Sports Leagues and Antitrust Policy

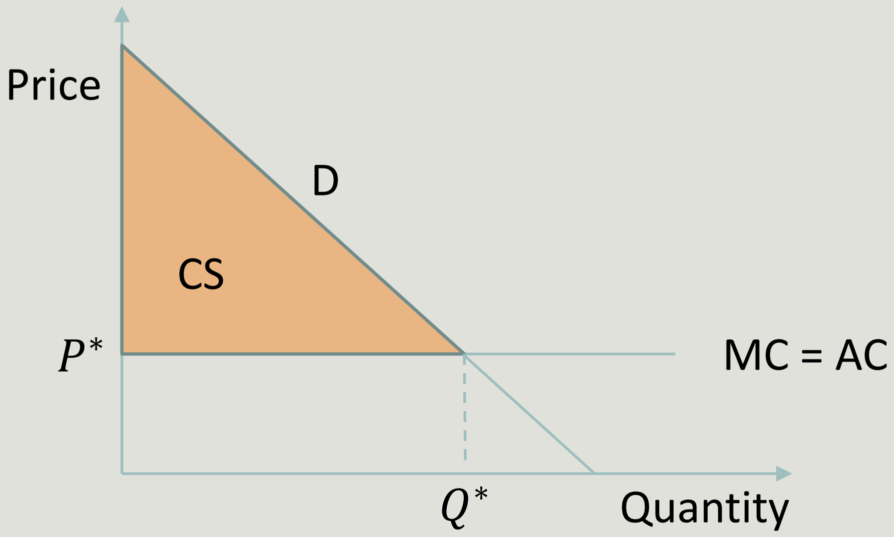
Chapter 9

Competitive Market

A little review:

Competitive output is found where demand and supply are equal

Social Welfare (CS+PS) is maximized

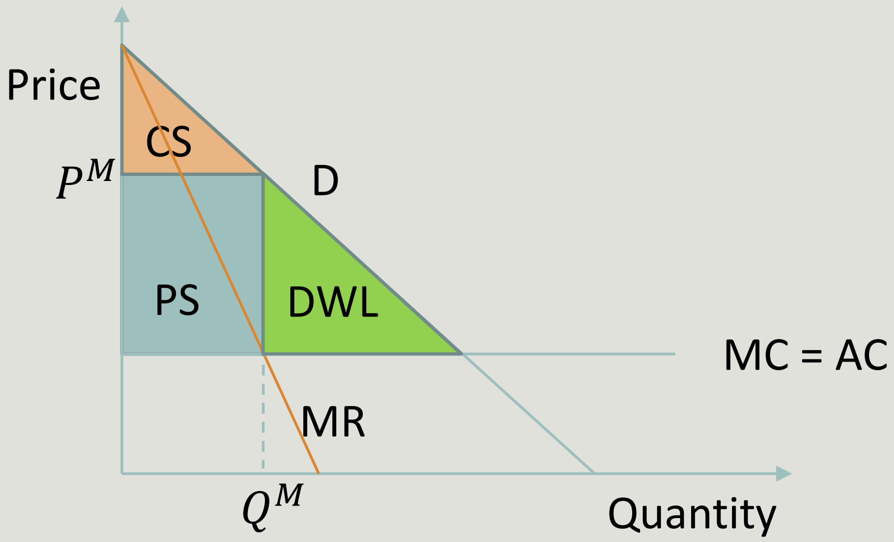


Monopoly

Monopolist output is determined where MR=MC

Producer Surplus is maximized (assuming price discrimination cannot be implemented).

There exists deadweight loss



Sherman Act

Passed in 1890

Cornerstone of antitrust policy in the US

The fundamental purpose of the Sherman Act is the protection of competition as a market structure and as a process for allocating resources

An antitrust violation is a felony, and conviction can result in substantial criminal penalties

Corporations can be fined as much as $100 million

Section 1 of the Sherman Act

“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, is declared to be illegal.”

Nearly any agreement that may raise, depress, fix, peg, or stabilize price is illegal under the Supreme Court’s interpretation of Section 1.’

The essence of a Section 1 violation is an agreement not to compete in the market on some dimension.

Section 2 of the Sherman Act

"Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony."

Some behavior is not objectionable even though it may result in a structural monopoly.

In its *Grinnell* opinion, the Supreme Court set out a two-prong test for illegal monopolization:

- The offense of monopoly under Section 2 of the Sherman Act has two elements:
    1. The possession of monopoly power in the relevant market
    2. The willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic incident

Thus a firm will only be guilty of illegal monopolization if it has acquired or maintained monopoly power in an exclusionary or predatory way rather than through competitive, honest industrial efforts.

