Designing Sports Leagues as Efficient Monopolists Rather Than Inefficient Cartels

Stephen F. Ross & Stefan Szymanski[*]

I. INTRODUCTION

Since the first professional sports league – the National League of Professional Baseball Clubs -- was formed in the late 19th Century, North American sports leagues have with rare exception adopted the same structure: owners of individual clubs in different cities individually undertake to run their own clubs, and jointly agree to organize an annual sporting competition leading to the designation of a league champion. The imprimatur of no less than the United States Supreme Court has been placed on this design of a sports league. Citing Robert Bork, the Court observed that the marketing of contests between competing clubs "would be completely ineffective if there were no rules *on which the competitors agreed* to create and define the competition to be marketed."[1] A critical aspect of the sports industry, the Court found, was that "horizontal restraints on competition are essential if the product is to be available at all." [2]

Actually, we do not believe this empirical assertion is correct. An organized team sports competition requires some economic entity to perform "competition organizing services," and then, in order to develop the competition, to acquire the services of clubs who will compete. In North America the "competition organizer" is typically a joint venture of participating clubs.

---

[*] Professor of Law, University of Illinois, B.A., J.D., University of California (Berkeley), and Professor of Economics, Tanaka Business School, Imperial College (London), B.A., University of Oxford, M.Sc., Ph.D., University of London, respectively. The authors thank Clark Griffith, Roger Noll, Gary Roberts, and Andrew Zimbalist for helpful insights in developing this draft.

[1] National Collegiate Athletic Ass'n v. Board of Regents, 468 U.S. 85, 101 (1984) (hereinafter "*NCAA*") (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").

[2] *NCAA*, 468 U.S. at 101. The term "horizontal restraints" is well known in antitrust jurisprudence, referring to agreements between competitors, and are distinguished from "vertical restraints" between suppliers and a variety of firms at a different level of distribution. *See* Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 730 (1988).

Thus, whether the National League's Chicago Cubs play the American League's Boston Red Sox in "inter-league play" is determined by a (usually super-majority) vote of the clubs themselves. However, there is no inherent reason why this must be so. Australian courts have recognized that leagues compete in a distinct market for "competition organizing services." In two important antitrust cases, rival leagues vigorously sought to recruit entire clubs to participate in their own competitions, and then agreed to exclude clubs from a merged competition organized by a Board of Directors only partially controlled by the participating clubs.[3] In the United States, the fastest growing sports competition exists among stock car drivers, who not only compete in

---

[3] In News Ltd. v. Australian Rugby League, 139 A.L.R. 193, 338 (Full Fed. Ct. 1996), the court found that rugby league clubs competed for the services of two rival leagues, Superleague and the Australian Rugby League, as competition organizers. An agreement among "loyal" clubs to collectively participate in the established ARL was found to be an unlawful collective decision to prevent the supply by the clubs of rugby league teams to any competition organizer other than the ARL, and to prevent the acquisition of competition organizing services from anyone other than the ARL. Eventually, the warring parties agreed to end inter-league rivalry and create a newly merged competition under the direction of a Board of Directors composed of three directors from News Ltd. (a media corporation that owned the pay television rights) and three directors from the Australian Rugby League, a federated organization where clubs participating in the premier competition had important but not exclusive influence. South Sydney District Rugby League Football Club Ltd. v. News Ltd., 181 A.L.R. 188, 195 (Full Fed. Ct. 2001), *rev'd*, [2003] HCA 45 (H.C. Aug. 13, 2003), concerned the agreement between the parties establishing a fourteen-team maximum for a newly merged league. The lower court reasoned that this provision unlawfully excluded the plaintiff from the receipt of competition organizing services. Indeed, the defense did not contest this point, but rather argued that the defendants had not enacted the fourteen-team limit for the purpose of excluding the plaintiff, an essential finding to warrant per se condemnation under the Australian Trade Practices Act. The High Court agreed on this point and reversed a finding of illegality, emphasizing that the plaintiff had sought to prove a per se violation and had not sought to prove that the merger had actually lessened competition.

Indeed, the evolution of a national rugby league competition in Australia demonstrated 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 have found that clubs competed among themselves for the right to participate in the annual top-tier competition. 139 A.L.R. at 318 ("the clubs were not members of the League); *id.* at 338-42 (detailing competition for competition organizing services).

individual races but whose success in races over the course of a season determines the winner of the lucrative Winston (now Nextel) Cup. Here, the competition organizer is not a venture of competing drivers, but rather a separate, for-profit entity, NASCAR, controlled by the family of Bill France, who founded the competition.[4] NASCAR, and not the participating drivers, determine the rules of competition and the location of premier races. Moreover, when the National Basketball Association created a women's league, they did so by explicitly giving majority control of the WNBA board of directors to owners and league executives who did *not* operate clubs in the new competition.[5]

The vibrancy of these non-traditional competitions demonstrates that the typical North American system is not inevitable; that rules on which the competitors agreed are *not* essential if the product is to be available at all.[6] Rather, the traditional model reflects a conscious decision to vertically integrate the "upstream" function of organizing an annual competition with the "downstream" function of operating clubs in that competition. This vertical integration has important consequences for the efficient operation of the competition. Antitrust decisions have implicitly acknowledged the different economic consequences when price, output, and innovation are determined jointly by competitors, and when they are instead determined by 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

---

[4] *See* Koszela v. National Ass'n of Stock Car Auto Racing, 646 F.2d 749, 750 (2d Cir. 1981) (anyone wishing to participate in stock car racing must "join" NASCAR but 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 LAWYERS J. 67, 70-71 (2001).

[5] *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.

[6] Cf. *NCAA*, 468 U.S. at 101.

entity.[7] The Supreme Court expressly noted that an agreement by rivals not to compete in each other's geographic markets is illegal, even though an agreement by an upstream firm that its downstream affiliates would not compete might not be.[8]

The purpose of this Article is to critically analyze the legal and economic implications of the prevailing choice of sports league design and to suggest an alternative more likely to promote efficiency and to avoid cartel-like inefficiencies. The Article's central theme is that monopolies are often more efficient than cartels, because bargaining costs prevent rival firms – who are 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. When a club-run league does not feel competitive pressure from a reasonable substitute (*e.g.* a rival league). Part II details our concern that bargaining costs among leaguemembers 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, the efficient allocation of players among teams, and an optimal balance between domestic and international competition. Identifying the core function of a league as the organization of a competition, we explain why key decisions relating to the identity, number, and location of participating clubs should be made by an economic entity independent of the participating clubs. We argue that a vertical separation between leagues and clubs, with responsibilities assigned in carefully considered and well-drafted franchise agreements between the league and each club,

---

7 *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).

8 United States v. General 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 Continental T. V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 59 n.28 (1977).

provides the best way to facilitate the efficient organization and marketing of the competition. In addition, we note significant legal advantages that a vertically separate league would have in operating more flexibly than club-run leagues. Part III examines how to implement the proposed restructuring. First, we suggest ways in which current leagues or outside investors could take the initiative to create a new business entity (perhaps "NFL, Incorporated") that, when combined with the remaining value of clubs as franchisees, should significantly exceed the combined current value of the teams in the club-run league. Although investment bankers and outside investors should find it profitable to seek to purchase the assets and rights necessary to become the competition organizer, 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, the Part concludes with a discussion of legal theories that might bring about the involuntary restructuring of sports leagues along the lines discussed in this Article, if owners were to reject restructuring efforts without legitimate justification.

One final point merits attention in this introduction. 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. At the same time, we assume that each league' insulation from rivalry is not subject to imminent threat from antitrust intervention.[9] Thus, this Article accepts the continuing ability of leagues to exercise market power, but suggests ways to facilitate greater efficiencies within that context. In short, we suggest that both profitability and the provision of services responsive to consumer

---

[9] One of us has previously suggested that the government intervene to require a divestiture of monopoly sports leagues into competing entities. Stephen F. Ross, *Monopoly Sports Leagues*, 73 MINN. L. REV. 643 (1989) [hereinafter *Monopoly Sports Leagues*]. We have also discussed ways that league power could be restrained through intervention to facilitate new club entry. Stephen F. Ross & Stefan Szymanski, *Open Competition in League Sports*, 2002 WISC. L. REV. 625 [hereinafter *Open Competition*].

demand would improve if sports leagues looked more like McDonald's and less like the United Nations.

II. THE CASE AGAINST VERTICAL INTEGRATION IN DOMINANT SPORTS LEAGUES

A. Thinking About Sports Leagues as a Product of Upstream Competition Organizing and Downstream Club Participation

In this section, we adopt the approach of Australian courts 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. Most obviously, these include rules basic to the integrity of the game, and the means to enforce these rules and to sanction those who violate them. The desirability of an independent provider of these particular services is already recognized by most North American club-run leagues with provisions that grant broad authority in this regard to an independent commissioner.[10] At the other end of the spectrum, downstream services are functions that are best fulfilled by the individual clubs, such as 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, are the myriad activities that can be organized either by an independent governing body or by collective action among participating clubs (or even a combination of both). These services include the determination of the number of teams admitted to the league, the determination of player

---

10 *See, e.g.*, Milwaukee Am. Ass'n v. Landis, 49 F.2d 298, 299 (N.D. Ill. 1931) (with regard to enforcing the code, 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*").

contract and trading rules, stadium facility standards, the sale of broadcasting rights, the extent of revenue sharing, and the allocation of shared revenues. Traditionally, these decisions are made in North American sports leagues by a governing body composed of a representative from each club, with a super-majority required for major changes or initiatives.[11] In contrast, we consider the alternative of a vertically separate entity ("The League") that would control many of the decisions in the middle category discussed above, and would also determine when these functions are best carried out at the club or league level.

In this section, 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 the substantial transaction costs that prevent optimal results. Not only does this reduce the potential profits available to providers of sports entertainment, but – because of the lack of effective product market competition for the dominant sports leagues – 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.

---

[11] Indeed, league commissioners have rarely exercised their power to act "in the best interests" of a sport to regulate the economic issues that could be performed by an upstream governing authority or by club agreement. Thus, while the *Milwaukee v. Landis* case, *supra*, upheld the power of baseball's "all-powerful" first Commissioner, Kenesaw Mountain Landis, to prevent the St. Louis Browns from evading existing rules designed to prevent major league teams from using minor league clubs as "farm teams" for player development, the clubs subsequently voted over Landis' objection to permit the development of the farm system (whereby major clubs enter into agreements with minor league affiliates to develop players), and Landis did not try to overrule the clubs in that regard. *See* G. EDWARD WHITE, CREATING THE NATIONAL PASTIME 290-91 (1996). *See also* Chicago National 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 23-25 (2d ed. 1998) (holding Commissioner's broad power did not extend to alignment of clubs within league divisions, 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).

B. Economic theory of vertical integration and its application to sports leagues

Economists and lawyers have long debated the economic effect and appropriate antitrust treatment of vertical integration. The issue has revolved around the Chicago-school argument that a monopolist would not choose to vertically integrate if this were to cause a reduction in output (thus reducing monopoly profit) and that therefore vertical integration can only be motivated by efficiency (output enhancing) motives.[12] This model views the relationship between an upstream supplier and a downstream manufacturer as a simple principal-agent relationship in which efficiency requires the total surplus generated by the relationship to be maximized. Maximization might be inhibited, however, (1) where both firms have market power, if the upstream firm dictates a linear price schedule which maximizes its own profit, 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;[13] (2) if firms under-invest in promoting the product because of a desire to free-ride on promotional efforts of others;[14] or (3) firms under-invest for fear that the partner firm will renegotiate wholesale prices to avoid repaying the sunk cost element.[15] Although these problems could theoretically be dealt with through arms length contracting,[16] the Chicago school insight was that vertical integration would be an equally efficient solution. Because, in this view, the burden of monopoly cannot be

---

12 *See, e.g.,* ROBERT H. BORK, ANTITRUST PARADOX 226-31 (1978). This approach and the competing theories discussed in text are outlined in JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION (1988), Ch. 4.

13 This is the so-called "double marginalization" problem. TIROLE, *supra* note 12, at 174-76.

14 *Id.* at 185.

15 *Id.* at 24-25.

