Assocs.*, 405 U.S. at 608.

146. *Sealy, Inc.*, 388 U.S. 350. The decision in *Fraser*, 284 F.3d 47, further supports the distinction between a separate entity organizing a competition and a club-run league. The court refused to accept the claim that a league consisting of rival owners who simultaneously invested in the league and their own clubs was an entity akin to a corporation (indeed, akin to The League that is envisioned by this Article). Citing *Sealy*, the court of appeals emphasized that, unlike a single entity, the league was controlled by these rivals. *Id.* at 57, 57 n.5.

input (in this case competition-organizing services) be provided by an independent firm, we believe that such a remedy is justified here by the unique features of sports leagues. Two of the leading cases help illustrate this point.

In *United States v. Terminal Railroad Ass'n*,[147] the Court held that the Sherman Act barred a consortium of rival railroads from acquiring the only three means by which railroads could cross the Mississippi River at St. Louis and using crossing charges to disadvantage non-owner rivals. Because of the significant efficiencies in joint operation of the three previously-independent crossing points, the Court declined to order a horizontal divestiture. Instead, the Court required open access to the venture.[148] Similarly, in *Associated Press v. United States*,[149] the Court invalidated a by-law provision that allowed AP members to veto new members within their territories. The veto was effective even if the additional members might provide stories of value to the rest of the membership. This by-law demonstrated the inefficient divergence of the interests of AP members and the entity as a whole.[150] Here, the remedy permitted presumably independent non-rivals to determine membership decisions.[151]

Where a monopoly bottleneck exists, the ability of the bottlenecked function to be captured by an open-access cooperative among buyers may, in some cases, actually have the potential to eliminate the distortion caused by monopoly profits. For example, in *Terminal Railroad*, if the company that operated the river bridges had been owned by all railroads, it would have no

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147. 224 U.S. 383 (1912)

148. One possible objection to any antitrust relief when firms collectively control an input essential to participating in the market is that such relief may lessen incentives for investment at either level. Where the remedy is designed to preclude monopoly profits that arise from a natural monopoly that is natural, as opposed to one resulting from "superior skill, foresight, and industry," *cf. Aluminum Co. of America*, 148 F.2d at 430, incentive problems should not deter antitrust relief. Stephen G. Breyer, *Antitrust, Deregulation, and the Newly Liberated Marketplace*, 75 CAL. L. REV. 1005, 1033-34 (1987). In the case of developing sports, perhaps the only firms interested in investing in a new league would be those interested in operating clubs, and so a club-run league may well be efficient for sports that lack market power. Once a sport obtains market power, however, there should be no shortage of investors for a entity capable of organizing the competition (The League). The principle that restraints may be justified for new entrants but not after the firm has established market power has strong support in antitrust precedents. *See, e.g.*, Jefferson Parish Hosp. Dist. v. Hyde, 466 U.S. 2, 23 (1984) (citing United States v. Jerrold Elecs. Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961)) (tied sale to ensure new entrant's reputation for quality would be maintained was reasonable, but after firm was established no longer necessary). Similarly, non-competition agreements are reasonable for a limited time until the promisee has been able to establish itself in the marketplace. RESTATEMENT (SECOND) OF CONTRACTS §§186-88 (1982).

149. 326 U.S. 1 (1945).

150. Hovenkamp, *supra* note 4, at 37-44.

151. Given the thousands of members of the association, the risk of reciprocal rejection of new entrants to protect local incumbents was apparently not given serious consideration.

incentive to charge monopoly prices to its own members.[152] Thus, vertical divestiture would actually have increased the potential for monopoly pricing. A requirement that an independent firm contract to purchase news stories from papers around the country and resell them elsewhere could have a similar effect. Moreover, complete vertical integration may be procompetitive in markets characterized by natural monopoly at several levels. Economic theory suggests that in this case of "serial monopoly," prices may be raised and welfare reduced as both monopolists seek to take monopoly profits.[153] Because it is often efficient to allow a vertical integration between the two serial monopolists, which will result in a single monopoly price,[154] open access regimes may not be welfare enhancing.[155]

Sports leagues, however, are different. Most significantly, because there is an optimal number of clubs in a top-tier league, leagues cannot really be subject to the open access regime contemplated by *Terminal Railroad*.[156] Nor can leagues avoid the serial monopoly problem discussed above simply by acquiring and operating all of the teams. Separately owned clubs form an important aspect of sport's consumer appeal.[157] Because of sports leagues' interdependence, a model where "downstream firms" (here the clubs) jointly operate the "upstream firm" (here the league), and then compete among themselves, will not work in live gate, stadium, and some television and

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152. Hovenkamp, *supra* note 4, at 36.

153. Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 68 J. POL. ECON. 347 (1950).