16 For example, a fixed fee plus a variable charge equal to marginal cost will solve the double marginalization problem, *id.* at 176, and long term contracts can deal with hold-up. *Id.* at 26-27.

increased through vertical integration, such integration must be due to the parties recognition that the costs of integration are less than the costs of contracting.[17]

Not all economists share this sanguine view of vertical integration. The standard fear is that vertical integration could be used as a means to foreclose entry into a related market, while maintaining vertical separation would permit non-integrated rivals to compete in upstream or downstream markets.[18] Yet another important concern is that vertical integration -- whether complete or long-term via exclusive dealerships – can relax downstream competition. For example, integration may relax incentives for competitive downstream firms to pressure upstream firms for lower prices, and for upstream firms to incite downstream rivalry.[19]

The concern that vertical integration will relax downstream competition seems particularly applicable to sports leagues. Certainly, vertical integration into the upstream services by the clubs -- scheduling, marketing, and organizing the competition itself -- is a plausible way to relax economic competition between the teams, because it permits the clubs to agree on matters like exclusive territories for live gate and television rights sales, labor market restraints, and revenue sharing. Indeed, economic theory supports the argument that decisions made by a club-controlled body subject to a super-majority are unlikely to be optimal. In any partnership where the payoffs to decisions 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.[20] Efficient allocation of resources requires the

---

17 *See, e.g.*, BORK, *supra* note 12, at 227 (a vertical merger is "merely an instance of replacing a market transaction with administrative direction because the latter is believed to be a more efficient method of coordination").

18 TIROLE, *supra* note 12, at 193-95.

19 Patrick Rey & Joseph Stiglitz, *The Role of Exclusive Territories in Producers' Competition*, 26 RAND J. ECON. 431, 432 (1995).

20 *See e.g.*, Bengt Holmstrom, *Moral Hazard in Teams,* 13 BELL J. ECON. 324 (1982); Armen Alchian and Harold Demsetz, *Production, Information costs and economic organization*, 62 AM. ECON. REV. 777 (1972).

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.[21] We detail, in subpart C below, how the absence of this independent actor results in inefficiencies in a variety of markets in which sports leagues operate.

Sports leagues' unique features make this aspect of vertical integration 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. Although antitrust decisions generally treat vertical restraints imposed by pressure from downstream firms more harshly,[22] exclusive territories and other intra-league restraints are specifically tolerated in sports because of clubs' unique inter-dependence.[23] A league run by the teams themselves are liable to make agreements that limit the extent of economic competition in order to simultaneously enhance the overall quality of league play (acceptable under antitrust law) and limit the extent of economic competition for the sake of increasing profits (unacceptable under antitrust law).[24] Contrary to the Supreme Court's dicta,

---

21 HOLMSTROM, *supra* note 20, at 327 (theorem 2).

22 *See, e.g.*, Continental T.V., Inc. v. G.T.E. Sylvania, Inc., 694 F.2d 1132, 1137 (9th Cir. 1982) (emphasizing that vertical restraint imposed by manufacturer and not at the request of other dealers). At the same time, the Court as suggested that this problem is rare. *See, e.g.*, Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 727 n.2 (1988).

23 National Collegiate Athletic Ass'n v. Board of Regents, 468 U.S. 85, 101 (1984) (rule of reason appropriate for otherwise illegal agreements among competitors because on-field rivals must agree on rules for sport to exist); United States v. National 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).

24 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 Memorial Coliseum Comm'n v. National 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. National Football League, 543 F.2d 606 (8th Cir. 1976) (restraints on competition for players to promote competitive balance permissible but existing plan overbroad); United States v. National Football League, 116 F.Supp. 319 (E.D.

however, it is *not* necessary that competitors agree on these matters; the industry certainly can be structured so that these measures are determined by a vertically separate competition organizer, as is the case in Australia, with NASCAR, and with individual sports like golf, tennis, or track and field.[25]

Moreover, it is important to distinguish the typical vertical integration of a single upstream firm and a single downstream firm from an integration that effectively results in the upstream functions being performed by a cooperative of downstream firms. Club-run leagues still face the problems of double marginalization,[26] free riding, opportunistic behavior,[27] and costly contracting that vertical integration is presumed to avoid. Because vertical integration 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

---

Pa. 1953) (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).

[25] It would be alarming, to say the least, if the contestants in the Olympic 100m sprint final determined exactly the rules on which they would compete and how they would be monitored (consider doping, for instance).

[26] *See supra* note 13.

[27] 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. When one considers the likelihood that a franchise agreement between a vertically separate competition organizers and club/franchisees would be very carefully drafted to attempt to eliminate forseeable opportunistic behavior, it is difficult to conclude that club-run leagues offer significant advantages in this regard.

competition, the general Chicago School presumption that vertical integration is efficient is particularly unwarranted with regard to sports leagues.

C. Comparing Club-Run and Vertically Separate Leagues

Although the foregoing economic analysis precludes an assumption that vertical integrations are necessarily efficient, theory cannot prove the efficiency *vel non* of any particular league's decision to operate as a club-run league. A comparison of the economic structure of club-run and vertically separate leagues, however, does demonstrate that separately-run leagues have the proper economic incentives to reach efficient results, while club-run leagues do not. Noting again our acceptance of the existence of a single dominant league in the major North American sports, which itself causes predictable anticompetitive effects,[28] our claim is that the design of a traditional club-run sports league results in even greater inefficiency than would result from the activities of an efficient, profit-maximizing monopolist.

We contrast club-run leagues with a new type of independent business entity ("The League") that would organize a competition. 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 re-allocated 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 forseeable. The League

---

28 *See, e.g.,* JAMES QUIRK & RODNEY FORT, HARD BALL: THE ABUSE OF POWER IN TEAM SPORTS (1999); SPORTS, JOBS, AND TAXES (Roger G. Noll & Andrew Zimbalist, eds.) (1997);*Monopoly Sports Leagues*, supra note 9; *Open Competition, supra* note 9.

would determine the number and location of franchises, subject to side payments provided for in the franchise agreement if necessary to protect franchisee expectations. The League also would negotiate a collective bargaining agreement with the players' union that would determine the structure under which clubs would compete for players' services.

This part examines the incentives for club-run leagues to make efficient decisions in six important areas, and 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 inability of the clubs to agree on how to share the proceeds of profit-enhancing initiatives. As a result, club-run monopoly leagues are likely to produce (i) fewer franchises, (ii) fewer opportunities for broadcasting or web-casting of their games, (iii)less effective licensing of merchandise, (iv) greater tolerance for inefficient front-office management, (v) a less efficient allocation of players among teams (in part due to inefficient sharing of revenue that might promote competitive balance to enhance consumer appeal), and (vi) a greater bias in favor of club competition at the expense of the dynamic growth of international play that fans may prefer. We suggest that, in contrast, a vertically-separate structure is likely to result in a more efficient allocation of revenue streams between The League's shareholders and franchisees, and re-allocations to create incentives to improve the sport's consumer appeal. As a result, consumers will benefit from receiving an entertainment product delivered more efficiently and responsively to their demand, and investors should also see profits increase from these realized efficiencies.

1. 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.[29] Club-run leagues will necessarily reduce output by even more than a profit-maximizing single-firm monopolist would, and will avoid locations that, while more efficient, may hurt individual club owners' interests.

The optimal number of clubs within a league competition depends on the revenue expected from additional clubs, additional costs associated with additional clubs, and any lost revenue that arises because of reduced demand for games involving existing clubs.[30] Revenue is likely to increase with an additional club because of the new set of fans attracted to matches and/or the increased attractiveness of matches to existing fans due to the involvement of the new club. 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 for several reasons: (a) the substitution by fans of matches involving the new club for matches involving an existing club, (b) the total quality of the league may be diminished by the addition of a club (*e.g.*, because talent become spread too thinly and the overall quality of each match declines),[31] and/or (c) because the number of games between popular teams is reduced by the need for these teams

[29] *See Monopoly Sports Leagues*, *supra* note 9, at 656; NOLL & ZIMBALIST, *supra* note 28, chapter 1.

[30] 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.

[31] We suspect 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 reduce significantly their patronage of their favorite sports teams, much as they might like to complain about it over a beer in their favorite drinking establishment.

to also play against expansion clubs (*i.e.*, to make room for more games with the Tampa Bay Devil Rays, the New York Yankees play fewer games against the Boston Red Sox).

A profit-maximizing league will expand whenever it will be profitable to do so – *i.e.*, whenever net marginal revenue exceeds marginal cost. A club-run league, however, will not expand unless net *average* revenue exceeds marginal cost.[32] Indeed, if (as is common) a super-majority vote is required for expansion, a profitable expansion will be rejected by a club-run league unless the increased revenue from the new team that is shared with other owners (such as expansion fees, increased broadcast rights fees because of higher ratings, greater sales of merchandise) makes a super-majority of clubs better off. This is because each club's representative votes for the amount of expansion which maximizes *their own club's* profits.

Of course, if transactions costs were zero, the members of the league would be able to agree a set of side payments which ensures efficient expansion. However, where transactions costs are not zero, then efficient contracting may well not occur.[33] Clubs in North American sports leagues all share revenues from collective sales of television rights and licensing; each club's analysis of whether to vote for expansion will also consider the club's reduced share of these revenues. Club-run leagues are also likely to under-expand as part of explicit or implicit agreements to protect local markets from competition. Many suggest, for example, that Major League Baseball's refusal to expand to the Washington, DC area is due to vigorous opposition from the Baltimore Orioles.[34]

---

[32] For a mathematical demonstration, see *Open Competition, supra* note 9, at 630-31 n.21. 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).

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

[34] Mark Asher, *Expos' Relocation In 2004 Is '50-50'*, WASH. POST, April 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 Memorial Coliseum Comm'n v. National Football League, 726 F.2d

In contrast, The League has the 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 will follow the now-typical franchisor practice of granting non-perpetual franchises, with specified terms for non-renewal,[35] and will not guarantee geographic exclusivity but will provide in its franchise agreement some mechanism for flexibility in this regard.[36]

1381 (9th Cir. 1984). Side payments can compensate clubs in some cases, but difficulty in agreeing on the size of the payment can preclude welfare-enhancing expansions.

35 *See* Andrew A. Caffey, Stuart Hershman, and Lewis G. Rudnick, *Structuring the Franchise Relationship* in FUNDAMENTALS OF FRANCHISING (Rupert M. Barkoff & Andrew C. Selden, eds.) 47, 61 (1997).

In the food service industry, it appears that newer companies may grant greater protection for franchisees than well established firms. For example, neither Taco Bell nor Subway's grants any exclusive territories, while the newer Jimmy John's firm states that it "usually" will not grant competing franchises and allows franchisees to purchase "development territories." See http://www.worldfranchising.com/Top50/Food/ . Unlike food service, of course, preserving the integrity of on-field competition would not allow the NFL, for example, the flexibility to give the Chicago Bears the right to own a second franchise in Chicago if market circumstances warranted.

36 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 Open Competition, supra* note 9. Thus for example, in the English Premier League, the three worst performing teams are relegated to the Football League Division One and replaced by the three best performing teams from that division. For the history of how this system came into being, see SIMON INGLIS, ENGLISH LEAGUE FOOTBALL AND THE MEN WHO MADE IT 27, 30, 40-44, 47 (1988). This system has several desirable incentive properties. Because teams out of contention for the title still have an incentive to compete until the end of the season, this results in more exciting matches and desirable properties in relation to marketing the league. Since every city can aspire to have a team playing at the highest level of competition one day, the league has the potential to maintain local interest even in markets that do not currently have a team playing at that level. For analysis of the details of promotion and relegation, see *Open Competition, supra* note 9; Roger Noll, *The Economics of Promotion and Relegation in Sports Leagues: The Case of English Football*," 3 J. SPORTS ECON. 169 (2002); Stefan Szymanski & Tommaso Valletti,

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, DC area and two expansion teams were added in suburban New Jersey and Connecticut:[37] that is, the sum of increased revenues from expansion fees, live gate and stadium related sources at these three new locations, and marginally increased revenues from broadcasting and increased 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 3.333% to 3.125%, and the New York Mets and Yankees and 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.

Promotion and relegation in sporting contests (Imperial College Working Paper 2003), *available at* http://www.ms.ic.ac.uk/tommaso/recent.htm.

The League might alternatively find it more profitable to continue the North American practice of reaping significant monopoly profits by demanding public subsidies for stadia, which could be recovered by The League in the form of an entry fee. For sports that seek geographic expansion, The League may deliberately seek out, subsidize, and make medium-term guarantees of competition participation for franchisees located in under-developed areas. If The League fears potential entry, it may wish to ensure a number and location of franchises that deters new rivals. Thus, for example, the National Hockey League may act strategically to assure franchises located in the American sunbelt (in order to develop the sport and national television ratings there) and in Canadian cities (to forestall the creation of a rival league in the sport's founding country).

[37] Although this assumption is purely illustrative, we note that this would give the New York metropolitan area four of 32 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 20-team elite competition.

2. *Sale of Broadcast Rights*

Club-run leagues also have a disincentive to maximize profits from the sale of broadcast and internet rights, because of difficulties in reaching agreement on how to share revenues available from expanded output in the sale of these rights. In the English Premier 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 380 possible games, the Restrictive Practices Court found that the league's limitation on television sales actually reduced revenues.[38] However, the clubs could not agree on how to share revenue gained from additional sales, whether negotiated individually or collectively.[39] Unlike English soccer, television rights to games not collectively sold by the NBA may be sold within a team's assigned territory by each club. 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 value of rights sales elsewhere.[40] Although the league could permit the Bulls games to be shown but tax excess profits,[41] but the league was unable to agree on a mechanism for doing so.

---

38 In re Football Ass'n Premier League Ltd., 1996 No. 1 (E&W) (Restrictive Practices Court, 28 July 1999), ¶313 (noting that Sky Sports, the holder of the rights to broadcast 60 matches per season, had manifested a willingness to purchase 90 matches, but was turned down).

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

40 Chicago Professional Sports Ltd. v. National 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). Subsequently, research has suggested that superstation telecasts might interfere with local or national baseball broadcasts. *See, e.g.*, Richard Sandomir, *Just How Super Are These Stations*, N.Y. TIMES, Sept. 1, 1992, at B13 (Neilsen ratings dropped 30% for Cardinal 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). One could argue, however, that baseball is unique in this regard;

Like other potential revenue streams, broadcast rights could be retained by The League, sold by each club, or divided among The League and its clubs. The League can be expected to make this assignment in a manner designed to maximize league-wide revenue. Revenue streams that are either global in scope or entail significant externalities between the clubs should be controlled by The League. While national broadcast contracts clearly fall in the latter category, local broadcast rights are less clear cut. If we were to assume that each club operated in completely independent broadcast markets, then it would make sense to leave these rights in the hands of the clubs. But this assumption is no longer true, if it ever was.[42] Rights for games not broadcast pursuant to national contracts, which traditionally have been sold by individual clubs, involve significant externalities. Because different packages of rights can be sold at different prices (enabling the league to price discriminate between different buyers), The League would have little incentive to reduce output. At the same time, allocating all broadcast revenues to The League removes the significant collective action problems that exist where clubs sell rights for revenues that are in part attributable to individual team effort and in part due to The League's overall appeal, or where the rights sold by one club could affect the rights sold by another club to varying and uncertain amounts; these issues are now internalized.[43] Assigning this revenue

---

compared to baseball's 162 game schedule, basketball's quicker pace and 82 game schedule leaves less likelihood for burn-out of the average sports fan. Jason S. Oletsky, Note, *The Superstation Controversy: Has the NBA Slam Dunked the Superstations?,* 11 U. MIAMI ENT. & SPORTS L. REV. 173, 193 n.134 (1993).

41 Chicago Professional Sports Ltd. v. National Basketball Ass'n, 961 F. 2d 667, 675 (7th Cir. 1992).

42 During the 1950s, National Football League teams routinely packaged the television rights to their home games for sale in many markets beyond their local metropolitan area. *See* United States v. National Football League, 196 F. Supp. 445 (E.D. Pa. 1961).

43 The *Chicago Bulls* litigation, *supra* note 40-41, 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.

stream to The League also avoids the potential that the competition could be distorted because of revenue disparities between clubs based not on performance but the size of the media market in which the clubs play.[44] Currently, most clubs sell local 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,[45] there may be efficiencies in a single negotiation).[46]

3. Licensing, Merchandise and Sponsorships

The design and licensing of professional sports merchandise 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 decision making in this

---

44 The League can address any marginal diminution in club incentives to succeed, because of the inability to recoup quality investments through higher fees for local broadcast rights, through the prize mechanism we discuss at text accompanying notes 65-66 *infra*.

45 As of 2002, Fox Sports Net had 18 owned or affiliated regional sports networks, Comcast Sports Net ran services in the Philadelphia and Washington/Baltimore markets, and Cablevision Systems Corp. or its Rainbow Sports subsidiaries controlled the Fox Sports Bay Area, Chicago, Florida, Ohio and New England services, Madison Square Garden Network (once itself a team-owned channel) and Fox Sports Net New York. R. Thomas Umstead, *Going to the Net Isn't Always Easy; Sports Teams' Start-Up Cable Channels Face Hurdles,* MULTICHANNEL NEWS, April 29, 2002, at 36.

46 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.

context should be left to those who have the best information.[47] 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, despite complaints by individual clubs. At the other extreme, clubs in the English Premier League offer little cooperative licensing of merchandise.[48] Revenue sharing could address any problems with individual 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 do so has led to disputes and litigation in the United States,[49] and the lack of any central licensing in England. Thus, while collective action problems on both sides of the Atlantic seem to explain the unwillingness of club run sports leagues to achieve an optimal balance of cooperation and local promotion, The League could simultaneously assign revenue streams to create optimal incentives for efficient local marketing, while devising revenue sharing schemes that promote competitive balance or other goals.[50]

---

47 *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).

48 For example, the league website, www.premierleague.com, features a “Shop” page that simply provides links to each club’s “team shop.” In contrast, www.mlb.com directs the consumer to a fully-integrated website where each club’s products are available.

49 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).

50 *See* text accompanying notes 65-66 *infra.*

4. Accountability of Club Executives

Profit-maximization at the club level requires a great deal of business acumen in varied tasks. The owner must assemble a staff capable of effectively dealing with stadium utilization issues (including construction and/or rental of facilities and management and marketing of luxury suites), with marketing and promotion of local live gate, local broadcast rights, and sponsorships, not to mention the organization of on-field playing talent. Incentives to insure that management decisions are achieving the most efficient results are reduced because North American club owners tend to be either entrepreneurs with independent wealth or corporations investing in clubs to pursue strategic advantages with affiliated businesses.[51] However, because each club's success is tied to some degree to the success of fellow owners, one might expect procedures that hold each owner accountable for the stewardship of her franchise. 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 agreement will probably specify standards that franchisees must achieve.[52] However, in a club-run league, the club owners rarely hold a fellow owner accountable for the poor stewardship of a club.[53]

51 *See* ANDREW ZIMBALIST, MAY THE BEST TEAM WIN (2003), ch. 4.

52 *See* Caffey, Hershaman and Rudnick, *supra* note 35, at 47, 61. *See also* Al Bishop Agency, Inc. v. Lithonia, 474 F. Supp. 828, 833-34 (E.D. Wisc. 1979) (even under Wisconsin statute protecting franchisees from termination except for good cause based on "essential and reasonable requirements," failure to meet goals in terms of sales was grounds for termination).

53 Nor is it likely 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. Currently, club run leagues tolerate persistent mismanagement of franchises such as the Cincinnati Bengals (NFL) and Los Angeles Clippers (NBA). 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. For a suggestion that owners whose clubs fail to make the post-season for six consecutive years lose their franchise absent a persuasive plan for corrective action, see Stephen F. Ross, *Light, Less-Filling, It's Blue-Ribbon!,* 23 CARDOZO L. REV. 1675, 1701-03 (2002).

5. Competition for Players

All four major North American sports leagues face well-organized players' unions. Thus, the goal of a well-run league should be to minimize labor costs consistent with an efficient allocation of players among teams. This goal is hampered, however, by the requirement that the league's negotiating team secure approval of a super-majority of clubs to ratify any collective bargaining agreement. Collective action problems inhibit efficient cost minimization in two discrete ways. First, different clubs have different incentives in any labor negotiation: the importance of minimizing labor costs, the cost effect of particular labor restraints, and the harm caused by a strike or a lockout varies widely from team to team. Thus, private and collective interests often conflict. The inability of club-controlled management negotiators to present a united front may make it easier for union leaders to assume that management will not remain firm; in other cases, the union's perception that it the needs to create a sufficiently credible threat of disruption to persuade the most militant one-third plus one of the clubs to reach a compromise may result in miscalculations that also lead to inefficient labor disruptions. Second, creative labor negotiations often involve reasonable compromises or win-win solutions that may be demonstrably in the interest of a majority of the players and the league as a whole. Current structures allow a minority of clubs, however, to block such solutions.

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.[54] 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.[55] Devising schemes to directly or indirectly restrain the

---

54 *See, e.g.*, United States v. National Football League, 116 F.Supp. 319 (E.D. Pa. 1953); Walter C. Neale, *The Peculiar Economics of Professional Sport*, 78 Q. J. ECON. 1 (1964).

55 *See, e.g.*, PAUL WEILER, LEVELING THE PLAYING FIELD 189 (2000) (noting the "externality" that all other clubs suffer if dominant team signs star); *Monopoly Sports Leagues*, *supra* note 9,

labor market to obtain a more balanced competition is a complex endeavor. Complete revenue sharing, for example, will provide balance but will reduce incentives for clubs to invest in talent; schemes can also result in too much balance, resulting in reduced consumer appeal because of the different revenue potential in different markets (thus, overall appeal may be higher if New York and Kansas City do not win an exactly equal percentage of the time) and because of consumer interest in dynasties. However, even if balancing schemes are welfare-enhancing, they are unlikely to be adopted by wealthier clubs.[56] Given super-majority requirements, this means that club-run leagues are likely to reject some profit-maximizing, welfare-enhancing proposals because they make a significant minority of clubs worse off. This is further complicated because revenue sharing formulae are often adopted in the context of collective bargaining.[57] To achieve the various political trade-offs necessary to win super-majority club approval can result in bizarre schemes. For example, the current Major League Baseball revenue sharing agreement, although assertedly designed to promote competitive balance, focuses on actual revenue earned by clubs rather than potential revenue from their local markets, with perverse results. 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 because the resulting improvement in team quality produced $12 million in additional revenue to the club, revenue sharing transfers would be reduced by $9 million, resulting in a net loss to the club of over $3 million.[58]

---

at 687-88 (same). *But cf.* Stefan Szymanski, *The Economic Design of Sporting Contests,* 56 J. ECON. LIT. 1137 (2003) (literature review finds mixed support for hypothesis that promoting contest or seasonal uncertainty – i.e. competitive balance – increases popularity).

56 *See* Stefan Szymanski & Tommaso M. Valetti, *Promotion and Relegation in Sporting Contests* (Imperial College working paper), *currently available at* http://www.ms.ic.ac.uk/tommaso/recent.htm.

57 The labor law aspects of this issue are discussed in note 98, *infra*.

58 This is illustrated in ZIMBALIST, *supra* note 51, at 103-07.

In contrast, The League is free to make its best deal with the players' union, without the additional need to ensure that the agreement makes a super-majority of clubs better off. In regard to changing the incentives clubs may have to compete in the labor market, The League can provide for pro-rata, prize, or strategically targeted revenue transfers to permit clubs to operate effectively. Revenue redistribution can, for example, enhance consumer appeal through improved competitive balance and by increasing club incentives to improve performance within the competition.[59] Indeed, analysis of "economic contests" reveals that The League's appeal can be significantly enhanced by the incentive-altering distribution back to the clubs of substantial revenues retained by The League.

A sports league fits naturally into models of economic contests.[60] Teams contribute effort/investment in talent toward winning a prize (the league championship). The contest model also makes clear the distinction this Article highlights between the function of contest organizer (who designs the competition and specifies the prize) and the contestants. While this vertical separation is clear in individual sports such as golf and tennis, it has been obscured in team

---

59 Where The League is designed for goals other that profit maximization, The League may also seek to redistribute revenue to beneficiaries other than clubs, such as sport development programs now undertaken by various international and European soccer federations, the International Cricket Council, and the International Rugby Board. Balancing these interests with those of the major league competition that The League organizes is a topic beyond the scope of this Article.

60 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, Robert Tollison and Gordon Tullock, 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 Lazear and 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).

sports, however, by the focus of economic analysts on treating sports leagues either as cartels,[61] single entities,[62] or joint ventures.[63] Moreover, this obfuscation has been increased by the focus of analysts (and owners) on the issue of competitive balance and the need to adopt redistributive measures.

Thus the conventional argument is that (i) fans value uncertainty of outcome, (ii) uncertainty is maximized when the quality of team players on either side is roughly equal, and (iii) that redistribution of resources can produce a roughly equal balance. Each of these propositions is open to empirical question,[64] but more importantly this approach has misled many into thinking that a balanced outcome will be produced by taxing the rich and giving to the poor. Whatever the ethical attractions of such a policy, it is not one best calculated to equalize efforts. Rather, 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.