154. David Reiffen & Andrew Kleit, Terminal Railroad *Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly?*, 33 J. L. & ECON. 419, 424 (1990). For a contrary view, see Richard D. Friedman, *Antitrust Analysis and Bilateral Monopoly*, 1986 WIS. L. REV. 873 (arguing that firms will agree on profit-maximizing output); Peter Carstensen, *Khaning the Court: How the Antitrust Establishment Obtained an Advisory Opinion Legalizing "Maximum" Price Fixing*, 34 U. TOL. L. REV. 241, 288 (2003) (noting that because monopoly pricing takes place on elastic portion of demand curve, bilateral monopolists will err on the side of lower prices and increased output). The latter two articles do not, however, discuss the serial monopoly problem in the context of joint venture of independent downstream monopolists and a collectively run upstream monopolist.

155. A sports illustration cited by Reiffen and Kleit, *supra* note 154, at 414, is *Fishman v. Wirtz*, 807 F.2d 520 (7th Cir. 1986), where they imply that the court erred in finding a Sherman Act violation in the refusal of the owner of Chicago Stadium, who was seeking to own the Chicago Bulls basketball team, to offer a stadium lease to a rival bidder. A rival bidder would have sought to exploit the Bulls' local monopoly while paying monopoly rents to the owner of the only suitable stadium. On the other hand, the refusal to permit rivals to gain access to the stadium precludes the sort of competition for the natural monopoly that antitrust law generally encourages. Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582, 590 n.4 (1st Cir. 1960). Which effect predominates requires a case-by-case analysis.

156. Ross and Szymanski, *supra* note 20, at 649-50 and nn. 109-110.

157. The Court of Arbitration for Sport recognized this justification in upholding a challenge to a European soccer regulation barring clubs from participating in the European club competition if owned by the same entity. *AEK Athens*, CAS 98/200.

licensing markets.[158] Hence, if we accept the assumption that each sport will continue to feature a single dominant competition,[159] the monopoly power in competition organizing will not be dissipated. The inefficient and exploitive effects of club-run monopolies can, however, be mitigated. In light of the demonstrated benefits of vertical separation, this novel remedy is justified in the specialized context of sports leagues.[160]

VI. CONCLUSION

An inherent conflict exists when clubs participating in a sports league competition control the way in which the competition is organized. This conflict distorts the manner in which the league determines the number and location of franchises, how broadcast rights are sold, how merchandise, licensing, and sponsorships are marketed, how club executives are supervised, and how player talent is distributed among clubs. In each of these instances, any particular decision may make some clubs better off and some worse off, and transaction costs often prevent the most efficient result from being selected. Both profits and consumer welfare would increase if these decisions were made instead by a competition organizer independent of the clubs. Although owners and outside investors could capitalize the increased profitability of a vertically-separate league by voluntarily restructuring professional sports, the same transactions cost problem could prevent current owners from agreeing on how to divide the proceeds from such a restructuring, resulting in an inefficient *status quo*. To the extent that league owners refuse to voluntarily restructure the industry, we believe that a plaintiff could establish in antitrust litigation that the continuing agreement by clubs to run

158. *Cf.* Gamco, Inc. v. Providence Fruit & Produce Bldg., 194 F.2d 484 (1st Cir. 1952) (requiring reasonable access to wholesale fruit facility advantageously located in railroad terminal was required under the assumption that rival fruit merchants would then compete with each other).

159. *See supra* note 26 and accompanying text.

160. Although there are strong arguments in favor of a finding that the maintenance of vertically-integrated, club-run leagues in the major North American sports violates the Sherman Act, there are significant obstacles to judicially-mandated vertical divestiture. Such an order requires a plaintiff to bear the expense and risk of a lawsuit. In the case of Major League Baseball, either a lower court would have to narrowly construe the judicially-created antitrust exemption for the National Pastime or the Supreme Court would have to expressly apply the antitrust laws to the sport. *See, e.g., Flood*, 407 U.S. at 283 (Congress', "positive inaction" in refusing to overrule precedents exempting baseball's reserve clause from antitrust scrutiny justified its continued application, although it was concededly an "anomaly"); Butterworth v. Nat'l League, 644 So. 2d 1021 (Fla. 1994) (baseball exemption applies only narrowly to the specific restraint at issue in *Flood*); *Henderson Broad. Corp.*, 541 F. Supp. at 268-69 (exemption only applies to baseball's "unique characteristics and needs"); Major League Baseball v. Crist, 331 F.3d 1177 (11th Cir. 2003) (exemption applies broadly to "business of baseball"). For these reasons, Congress may wish to consider legislative approaches that would achieve the same welfare-enhancing result.

their own competition constitutes both an illegal restraint of trade and monopolization in violation of the Sherman Act.

Although the operation of a sporting competition raises some unique issues, the organization of a sports league also provides an accessible illustration of a more common issue with regard to joint ventures. Cooperation among competing firms often yields substantial benefits. At the same time, when joint ventures do not face the discipline of the market – either because they enjoy market power or due to the absence of an effective market for corporate control – there is a substantial risk that transactions costs will result in the operation of jointly-held assets in an inefficient manner as those assets are controlled by member firms whose individual interests may differ from those of the collective whole. This Article sets forth an argument about how the Sherman Act – our nation's "magna carta of free enterprise"[161] – can be invoked in a tailored fashion to permit the economy to reap the benefits of collective action while mitigating the effects of market power.

161. *Topco Assocs.*, 405 U.S. 596, 611 (1972).