In our model, The League will select a prize structure in order to maximize the incentives for clubs to succeed, subject to the constraint that teams are not driven into bankruptcy. The problem is to try to induce a level of effort equal to the aggregate return, measured by the prize

---

61 Rodney Fort and James Quirk, *Cross Subsidization, Incentives and Outcomes in Professional Team Sports Leagues*, 33 J. ECON. LIT. 1265 (1995).

62 *See, e.g.*, Gary R. Roberts, *Sports Leagues and the Sherman Act: the Use and Abuse of Section 1 to Regulate Restraints on Intraleague Rivalry*, 32 U.C.L.A. L. REV. 219 (1984).

63 Michael Flynn and Richard Gilbert, *An Analysis of Professional Sports Leagues as Joint Ventures*, 111 ECON. J. F27 (2001).

64 For a survey of the evidence, see Szymanski, *supra* note 55.

and any locally retained revenues for the league.[65] The more the prize dominates the income stream of the teams, the more balanced the outcome of the contest is likely to be. The prize thus can correct for club dependence on local revenues, with their inevitable asymmetry, and the perceived unfairness that arises when asymmetric local revenue bases create asymmetric outcomes.[66] If the only reward were a prize, every contestant would have an equal incentive to win. (Thus, if all revenues were shared and the World Series champion received a $40 million prize, New York teams would have no advantage over clubs from Pittsburgh or Kansas City.) This need not imply that The League should aim to achieve a perfectly balanced contest. Such a result would only be optimal if fans in each franchise location would derive an equal amount of utility for a given level of success. Thus, a scheme would be welfare enhancing if clubs with a larger fan base, or where fans respond to wins by greater attendance won disproportionately. Some mix of local revenue and prize money seems to be the likely means by which The League

---

65 *See* Tullock, *supra* note 60. 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.

66 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) [hereinafter "BLUE RIBBON REPORT"] *available at* http://www.mlb.com/mlb/downloads/blue_ribbon.pdf, which attributes 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 .58. Ross, *supra* note 53, at 1685-86 & n.38.

will profit through maximizing fan utility across all franchises, at least to the extent that the league revenues increase with greater fan utility.

In practice, it seems highly unlikely that a league entirely controlled by its member teams will voluntarily adopt a policy of maximizing the incentive to win by establishing a reward structure that favors winners over losers.[67] Clubs that control the competition aim to minimize aggregate effort, which means minimizing the economic reward for winning. The reverse order of finish draft rule reverses the conventional contest incentive by awarding the biggest prize (first draft pick) to the loser, with predictable consequences for effort contributions.[68]

With regard to direct labor market restraints, we suspect that the task of precisely pinpointing the optimal allocation of players among clubs over a decent interval of time is beyond human capability. The exercise requires not only a complex balancing of the elasticity of demand for wins of each club in the short term and the long term, but also a prediction of the effect of each player's prior performance on that elasticity, the effect of non-performance variables (stadium quality, marketing), and a precise prediction of the effect of player acquisition on club performance. We suggest, however, that as a general rule the most efficient means of allocating labor, as with other inputs, is the marketplace. We would therefore expect The League to establish some rules specifically tailored to promote competitive balance,[69] devise a revenue

---

[67] As Rosen and Sanderson observe, "All schemes used in the United States [major leagues] punish excellence in one way or another." Sherwin Rosen and Allen Sanderson, *Labor Markets in Professional Sports*, 111 ECON. J. 469, F47-F68 (2001).

[68] Beck Taylor and Justin Trogdon, *Losing to win: Tournament incentives in the National Basketball Association*, 20 J. LABOR ECON.1 (2002).

[69] Examples of rules tailored to promote competitive balance would include roster limits with waiver rules: to prevent the best clubs from stockpiling players, each club would be limited to a certain number of players, with surplus players being subject to claim by other teams and with inferior teams having priority claims.

redistribution policy to permit give any well-run club a "regularly recurring reasonable hope of reaching post-season play,"[70] and otherwise allow the market to work.

Club-run leagues have not been very successful in achieving the desired trade-off between cost minimization and maximizing flexibility in efficientlyallocating players among teams. Currently, club owners in Major League Baseball, the National Basketball Association, and the National Hockey League complain mightily about the high cost of players, particularly veteran "free agents" who attract huge sums in inter-club competition when their contracts expire. In a misguided effort to lower payroll, clubs insist in collective bargaining on limiting the number of players able to receive competitive bids for their services.[71] Older players, seeking job security, not only attract high salaries but long-term contracts where these salaries are guaranteed for a number of years. A significant reason why clubs are willing to meet older players' demands is that in any particular off-season, the number of free agents is so restricted by owner-sought rules that many clubs in need of key talent chase very few players.[72]

---

70 This phrase as a workable definition of the sort of competitive balance than enhances consumer appeal comes from BLUE RIBBON REPORT, *supra* note 66, at 8.

71 Under the Major League Baseball collective bargaining agreement, only players with more than six years of major league service can receive competitive bids for their services. RODNEY D. FORT, SPORTS ECONOMICS 283 (2003). Under the National Hockey League collective bargaining agreement, only players who are older than 32 and have four years of major league services can receive open and competitive bids for their services; under a complicated formula, other players can receive bids from clubs other than their current employer, subject to provision that give their current employer rights of first refusal and/or compensation from the signing team. *Id.* at 293. Free agency is more permissive in the NFL and the NBA, but competitive bids are restricted, especially in the NBA, because of salary caps on each term's payroll. Salary caps are considered *infra*.

72 The model for the modern paradigm of labor relations was established in the initial collective bargaining agreement between the Major League Baseball Players Association and the owners following an arbitration order that would have allowed almost all players to negotiate freely with any team. Although owners who had traditionally had perpetual exclusive rights to negotiate with players reflexively sought to limit the number of players free to seek competing bids, the players' union chief recognized that there was an "optimal mix of supply and demand" to maximize player salaries, which he predicted was based on requiring between four and six years

Without the need to secure approval of a super-majority of clubs, The League will have greater freedom to find terms agreeable to the union that would facilitate a more flexible labor market.[73] We think it unlikely that The League would establish across-the-board salary caps, for several reasons. These caps reduce consumer appeal to the extent that they prohibit inferior clubs from quickly improving by increasing payroll through the infusion of new talent.[74] With optimal revenue sharing and substantial prizes for competitive success, the revenue disparities between clubs will be minimized and the need to cap payrolls of "large market" teams will be significantly reduced.[75] The League might well consider more tailored payroll limits, such as rules preventing the very best teams from further increasing a high payroll,[76] or rules that limit

---

of service. This system was agreed to. *See* MARVIN MILLER, A WHOLE DIFFERENT BALL GAME 266-67 (1991).

73 The League may prefer to induce players' unions to agree to a more flexible approach, similar to the model of European soccer, where players rarely become "free agents" but are constantly renegotiating long-term contracts that are assigned to other clubs for substantial sums if the current employer is unlikely to be able to pay the salary the player demands. To minimize costs, The League might negotiate a fixed percentage of these transfer fees that will be retained by the player. In addition, the league might offer concessions on other issues to induce the union to agree that a maximum percentage of each contract would be guaranteed. One of the key features that promotes competitive balance in the National Football League is the fact that most contracts are structured with a substantial "signing bonus" that the player receives as guaranteed money, with the remaining salary subject to non-payment if the player is released. This allows clubs with high payrolls and low performance to improve by releasing under-performing players.

74 Stephen F. Ross, *The Misunderstood Alliance Between Sports Fans, Players, and the Antitrust Laws*, 1997 U. ILL. L. REV. 519, 567-77 [hereinafter *Misunderstood Alliance*].

75 Baseball's Blue Ribbon Report concluded that competitive balance flourished in baseball without any salary caps as long as the revenue differential between the top and bottom quartile approximated 2:1. When the gap approached 3:1 in the late 1990s, the Report found reduced balance. BLUE RIBBON REPORT, *supra* note 66, at 6-7.

76 One example of this type of scheme is the so-called "Rooney Rule," came into play for only the first year of the NFL collective bargaining agreement signed in 1994. Under this rule, the top eight teams are limited in their ability to sign a greater number of veteran free agents than they lost from their own roster. *See* White v. Nat'l Football League, 822 F. Supp. 1389, 1413 (D. Minn. 1993).

team spending to prevent profligate expenditures that threatened club solvency. Significantly, The League can control expenditures through the prize: if teams are trying too hard (insolvency), The League would reduce the prize fund or change the prize spread so that the benefits to winning are reduced, while using revenue sharing or a handicapped prize to deal with market asymmetries.[77]

Club-run leagues are largely focused on providing "cost certainty" to their member-owners, who may well prefer certainty about profits as much if not more than maximizing profits.[78] Although a fledgling or flailing league that requires additional incentives to attract investors to operate clubs may find cost certainty to be a legitimate priority,[79] The League's incentives will be to devise a labor market structure to maximize consumer appeal, and therefore revenues. Certainly, The League will have no particular desire to grant "cost certainty" to club owners seeking to evade their responsibility to increase spending because of their club's poor record in prior seasons.

---

77 However, because large revenue teams often have fan bases with a high demand for winning, caution is warranted to avoid going too far in eliminating asymmetry.

78 NHL executives have claimed that cost certainty is the overriding priority in upcoming collective bargaining negotiations with players. *See* Andy Bernstein, *NHL locks in on controlling player costs: Linking payrolls to revenue is league's priority in labor plan*, SPORTS BUS. J., Sep. 15, 2003, at 1, 18. *See also* Declaration of Russell T. Granik ¶ 42, NBA v. Williams, 94 Civ. 4488 (KTD) (S.D.N.Y. 1994) (NBA Deputy Commissioner justified salary cap in part on grounds of "cost certainty"). *Cf.* 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").

79 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.

6. International Competition

Innovations often require creative solutions to achieve optimal results. In soccer and rugby, where competition between teams of all-stars representing their country is traditionally profitable, the increasing revenues from both domestic club competition and innovative multi-national club tournaments create tensions over the number games and the design of tournaments. In baseball, basketball and hockey, where North American domestic club competitions dominate, there is increasing demand that room be made within schedules for international competition. There surely is an optimal balance between international and domestic league competition. However, achieving that balance is significantly impeded when domestic leagues are run by the clubs. Lucrative international competitions will inevitably diminish revenues from domestic competitions, either by a shortened or interrupted schedule or by reduced consumer appeal from having the domestic competition continue without the benefit of international stars. Side payments to facilitate an appropriate balance would be much easier to achieve if the organizer of the domestic competition were a single entity rather than a group of clubs, especially a group where super-majority voting is often required for change.[80] Thus, for example, when improvements in communication and broadcast technologies made it feasible and desirable to develop European-wide club competitions at the end of the 1950s,[81] the existence of a competition organizer separate from the clubs made it possible to develop the competition to the

---

80 In addition to the sports discussed above, cricket is a sport without any significant professional club competition except for English county cricket, which is heavily subsidized. For a proposal to create an international club competition, see Ian Preston, Stephen F. Ross, & Stefan Szymanski, *Seizing the Moment: A Blueprint for Reform of World Cricket* (working paper), *available at* http://www.ms.ic.ac.uk/stefan/.

81 The midwife of European club football championships was the French newspaper *L'Equipe,* which brought together Europe's 18 leading clubs in 1955. *See* 4 ASSOCIATION FOOTBALL, Part XVIII, ch. 7 (A. H. Fabian and Geoffrey Green eds. 1960).

point that today the Champions League is probably the most successful club competition in world soccer.[82]

7. 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 games between highly attractive clubs. More telecasts 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. Increased globalization permits greater interest in international competition, but the huge potential for revenues from competition among national teams or international club tournaments must be offset against losses from domestic competition. These trade-offs are challenging enough for skilled professionals to accomplish. However, executives of club-run leagues face an additional formidable obstacle. They must not

---

[82] The Champions League is organized by UEFA, an organization comprised of the various domestic federations that govern European football. For a brief discussion of how soccer federations govern the sport, see notes 137-38 *infra* and accompanying text. For the popularity of Champions League matches internationally, *see, e.g.*, http://www.uefa.com/newsfiles/82383.pdf. At the same time, the integration of national governance with continental governance (UEFA is governed by representatives of each nation's federation, rather than by an independent body) has resulted in the maintenance of two overlapping competitions each year – one European, one national – which may not be the most efficient way to organize the competition. *See* Tom Hoehn & Stefan Szymanski, *The Americanization of European Football*, 28 ECON. POL. 205 (1999) (advocating creation of pan-European league of 60 clubs in ten conferences who would no longer compete in domestic competitions.)

only develop a business model that optimizes these trade-offs in a way that maximizes profits for the sport, but their model must also be presented for approval to owners who, based on their own long-term, short-term, or other strategic interests, will endorse or reject the proposal; often a super-majority of individual clubs must approve. 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.

Predictions made in this Article 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. The League, unlike the clubs acting collectively, has the incentive to optimally set the number and location of franchises. The League, unlike the clubs collectively, has the incentive to determine the optimal sharing of revenues from broadcasting, licensing, and sponsorships, in order to capture both operational efficiencies and eliminate welfare-decreasing externalities. To promote competitive balance or otherwise permit clubs to enhance consumer appeal, revenues retained by The League will be divided between a return on investment for The League's stockholders and targeted re-investment in prizes or revenue redistribution. Unlike the clubs acting collectively, The League has the incentive to design rules regulating labor markets that maximize profits and minimize costs consistent with the need to collectively bargain with the players. The League has the incentive to hold club management accountable for the quality of their stewardship. Finally, removing the need to establish the benefits of welfare-enhancing innovations like international play for a super-majority of individual clubs will facilitate the implementation of these consumer-enhancing new competitions.

D. Legal Advantages of Vertical Separation Between The League and its Clubs

The traditional legal response to allegedly anticompetitive acts by club-run monopoly sports leagues has been to scrutinize these restraints for reasonableness under the Sherman Act. Although league attorneys and some academic defenders have argued that club-run leagues are themselves "single entities" whose intra-league decisions, like those of a single corporation, are not considered conspiracies in restraint of trade under section 1 of the Sherman Act, that argument has been overwhelmingly rejected by the courts.[83] Indeed, one of the principal doctrinal insights to be gleaned from the economic analysis set forth in this Article is that club-run leagues differ significantly from single-entity leagues in the way in which they are operated, further justifying continued close scrutiny of the former.[84]

---

83 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) [hereinafter *Antitrust Options*]. For academic commentary in favor and opposed to the single entity defense as applied to club-run leagues, see *Misunderstood Alliance*, *supra* note 74, at 549 n.136. *Cf.* Fraser v. Major League Soccer, L.L.C., 284 F.3d 47 (1st Cir. 2002), where the district court's rejection of an antitrust claim based on the single entity argument was criticized and the result affirmed on other grounds.

84 *Cf.* Chicago Professional Sports Ltd. v. National 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 U.C.L.A. L. REV. 219, 295 (1984). Our principal

One of the many advantages in creating The League would be that its structure would preclude many of the controversial antitrust decisions against sports leagues, either because The League would be unlikely to impose the challenged restraint or because the burden on an antitrust plaintiff challenging decisions of a single corporate entity separate from clubs is much greater than the burden of attacking decisions of clubs who agree to lessen competition among themselves. The League will 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.

Because the common law vests the right to telecast a ball game in the home team,[85] antitrust law views all rights sales by a club-run league as collective sales. These sales are subject to the Sherman Act, and will be struck down where their effect is to reduce viewership or render output unresponsive to consumer demand.[86] Where sports competitions are organized by The League, we envision that the clubs' common law television rights would be transferred to the League as

---

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 n.261, while 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.

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

86 National Collegiate Athletic Ass'n v. Board of Regents, 468 U.S. 85, 107 (1984). *See also* Stephen F. Ross, *An Antitrust Analysis of Sports League Contracts with Cable Networks*, 39 EMORY L.J. 463 (1990) [hereinafter "*Cable Contracts*"]. 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.

part of the franchise agreement. All subsequent rights sales from The League to programmers or networks would no longer be viewed as a collective sale for purposes of the Sherman Act.[87]

The franchise agreement provision initially granting all rights to The League would remain subject to section 1, but we believe that it would be upheld as being, on balance, welfare enhancing. Allowing The League to distribute all broadcast rights avoids the significant collective action problems when clubs individually sell rights and then must reach agreement as to how revenue is shared. Moreover, it provides The League with a critical base of revenue that can be used to promote competitive balance, through outright redistribution or through competitive prizes.[88]

---

87 The League's freedom to license broadcast rights would still, however, be subject to antitrust scrutiny to the extent that a particular transaction had demonstrable anticompetitive effects in broadcast markets. *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 (April 17, 1999), *available at*http://www.competition - commission.org.uk/rep_pub/reports/1999/index.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).

88 See text accompanying notes 65-66, *supra.*

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 51, 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, *Cable Contracts, supra* note 86, at 481, the unilateral sale by The League to a 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, §§ 97-105 (U.K.); Broadcasting Services Act 1992 (Aus.) (authorizing minister to list events required to be available on free-to-air television).

Perhaps the area where the specter of antitrust liability poses the greatest concern for club-run leagues concern questions of 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 characterizing these decisions as group boycotts or unreasonable horizontal trade restraints.[89] As the Supreme Court noted in *NCAA*, horizontal restraints among competitors are generally treated with suspicion under the antitrust laws.[90] In contrast, there will be minimal antitrust scrutiny of The League's entry and relocation decisions. Even for club-run leagues, courts are generally deferential on questions of entry,[91] and there is even less risk if, as we predict, The League will maintain some basis for efficiently determining the optimal number of teams and for allowing efficient entry where the dynamics of the market indicate. Antitrust scrutiny of relocation decisions have focused on a fear that club-run leagues were denying relocation to protect local

---

89 *See, e.g.*, St. Louis Convention & Visitors Comm'n v. National 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); National 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 Memorial Coliseum Comm'n v. National Football League, 726 F.2d 1381 (8th Cir. 1984) (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. National 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).

90 *NCAA*, 468 U.S. at 100.

91 In Mid-South Grizzlies v. National 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.

incumbents or because of an inability to agree on dividing any surplus from relocation. If, as we expect, franchise agreements give The League primary control over franchise location, these concerns are substantially reduced. 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 horizontal restraint, any decision by The League would be considered a vertical restraint and a plaintiff would have a heavy burden to show that The League's interest was not the same as fans.[92]

With regard to labor restraints, club-run leagues are today substantially shielded by the Supreme Court's expansion of a judicially-created "non-statutory labor exemption" to cover any restraints subject to collective bargaining under federal labor law when they primarily affect the labor market.[93] However, players retain the option of decertifying their union as their bargaining representative and filing an antitrust suit instead, alleging that clubs competing for players' services were illegally restraining trade among themselves.[94] The League would face no such threat if collective bargaining fails and it centrally controlled all labor relations.[95]

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. Although we believe that the increased likelihood that The League would

---

92 *Compare* Continental T.V., Inc. v. GTE Sylvania, Inc. 433 U.S. 36 (1977) ("vertical" territorial restraint imposed by television manufacturer on locations where its product could be sold at retail subject to rule of reason) *with* United States v. General Motors Corp., 384 U.S. 127 (1965) ("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.

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

94 *See, e.g.,* Powell v. National Football League, 764 F. Supp. 1351, 1359 (D. Minn. 1991).

95 Although centrally-controlled labor relations were subjected to close antitrust review in Fraser v. Major League Soccer, 284 F.3d 47 (1st Cir. 2002), the league was not found to be independent of rival clubs but rather was controlled by the club owners. *Id.* at 57 & n.5.

create rules designed to optimally allocate players among teams is a strong case in favor of the reasonableness of this approach, players may fear such a restructuring and argue that these efficiencies do not justify the elimination of competition among independent actors for their services. Because we believe that an optimal approach would create a generally free labor market,[96] with franchisee clubs bidding through an internal auction for players, 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 foreclosing an antitrust challenge. Indeed, having a long-term collective bargaining agreement in place before the initial sale of shares in The League were offered would probably enhance the value of offering.[97] Moreover, such bargaining may well be necessary anyway 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.[98]

---

96 *See* text accompanying notes 69-79, *supra.*

97 Current owners may find that their capital gain on an initial public offering in shares in The League would be maximized by creating The League prior to issuance of public stock, securing a highly regarded Board of Directors and executive team, and securing a collective bargaining agreement with players. *Cf.* Taylor Milk Co. v. Teamsters, 248 F.3d 239 (3d Cir. 2001) (describing merger where acquiring firm desired to have new collective bargaining arrangement secured before closing deal).

98 In Mackey v. National Football League, 543 F.2d 606 (8th Cir. 1976), the court held that an agreement among owners to provide compensation (either agreed-upon or to be determined by the league commissioner) when successfully bidding for the rights of a player previously employed by another club was a mandatory subject of bargaining under federal labor law. Although the court acknowledged that the rule did not facially concern wages, hours, and working conditions, the statutory scope of the mandatory subject of bargaining under § 8(d) of the National Labor Relations Act, 29 U.S.C. § 158(d), it concluded that the agreement operated in practice "to restrict a player's ability to move from one team to another and depresses player salaries." 543 F.2d at 615. Although The League could construct its franchise agreement with clubs in such a way that there would be no restriction on player movement or downward effect on player salaries, certainly the restructuring proposed here would give The League the power to harm players' interests. The practical effect would appear to be similar to *Mackey*, and thus a mandatory subject of bargaining.

Finally, leagues have also faced antitrust litigation concerning the creation or application of policies concerning ownership. For example, the National Football League's rule against corporate ownership of its clubs was found to unreasonably shield owners from competition from more efficiently-structured entities,[99] while the NBA's rejection of a particular buyer was upheld.[100] Antitrust liability for club-run leagues ownership rules is increased because the rules restrict the structure of their competitors. Plaintiffs will allege that incumbents are trying to hamper their rivals by precluding more efficient ways of obtaining capital or organizing rival clubs. If The League unilaterally imposed its own rules on franchisees, it would be difficult to construct a theory of competitive harm.[101]

This issue presents somewhat of a tactical dilemma for the party most likely to be affected – the relevant players' union. An assertion that restructuring is a topic of mandatory bargaining assists in the process of collective negotiation, but under *Brown v. Pro-Football, Inc.,* 518 U.S. 231 (1996), protects the restructuring from antitrust attack. The contrary assertion would leave open an antitrust challenge, but potentially foreclose effective bargaining. We suspect that unions will generally prefer to enlarge their rights under labor law rather than reserve their options to file expensive antitrust suits. *Cf.* Jessica Cohen, Note, *Sharing the Wealth: Don't Call us. We'll Call You: Why Revenue Sharing is a Permissive Subject and Therefore the Labor Exemption Does Not Apply*, 12 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 609 (2002) (based on questionable factual assumption that effect on revenue sharing on owners' willingness to bid for players is too remote, concludes that revenue sharing is not mandatory subject of bargaining).

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 need to enter into a new collective bargaining agreement with the players.

99 Sullivan v. National Football League, 34 F.2d 1091 (1st Cir. 1994).

100 Levin v. National Basketball Ass'n, 385 F. Supp. 149 (S.D.N.Y. 1974).

101 In *Sullivan*, the NFL made the legitimate argument that the overall appeal of the league 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. The jury in *Sullivan* was persuaded that the fear of competition from clubs owned by publicly traded corporations trumped this concern, 34 F.3d at 1100, but The League would be much more likely to prevent clubs from being operated by those whose ownership structure was inimical to the best interests of the overall competition.

Antitrust scrutiny of agreements among clubs participating in The League would remain in place to protect consumers from anticompetitive harm.[102] The Sherman Act would 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

---

102 Although agreements among competing clubs would remain suspect under the antitrust laws, clubs participating in a restructured league should have much less of a need to agree on competition-restricting rules. Procompetitive joint ventures, such as joint scouting combines, multi-club training facilities, or joint marketing of products (like sponsorship rights) in markets where clubs lack market power, would pose little risk of antitrust liability. Horizontal agreements among clubs that threatened to increase price, reduce output, or render output unresponsive to consumer demand would also be subject to prohibition by The League in a well-drafted franchise agreement.

efficient than The League's should be able to attract almost all the clubs thru individual negotiations.[103]

Because The League would likely be the dominant provider of competition organizing services in each sport, it would still remain liable under section 2 of the Sherman Act for attempted or actual monopolization.[104] However, its liability in this regard is no greater than that faced by club-run leagues today. Antitrust law does not forbid the exercise of monopoly power, only its illegal maintenance.[105] The law reasons that monopoly pricing actually encourages entry and thus does not allow a firm to illegally maintain monopoly power.[106] Although the Sherman Act prohibits The League from engaging in anticompetitive acts to maintain its dominance, to prove illegal monopoly maintenance a plaintiff must prove not only that rules are exclusionary

---

103 If the League's viability is threatened by wholesale defection of clubs, we would expect that The League is unlikely to continue to enforce player contracts (and pay player salaries) for athletes without a club to play for, thus opening up the market for clubs in the new league.

104 Courts have generally found that the dominant league in a major sport possesses monopoly power. *See, e.g.,* United States Football League v. National Football League, 842 F.2d 1335, 1364 (2d Cir. 1988); Philadelphia World Hockey Club, Inc. v. Philadelphia Hockey Club, Inc., 351 F. Supp. 462 (E.D. Pa. 1972); Fishman v. Estate of Wirtz, 1981-2 Trade Cas. (CCH) ¶64,378 (N.D. Ill. Oct. 28, 1981), at 74,756. The reasoning of these and other Supreme Court precedents support a similar conclusion for Major League Baseball. *See, e.g.,* International Boxing Club v. United States, 358 U.S. 242 (1959) (ordinary boxing matches do not constrain power of those dominating championship boxing); National Collegiate Athletic Ass'n v. Board of Regents, 468 U.S. 85 (1984) (college football is a separate market).

105 *See* United States Football League v. National 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").

106 As the court explained in Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 294 (2d Cir. 1970), the mere exercise of monopoly power "is not in itself anticompetitive. Indeed, although a monopolist may be expected to charge a somewhat higher price than would prevail in a competitive market, there is probably no better way for it to guarantee that its dominance will be challenged than by greedily extracting the highest price it can." In contrast, for example, Article 82 of the European Treaty condemns not monopolization but "abuse of dominant position," an offense that includes imposing "unfair prices." *See* Treaty Establishing the European Community, at 82, Nov. 10, 1997, 1997 O.J. (C340) 173.

but they are unnecessarily so – that is, that they are inefficient. Rules designed to promote consumer appeal or to achieve efficiencies are lawful.

To be sure, The League – like current club-run leagues – could not engage in blatantly anticompetitive acts, such as blacklisting players who sign with rival leagues.[107] In addition, foreclosing rivals from essential inputs would subject The League to liability. Thus, The League could not tie up every television network.[108] The League would also have to ensure that player contracts were structured so that a rival could have access in any given year to a sufficient number of players (either amateurs coming out of college, minor leaguers, or veteran free agents) in order to viably compete.[109]

Because even in natural monopoly markets antitrust laws favors competition for the monopoly,[110] it could be argued that the best way to promote competition in the market for

107 *See* Radovich v. National Football League, 352 U.S. 445 (1957).

108 Although not proven on the facts, this was a principal theory of the USFL's monopolization case. United States Football League v. National Football League, 842 F.2d 1335 (2d Cir. 1988).

109 *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.)

110 As the court noted in Hecht v. Pro-Football, Inc., 570 F.2d 982, 991 (D.C. Cir. 1977):

> To hold otherwise could effectively mean that a defendant is entitled to remain free of competition unless the plaintiff can prove, not only that he would be a viable competitor, but also that he and defendant both would survive. This result would be ironic indeed: we cannot say that it is in the public interest to have the incumbent as its sole theatre, or its sole newspaper, or its sole football team, merely because the incumbent got there first. Assuming that there is no identity of performance, the public has an obvious interest in competition, "even though that competition be an elimination bout" [quoting Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582, 584 n.4 (1st Cir. 1960) and citing Greenville Pub. Co., Inc. v. Daily Reflector, Inc., 496 F.2d 391, 397 (4th Cir. 1974)]. 'It has been the law for centuries,' Justice Holmes once wrote, 'that a man may set up a business in a small country town, too small to support more than one, although thereby he expects and intends to ruin some one already there, and succeeds in his attempt.' Vegelahn v. Guntner, 44 N.E. 1077, 1080 (Mass. 1896). The newcomer and the incumbent may both succeed, or either or both may fail; this is what competition is all about.

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. As noted above, 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.[111] 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 employed players, would not seem to be reasonable.[112]

On the other hand, it is more difficult to see efficiency justifications for The League's control of club-based trademarks. Allowing clubs to keep their trademarks (subject to limited assignment to The League for licensing purposes, as now occurs) if they choose to join another league would enhance the opportunity for rivalry in competition-organizing services and the

---

111 *See* text accompanying notes 69-77 *supra.*

112 If instead we presume that the market for competition organizing is capable of stable rivalry between competing leagues, then a dominant league's employment of players, precluding a rival for competing for clubs to participate in its own competition, becomes more complex. A number of commentators have advocated horizontal restructuring of existing leagues into multiple competing leagues that agree on a championship but economically compete for franchises, players, broadcast rights, and merchandise. *See* ZIMBALIST, *supra* note 51, at 155, *id.* at 189 n. 42 (citing others to same effect).

likelihood of The League's displacement by a more efficient rival. In similar fashion, although franchise agreements can reasonably be set at 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.[113]

In short, an independent entity organizing a popular sporting competition is likely to enjoy significant advantages over the tradition club-run leagues. 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, given the assumed absence of competition, should be greater profitability.

III. IMPLEMENTING A VERTICAL RESTRUCTURING OF A DOMINANT SPORTS LEAGUE

In a well-functioning market, those with the power to establish the structure of sports leagues would not design leagues that result 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, lack of effective oversight of each club's stewardship of its valuable franchise, and under-exploitation of international opportunities. 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

---

113 For analysis on this point, *see* XI HERBERT HOVENKAMP, ANTITRUST LAW ¶1802g (1998).

result.[114] However, where transaction costs are significant, the allocation of control rights to club owners can significantly affect the distribution of resources.[115]

In this section, we discuss ways in which owners of club-run leagues might effectuate a restructuring that would be profitable for them and result in a more efficient league. At the same time, we recognize that – unlikemost other businesses that could profitably restructure – neither actual or potential rivals nor the market for corporate control constrains individual club owners' pursuit of their own interests at the expense of an efficient league operation, and that there is a significant possibility that the same transactions costs that prevent current leagues from achieving efficient results significantly minimize the likelihood that an efficient re-structuring of sports leagues would be voluntarily embraced by current club owners. Still, 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 one of the surest incentives for parties to overcome transactions costs. After an exploration of why vertically separate leagues have not been established already if, as we claim, the idea is so efficient, the section concludes with a detailed analysis of legal options that courts or Congress could use to justify an involuntary restructuring through government intervention should transactions costs prove to difficult to overcome on a voluntary basis.

A. Voluntary Implementation Through Private Ordering

Experts in corporate finance 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 the sports competition efficiently. The means of implementation will likely differ

---

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

115 *See* COOTER & ULEN, *supra* note 33.

depending on whether the restructuring occurs at the initiative of the clubs or their management, or rather occurs at the behest of outside investors. We offer the following discussion to illustrate how a restructuring may occur.

If the clubs or their commissioners were to agree with this Article's conclusions, one effective way to vertically separate would be to create a The League as a separate corporate entity ("NFL, Inc.") with a relatively small percentage of outstanding shares created as voting stock and most of the shares retained 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 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 from potential capital gains from the appreciation of preferred shares in The League. Owners would retain the ownership in their clubs, although obviously the franchise value of the clubs would be substantially reduced under this restructuring. If appropriate, owners could be assigned a different number of shares to be redeemed in the initial public offering or as preferred shares. The ability of current owners to retain equity in The League makes this approach attractive to them, but to achieve the benefits of vertical separation, it is critical that their investment be non-voting (or strictly limited to a small percentage of voting stock). To facilitate the marketability of the preferred stock, it can be made immediately convertible to voting stock if acquired by anyone not involved with the operation of a club. Thus, once the market price had been established after the initial public offering, club owners could with skilled advice from their own investment advisers 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, could continue to appreciate.[116]

The foregoing approach would require the active cooperation and leadership by those currently owning and operating the league. 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 the use of debt or their own personal assets required to provide the initial cash payments to current owners.[117]

B. Why Current Owners May be Unwilling to Restructure Even if Efficient

Generally, when those outside a firm believe that the business can be operated more profitably, a market for corporate control facilitates the acquisition of the firm's assets by these

---

116 The value of sports franchises tripled in the last decade. *See* http://users.pullman.com/rodfort/SportsBusiness/BizFrame.htm. We thank Professor Cynthia Williams and investment analyst R. J. Bukovac for assistance regarding the mechanics of the restructuring.

117 Of course, as with the initial public offering, payment to the club owners could also include preferred stock in The League.

more efficient operators.[118] However, even if restructuring of a dominant sports league would be efficient, club owners may not agree to sell. A simple reason why club owners may not choose to surrender control of their club-run leagues to a more efficient centralized operation is that they do not have to.[119] Sports leagues do not face significant competition from actual or potential product market rivals.[120] As a result, market retribution will not be swift[121] should owners fail to achieve efficient results.[122] Even club-run leagues might face pressure for greater efficiency if a market for corporate control existed to create pressure on club officials to maximize profits for club shareholders. 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

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

119 *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) (Hand, J.) (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 the inevitable disposition to let well enough alone"); 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").

120 *See Monopoly Sports Leagues, supra* note 9 at 647-48. Judicial precedents support this conclusion. *See* note 104, *supra.*

121 *Cf.* Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982) (noting swift market retribution as a characteristic of firms lacking market power).

122 The inefficiencies engaged in by monopoly sports leagues, and an explanation for how competition would eliminate these inefficiencies, is discussed in *Monopoly Sports Leagues, supra* note 9.

interests that efficient operation of the league is not a principal concern.[123] Thus, a series of hostile takeovers of clubs is not a feasible option.[124]

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 will have to give up the power to make the rules, and have to accept directives from others. Even if this Article is correct that there are substantial efficiencies to restructuring, when the value of these efficiencies are divided among all the owners, it may not be sufficient to compensate for the loss of power. To illustrate, suppose that the current aggregate value of all Major League Baseball franchises were $9 billion,[125] and that a vertical separation would result in efficiencies sufficient to increase the combined value of MLB and club assets to $10 billion. The current thirty owners would then realize an average profit (some immediately realized in cash, some through increased valuation of preferred stock in The League) of $33 million.[126] Although the precise contours of the transfer of rights could well result in some owners receiving more and some less, it is certainly plausible that, for more than one-quarter of the owners, this sum is insufficient to deprive them of the power and control they now possess.

---

[123] For a more detailed discussion of this point, see Stephen F. Ross, *Antitrust Options to Redress Anticompetitive Restraints and Monopolistic Practices by Professional Sports Leagues,* 52 CASE W. RES. L. REV. 133, 145-46 (2001).

[124] 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.

[125] According to Forbes magazine's annual estimates, the 2003 combined value of franchises was $9,131,000. *See* "MLB Team Evaluations," *available at* http://www.forbes.com/free_forbes/2003/0428/064tab2.html.

[126] To be precise, assuming the Montreal Expos remain under the ownership of the league, individual owners would see their investment increase in value by $34.5 million.

The most likely reason that owners may reject the opportunity to vertically restructure their sport is the principal reason that vertical integration is inefficient – the significant transaction costs that exist whenever a potential pareto opportunity presents itself to a club-run league. The vast proceeds ($1 billion in my hypothetical illustration) would have to be divided among the current owners. Even George Steinbrenner would likely approve the concept if, say, $400 million 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 were sports leagues efficiently organized by an entity separate from the clubs, 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 can't agree on how to distribute small amounts available from increased sale of rights to out-of-market broadcasts,[127] one cannot be too sanguine about the likelihood of voluntary restructuring.

C. Why Leagues Haven't Done This Already if it is Such a Good Idea

To be sure, each major North American professional team sports league has always been vertically integrated. We believe that this is due in part to the dynamic economics of fledgling sports leagues that lack market power, and in part due to an accident of history rather than any inherent requirement of vertical integration to maximize consumer appeal or efficiently operate a competition in a team sport.

The traditional model of a vertically integrated, club-run league was developed when baseball's National League was created in 1876.[128] This model emerged as a consequence of two factors. First, a free-for-all then existing in baseball – characterized by (a) barnstorming teams

[127] Cf. *Chicago Bulls*, discussed *supra* notes 40-41 and accompanying text.

[128] The authoritative work on the origins of baseball, from which the textual narrative is derived, is HAROLD SEYMOUR, BASEBALL: THE EARLY YEARS (1960).

attracting support as long as they are winning and then collapsing when they lose (a rational bubble), (b) team owners dissipating all the rents in competing to hire the best talent, and (c) opportunities for gambling that generated significant match fixing – was undermining interest in the rapidly growing national sport. Second, revenues associated with baseball in the late 19th century were almost entirely generated locally by clubs, principally through sales of admission tickets.[129] 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[130] invested members with a stake in its long term success (to 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 confer monopsony rights over the players (ensuring that the income stream from matches accrued principally to the owners). The extraordinary success of this model made it not only the basis for the National Pastime, but also for the other North American team sports. American sports played in other countries adopted this model (e.g. baseball in Japan and Mexico, basketball in Australia).[131]

Although the founders of the National League deemed it natural to integrate governance functions with the supply of matches, this was not really inherent but rather a direct consequence of the lack of any alternative credible supplier of these services in 1876. In contrast, in England the Football Association (FA) was established in 1863 and had successfully standardized rules and maintained oversight of the development of English soccer, and had also developed two

---

129 *Id.*, ch. 7.

130 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.

131 *See* ALLEN GUTTMAN, GAMES AND EMPIRES (1994).

important forms of competition in its own right: the FA Cup, a knock out competition including all members, and international representative football, arguably the most successful competition structure ever invented.[132] Thus when, in 1888, leading clubs finding the same need as baseball teams for a fixed and reliable playing schedule created the Football League, 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 football to maintain an independent governing body at the head of the sport.[133] At the same time, because leading clubs and the FA have always perceived that the clubs possess a credible threat to secede from the FA and completely integrate into competition organizing,[134] the clubs have maintained a significant degree of control so that the modern structure of English soccer has many features similar to club-run North American leagues.[135] At

---

132 The early history of the game is recounted in GEOFFREY GREEN, SOCCER, THE WORLD GAME: A POPULAR HISTORY (1956), ch.3. Global audiences for the FIFA World Cup played between qualifying national teams attracts larger audiences than the Olympics. FIFA estimated that the 1998 World Cup Final was watched on TV by more than one billion viewers. *See* http://us.emt4.yimg.com/fifaworldcup.yahoo.com/releases/IP-401-E-TV.pdf.

133 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." *See* INGLIS, *supra* note 36, at 11. Another commentator described the relationship between the FA and League thus: "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." GREEN, *supra* note 132, at 62.

134 We discuss above why we believe a concerted secession from a competition by leading clubs should violate antitrust laws. See text accompanying note 102, *supra*. In England, in recent times the commercial power of the clubs has expanded dramatically, resulting in greater deference to club interests by the FA. *See, e.g,* JOHN WILLIAMS, IS IT ALL OVER? CAN FOOTBALL SURVIVE THE PREMIER LEAGUE, 53-60 (1999).

135 English football clubs control player contracts (subject to legal challenges based on competition law or the common law of restraint of trade). Historically, the clubs accepted FA

the same time, the FA has insisted, more controversially, that clubs release players without compensation to participate in international representative competition.[136] The English model of governance has been adopted globally in soccer, with each country's domestic competition operating under the aegis of a national association modeled on the FA, and an association of associations acting as governing bodies for each continent,[137] and an international federation acting as the world governing body.[138]

When a new league is formed – either wherea sport is just developing in the relevant market, or where the league is organized as a new entrant to challenge an established incumbent league – vertical integration can be extremely important precisely because there is unlikely to be a credible supplier of competition organizing services to clubs who might join such a league, and club owners are going to be reluctant to participate in such a risky venture without some role in controlling the fortunes of the new competition.[139] However, today's owner of the Chicago White Sox would not find, as his predecessor William Hulbert did, that there is no one else around willing and able to provide competition organizing services. The explosion in revenues

---

labor market restraints such as maximum wages and dividends. On the maximum wage, *see* INGLIS, *supra* note 36, at 53; on the maximum dividend, *see* STEFAN SZYMANSKI AND TIM KUYPERS, WINNERS AND LOSERS: THE BUSINESS STRATEGY OF FOOTBALL 6, 12, 16, 19 (2000).

136 Initially, clubs saw the release of players to represent their country as an honor, INGLIS, *supra* note 36, at 18, but by the 1960s it was seen increasingly as a burden. *Id.* at 243. Indeed, since the FA generates significant income as the organizer of the England soccer team, there seems to be a clear conflict of interest; one result has been a partial integration as clubs have tried to ensure over the years that they are adequately represented on the committees of the FA. *Id.* at 243, 260.

137 For example, Europe's governing body is the Union of European Football Associations (UEFA). *See* http://www.uefa.com/uefa/aboutuefa/overview/index.html.

138 The Fédération Internationale de Football Association (FIFA). *See* http://www.fifa.com/en/organisation/index.html.

139 The franchise method of business rarely develops from an untried new idea, but typically reflects the expansion of a business model that has proven successful elsewhere, either developed by the franchisor or acquired by the franchisor from the original innovator.

from broadcasting, merchandising, and sponsorships create huge incentives for vertically separate firms to perform these services. Unlike those seeking to organize Major League Soccer,[140] competition organizers would likely find many owners interested in participating in the dominant professional football 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 restructure 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. To illustrate, suppose hypothetically that vertical separation would result in an eleven percent increase in the value of Major League Baseball; while this would be approximately $1 billion today, a conservative estimate is that thirty years ago the capital gain would only have been about $26 million.[141]

Moreover, at least one recent development suggests that some current sports executives recognize 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."[142] Although not formally as separated as The League we suggest in this

140 *See* WEILER AND ROBERTS, *supra* note 11, at 495-97.

141 Today's calculation is based on Forbes' estimate of $9 billion as the aggregate value of Major League Baseball franchises today. *See* note 125 *supra.* The 1973 estimate is based on the sale of the New York Yankees in that year, to George Steinbrenner, for $10 million. *See* JAMES QUIRK & RODNEY D. FORT, PAY DIRT: THE BUSINESS OF PROFESSIONAL TEAM SPORTS 53 (1992). A conservative assumption that the Yankees were so poorly managed at the time that their value was average among the 24 teams then in baseball would yield an aggregate value of $240 million for all teams.

142 *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

Article, the Women's National Basketball Association 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. Although 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, while some of the problems that plague club-run leagues could rear their head, the benefits in negotiating broadcast rights and sponsorship deals without the fear that clubs may undercut national rights is a major advantage, according to the WNBA's chief executive.[143] 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,[144] a WNBA owner who put his club's interests ahead of the leagues in service on the WNBA board would arguably breach his fiduciary duty.

Part II of this Article lays out the argument for why club-run leagues have incentives to perform inefficiently in the market vis-a-vis vertically separate leagues. This section 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

---

143 *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 11, at 496 (Major League Soccer could not find investors absent ability to have local rights).

144 *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 being 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).

that is the case, legal intervention to effectuate an involuntary restructuring may be required. This is considered below.

D. Involuntary Restructuring Through Government Intervention

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. This part considers two alternative bases for intervention. First, applying conventional antitrust law 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. Second, we suggest that Congress may properly legislate to require divestiture under a clarifying amendment to the Sherman Act or via direct regulatory legislation, or to secure divestiture through the use of Congress' eminent domain power by acquiring from the clubs the property rights necessary to create a business entity, The League, separate from clubs that participate in its competition.

1. Mandatory Divestiture Under Antitrust Law

Contracts in restraint of trade violate the Sherman Act.[145] The Supreme Court held almost a century ago, however, that the broad language of the statute only precluded agreements that unreasonably restrained trade.[146] More recently, in *National Collegiate Athletic Association v. Board of Regents (NCAA),*[147] the Court provided, in the sports context, the guide to determining

145 Section 1 of the Sherman Act, 15 U.S.C. §1, 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."

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

147 468 U.S. 845 (1984).

unreasonableness. A showing that, as a result of an agreement, prices are raised, output is lowered, or output is rendered unresponsive to consumer demand compared to what would "otherwise be" is a "hallmark" of an antitrust violation,[148] even where some agreements among the defendant-rivals are considered necessary for the product to exist at all.[149] As to the latter point, one of Judge Richard Posner's most profound antitrust insights is also particularly relevant: "it 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."[150]

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

As noted above, club-run leagues distort competition in a number of relevant markets. 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 results 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, tolerate operational mismanagement of clubs, and fail to fully exploit opportunities for international competition, all of which results in output being unresponsive to consumer demand. As in the *NCAA* case, these are all hallmarks of

---

148 *Id.* at 107.

149 *Id.* at 101.

150 General Leaseways, Inc. v. National Truck Leasing Ass'n, 744 F.2d 588, 594 (7th Cir. 1984).

antitrust violations.[151] Like *NCAA*, the fact that these results are apparent[152] suggests that leagues do not face reasonable substitutes and thus possess market power,[153] supporting the majority of precedents finding that the dominant league in each sport possesses such power.[154]

Of course, the claims made in this Article are subject to proof in a court of law. Because the relevant legal standard requires a comparison of the quantity and demand-responsiveness of output of the challenged agreement with what would "otherwise be," expert testimony may well be required to persuade the fact-finder. Evidence that the 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 unwillingness of owners to voluntarily restructure would obviously favor the plaintiffs.

---

151 468 U.S. at 107.

152 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). 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 (April 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."). 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. *See* D. HARRIS, THE LEAGUE: THE RISE AND DECLINE OF THE NFL (1986). 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 *cf.* Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982) (Posner, J.) (noting this characteristic exists where firms lack market power).

153 468 U.S. at 111.

154 See note 104 *supra*.

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 agreed to by downstream competitors. This distinction supports mandatory vertical separation in the sports industry. In *Sylvania*,[155] the Court recognized that vertical restraints insulating a reseller from intrabrand competition have complex effects, simultaneously shielding the firm from the socially beneficial constraint of rivalry from sellers of the same product, while creating desirable incentives for promotion, quality assurance, or other investment that might be otherwise subject to free riding by rivals, potentially enhancing the brand's consumer appeal and thus promoting interbrand competition. 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.[156] 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 sum of the rivals' interest in reduced competition, and thus remains illegal.[157] In *Sealy*,[158] the Court likewise rebuffed the efforts of a joint venture that integrated the function of nationwide promotion of a single trademark with a market division scheme 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).[159]

---

155 Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51-52 (1977).

156 *Id.* at 54-56.

157 *Id.* at 57 n.27, citing United States v. Topco Assoc., Inc., 405 U.S. 596, 608 (1972).

158 United States v. Sealy, Inc., 388 U.S. 350 (1967).

159 The decision in *Fraser v. Major League Soccer*, 284 F.3d 47 (1st Cir. 2002), further supports the distinction between a separate entity organizing a competition and a club-run league. The

Thus, the Supreme Court has interpreted the Sherman Act's condemnation of restraints of trade to prohibit competitors from agreeing among themselves on schemes that reduce output and quality for consumers. The precedents recognize the important distinction between cartel behavior and 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 super-majority of the parts. These precedents therefore support the conclusion that the agreement to organize a vertically integrated club-run league constitutes an unreasonable restraint of trade in violation of section 1.

Section 2's condemnation of monopolization also provides a basis for a judicially-ordered restructuring of sports leagues. Leading antitrust precedents establish that the Sherman Act does not permit competitors to 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 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 *Terminal Railroad*,[160] the Court held that the Sherman Act barred the acquisition of the only three means by which railroads could cross the Mississippi River at St. Louis by a consortium of rival railroads and the use of 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.[161] Similarly, in *Associated Press*,[162] the Court invalidated a by-law

---

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, and n.5.

160 United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912)

161 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

provision that allowed 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.[163] Here, the remedy permitted presumably independent non-rivals to determine membership decisions.[164]

Where a natural 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 was owned by all railroads, it would have no incentive to charge monopoly prices to its own members.[165] In these cases, vertical

---

monopoly that is natural, as opposed to one resulting from "superior skill, foresight, and industry," cf. United States v. Aluminum Co. of America, 148 F.2d 416, 430 (2d Cir. 1945), incentive problems should not deter antitrust relief. Stephen G. Breyer, *Antitrust, Deregulation, and the Newly Liberated Marketplace*, 75 CALIF. L. REV. 1005, 1033-34 (1987). In the case of sports leagues, incentive problems are minimized by the market power requirement to find an antitrust violation. It may well be that the only firms interested in investing in a new lacrosse 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 Hospital Dist. v. Hyde, 466 U.S. 2, 23 (1984), *citing* United States v. Jerrold Electronics 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.

162 Associated Press v. United States, 326 U.S. 1 (1945).

163 Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy,* 1995 COLUM. BUS. L. REV. 1, 37-44.

164 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.

165 Hovenkamp, *supra* note 163, at 36.

divestiture would actually increases 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 can be higher and welfare reduced because as both monopolists seek to take monopoly profits.[166] Because it is often efficient to allow a vertical integration between the two serial monopolists, which will result in a single monopoly price,[167] open access regimes may not be welfare enhancing.[168]

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 an open access regime contemplated by *Terminal Railroad*.[169] Nor can leagues avoid the serial monopoly problem

---

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

167 David Reiffen and 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 WISC. 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.

168 A sports illustration cited by Reiffen and Kleit, *supra* note 167, 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.

169 *Open Competition*, *supra* note 9, at 649-50 and nn. 109-110.

discussed above simply by acquiring and operating all of the teams. Separately owned clubs form an important aspect of sport's consumer appeal.[170] Moreover, the entity that provides the competition organizing services does more than simply provide that service to clubs: because of the unique interdependence of sports clubs, it is actually more efficient for this entity to sell rights and services to consumers and licensees.[171] Thus, 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 licensing markets.[172] Hence, if we accept the assumption that each sport will continue to feature a single dominant competition,[173] the monopoly power in competition organizing cannot 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.

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. First, such an order requires a plaintiff to bear the expense and risk of a lawsuit.[174] Second, although justified

---

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

171 See text accompanying notes 38- 50, *supra*.

172 *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).

173 See note 9 *supra* and accompanying text.

174 Either because of a determination that other matters have priority on government resources or because of political pressure, neither the Justice Department's Antitrust Division, the Federal Trade Commission, nor state attorneys general (under the Clayton Act, 15 U.S.C. §§ 15c, 26,

by the unique nature of sports leagues, as noted above the relief sought is not the sort typically granted by antitrust courts and thus some judges may be reluctant to order an industry restructuring of this magnitude. Third, 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.[175] Finally, the structure of a divestiture and the liability for The League and clubs may be provided for with greater clarity if accomplished through specific legislation. For these reasons, Congress may wish to consider legislative approaches that would achieve the same welfare-enhancing result.

2. Mandatory Divestiture Under Congressional Regulatory Legislation

---

state attorneys general are authorized to enforce federal antitrust law, in federal court) may choose to initiate litigation. Few private parties would have a sufficient incentive to bring their own claim for injunctive relief. Sports fans are the primary victims of the inefficient conduct of club-run leagues catalogued above. A private consumer class action could be brought to secure the mandatory divestiture discussed above, but most class actions are motivated, and the expenses of bringing the suit justified, by the attorney's potential to receive fees based on a significant damage recovery. Although the current structure causes inefficiencies and additional welfare losses, proving precise damages would be difficult. *See, e.g.,* J. Truett Payne Co., Inc. v. Chrysler Motors Corp., 451 U.S. 557 (1981) (proof that conduct injured competition insufficient to show actual damages to plaintiff).

[175] In Federal Baseball Club v. National League, 259 U.S. 200 (1922), the Court held that baseball was not commerce subject to the Sherman Act. Although that outmoded view of commerce has now been rejected, the court in Flood v. Kuhn, 407 U.S. 258, 283 (1972), held that Congress', "positive inaction" in refusing to overrule *Federal Baseball* justified its continued application, although it was concededly an "anomaly." Since *Flood*, several lower courts have found that the exemption applied narrowly only to cover the specific type of labor restraint at issue in that case, *see* Butterworth v. National League, 644 So. 2d 1021 (Fla. 1994) and Piazza v. Major League Baseball, 831 F. Supp. 420 (E.D. Pa. 1993), or only to baseball's "unique characteristics and needs," *see, e.g.,* Henderson Broad. Corp. v. Houston Sports Ass'n, 541 F. Supp. 263, 268-69 (S.D. Tex. 1982), while other courts found that the exemption applied to the "business of baseball," a broader concept that would appear to cover the vertical integration into competition organizing services. *See, e.g.* Major League Baseball v. Crist, 331 F.3d 1177 (11th Cir. 2003) Morsani v. Major League Baseball, 79 F. Supp. 2d 1331 (M.D. Fla. 2000); Minnesota Twins Partnership v. State, 592 N.W.2d 847 (Minn. 1999).

Congress' plenary power to regulate interstate commerce includes the power to require clubs in monopoly sports leagues to sell those rights that will permit an independent entity to more efficiently organize a sports competition.[176] If Congress were persuaded by the arguments set forth above that club-run leagues cause significant welfare losses and consumer exploitation, there are at least three alternative legislative approaches to improve the quality and quantity of professional sports in the United States.

First, Congress could amend the antitrust laws to specifically correct the market distortion caused by clubs' insistence on maintaining control of monopoly sports leagues. There are historic antecedents to this approach. For example, Congress specifically targeted the web of anticompetitive lease provisions imposed by the dominant United Shoe Machinery Company on shoe manufacturers in crafting the Clayton Act of 1914.[177] Another advantage of antitrust legislation is that Congress could provide additional guidance to the courts to ensure that procompetitive conduct envisioned by the restructuring would be lawful, and to specifically prohibit foreseeable anticompetitive conduct.

Second, 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[178] regulating the break-up of AT&T, which

---

176 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.

177 *See* H. Rep. No. 627, 63d Cong., 2d Sess. 13 (1914).

178 Pub.L.No. 104-104, 110 Stat. 56 (1996).

prohibited the "Baby Bells" (the local phone monopolies) from entering the market for long-distance phone calls unless the local telephone market was open to competition.[179]

3. Mandatory Restructuring Under Congressional Eminent Domain Power

Finally, Congress could use its eminent domain power to purchase the bundle of rights necessary to organize a competition efficiently, and then resell these rights to The League. The Supreme Court has clearly established that the power of eminent domain can be used not only to acquire property for future public ownership, but also to the mandatory purchase of property by the government for resale to a private party, where that sale would serve a public purpose.[180] 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.[181] Moreover, the Supreme Court has expressly recognized that correcting for the welfare reducing effects of business conduct that occurs in concentrated

179 *See* 47 U.S.C. § 271.

180 Berman v. Parker, 348 U.S. 26 (1954) (use of eminent domain for urban renewal project).

181 Indeed, courts have even held that the mandatory sale of a club to permit its resale to a buyer pledging to keep it within a particular city was a valid public use. City of Oakland v. Oakland Raiders, 646 P.2d 835 (Cal. 1982). Although the *city's* use of eminent domain in the context of a national business unconstitutionally burdened interstate commerce, 220 Cal. Rptr. 153 (Cal. App. 1985), this concern would not deter *congressional* use of eminent domain.

The use of eminent domain to construct a major league baseball stadium was upheld in City of Los Angeles v. Superior Court, 333 P.2d 745 (Cal. 1959). *See also* N. J. Sports & Exposition Authority v. McCrane, 292 A.2d 545, 552 (N.J. 1972) (same); Martin v. City of Philadelphia, 215 A.2d 894 (Pa. 1966) (approving municipal loan for stadium construction as a legitimate public purpose). The Supreme Court held that public uses are not limited, in the modern view, to matters of mere business necessity and ordinary convenience, but may extend to matters of public health, recreation and enjoyment. Rindge Co. v. Los Angeles, 262 U.S. 700 (1923).

markets is a legitimate public purpose justifying use of the eminent domain power.[182] Indeed, in a mixed-market economy, while the breadth of governmental power to buy and re-sell private property may superficially appear to be interventionist, it is preferable to a more limited view that, under the precedents, would permit the government to nationalize sports leagues as the only means to correct market failures.[183]

The principal economic justification for governmental purchase and resale is to overcome significant transaction costs that render voluntary exchange difficult.[184] If our arguments above are persuasive, this is the precise problem here: sports leagues could be more efficiently operated by The League than by a club-run league, but current clubs may not voluntarily agree to an initial public offering or other sale because of an inability to agree among themselves on how to divide the proceeds.

In contrast with the traditional use of eminent domain to secure property for public ownership, the use of eminent domain to purchase and resell property has been criticized because

---

182 Hawaii Housing Authority v. Midkiff, 467 U.S. 229 (1982) (state condemned vast estates owned by few huge landowners for resale to tenants, to break up real estate oligopoly); *See also* Richardson v. City & County of Honolulu, 124 F.3d 1150 (9th Cir. 1997) (approving use of eminent domain to correct for other perceived failures in real estate market). At least from reported cases involving challenges to exercises of eminent domain, Hawai'i appears to be the only jurisdiction to have used the power to correct for economic dislocations caused by concentrated markets.

Although not directly on point, a leading example of the use of federal eminent domain power to remedy inefficiencies caused by transactions costs is described in Manufacturers Aircraft Ass'n v. United States, 77 Ct. Cl. 481 (1933), which 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.

183 *See* JOSEPH WILLIAM SINGER, INTRODUCTION TO PROPERTY 683 (2001).

184 Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 84 (1986) (citing Guido Calabresi and Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1107-10 (1972)).

of its potential abuse. In a leading article,[185] Professor Thomas Merrill notes three major objections to these sort of mandatory sales: (1) they will not fully compensate the condemnee for subjective losses; (2) they result in an unfair wealth transfer from the condemnee to the private acquirer of the surplus to be derived from the exchange; (3) they encourage potential acquirers to inefficiently create a scenario requiring eminent domain instead of taking efficient steps to secure desired property through voluntary trade. None of these concerns are implicated in a forced sale of assets necessary to create a league not controlled by clubs.

In a typical purchase-and-resell condemnation for industrial or retail development, for example, condemnees may be forced to give up homes or other property to which they attach great sentimental value, or to which they have made specific improvements appropriate for their needs.[186] Under our proposal, club owners would suffer some subjective, uncompensated losses as well, but hardly ones that should attract the same amount of public concern. After the sale, club owners would lose the power to make some of the important business decisions about how their sport's competition is organized, and there is a risk that The League would award their local franchise to someone else who would be more efficient. However, the current "power" to exercise significant discretion in running their ball club in the context of a league competition they control is primarily a result of the monopoly power that the club owners enjoy, hardly a power worthy of protection.

As to the second point, it is true that an initial public offering should result in significant surplus resulting from the more efficient operation of a sport by The League; however, if organized correctly, an initial public offering should result in almost all of this surplus being recovered by the clubs owners.[187] Indeed, to the extent that sports fans or others receive non-

---

185 Merrill, *supra* note 184.

186 *Id.* at 83.

187 An initial public offering structured in the manner outlined in Part A, *supra,* would be expected to allow existing clubs to enjoy most of the surplus created from the restructuring.

pecuniary value from being able to "own" part of a popular sports league, the price received by owners may actually exceed the economic surplus resulting from the efficient restructuring of the competition.[188]

The third concern may be expressed in two alternative ways: the private acquirer may have acted or failed to act in a way to create the transaction cost problem[189] or other government policies may have created the significant public need for condemnation. As to the latter, the best known example is the controversial use by Detroit of eminent domain power to destroy a working-class neighborhood to create land for a new General Motors factory, necessitated by General Motors' threat to relocate the factory to another state offering generous tax subsidies.[190] Detroit would not have used eminent domain if Congress, in the exercise of its authority to regulate interstate commerce, had adopted the approach of the European Union and prohibited states and local subsidies for the relocation of firms.[191] While Detroit used eminent domain as part of a "bidding" process that allowed firms with power to credibly threaten relocation to exploit cities and their taxpayers, in the sports scenario eminent domain is being used to promote efficiency and reduce consumer exploitation. Thus, eminent domain should be considered a viable and non-problematic option for implementing our proposal.

* * *

188 *See* Sullivan v. National Football League, 34 F.32d 1091, 1100 (1st Cir. 1994) (Professor Roger Noll testified that fans' demand for sports stock increases value). Thanks to Professor Gary Roberts for this insight.

189 Merrill's illustration is the deliberate construction of a structure on a neighbor's land. Merrill, *supra* note 184, at 88.

190 *See* Poletown Neighborhood Council v. City of Detroit, 304 N.W.2d 455 (Mich. 1981).

191 *See* Treaty Establishing the European Community, arts. 87-89 (ex arts. 92-94), Nov. 10, 1997, 1997 O.J. (C 340) 173.

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, how player talent is distributed among clubs, and how domestic and international competitions coincide. 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 transaction 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 their own competition constitutes both an illegal restraint of trade and monopolization in violation of the Sherman Act. Failing litigation, Congress could amend the antitrust laws, enact specific regulatory legislation, or use its power of eminent domain to acquire the rights necessary for the creation of The League as an entity organizing a sporting competition that is separate from the owners.