Economic Analysis

Procompetitive: promotes competition in market

Anticompetitive: prevents or reduces competition in market

Some examples of anticompetition:

- Dumping: A company sells a product in competitive market for a loss in order to force other competitors out of the market.
- Price Fixing: Companies collude to set prices/quantities
- Dividing Territories: Agreement by companies to stay out of each other’s regions
- Limit Pricing: Price is set by monopolist at a level that discourages entry into a market

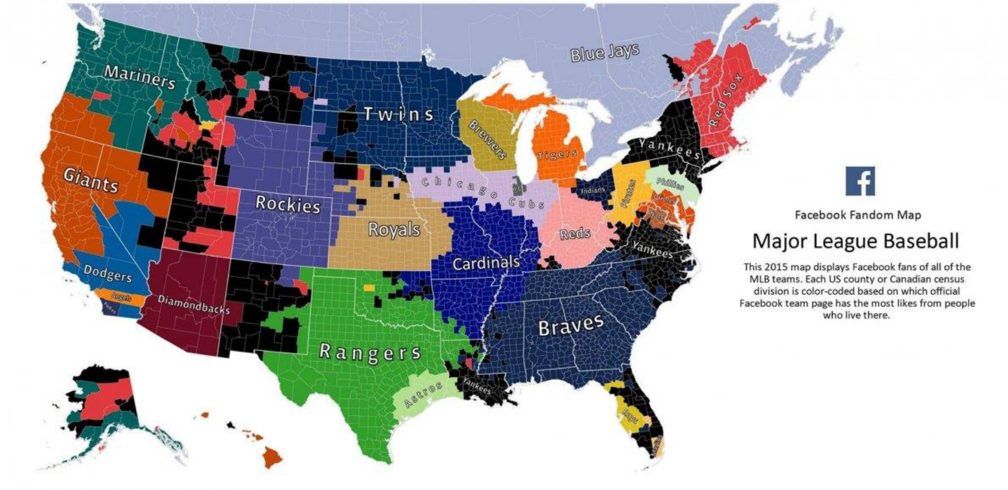
Economic Analysis

Rule of reason used to evaluate sports leagues' and organizations' conduct:

- Market structure is examined, and purpose and effect of the conduct are determined and economic consequences are identified.
  - Procompetitive and anticompetitive aspects of conduct analyzed
  - If anticompetitive consequences outweigh procompetitive consequences, conduct is impermissible

There must be net harm to society before business conduct will be condemned by the antitrust laws.

Market Definition



There are two dimensions to a relevant antitrust market:

1. Product dimension
2. Geographic dimension

Market definition is very important. For example, we could define the following markets:

- MLB games in San Francisco (Giants have monopoly)
- MLB games in Bay Area (Giants face competition from Oakland A’s, thus no monopoly)
- Major league sports in San Francisco (Giants face competition from 49ers, thus no monopoly)

Relevant Product Market

Relevant product market should encompass all products that are reasonable substitutes for one another.

To identify substitutes, we use cross-price elasticity. Let Q_A by the quantity demanded for product A, and let $P_B$be the price of product B. The formula for cross-price elasticity is:

$$\theta_{AB} = \frac{\%\Delta Q_A}{\%\Delta P_B}$$

Δ denotes a small change

It can be interpreted as:

- If price of product B changes, how does quantity demanded for product A change?

*Note: in this class, to calculate percent change we will use the formula:

$$\%\Delta Q = \frac{Q_{Final} - Q_{Initial}}{Q_{Initial}} \times 100 \qquad \%P = \frac{P_{Final} - P_{Initial}}{P_{Initial}} \times 100$$

Relevant Product Market

$$\theta_{AB} = \frac{\%\Delta Q_A}{\%\Delta P_B}$$

In general:

Positive θ_{AB}: substitutes

Negative θ_{AB}: complements

With antitrust, we are concerned with "close substitutes" (as opposed to remote substitutes). From a buyer's perspective, we want to identify goods and services that are reasonably interchangeable for each another in consumption.

Relevant Product Market

Example: If the price of San Francisco Giants tickets were to rise, could buyers reasonably substitute a ticket to an A's game, a 49ers game, or a concert ticket?

- If so, they are all in the same product market
- If not, they are in separate product markets

We could use similar analysis for relevant geographic markets by identifying reasonable substitutes.

Monopoly Power

We can measure the power a firm has by using the Lerner Index:

$$\frac{(P-MC)}{P} = \frac{-1}{\theta}$$

Where θ is the elasticity of demand, and is defined as:

$$\theta = \frac{\%\Delta Q_D}{\%\Delta P}$$

or percent change in quantity demanded divided by percent change in (its own) price.

Notice the greater the elasticity of demand, the lower the Lerner Index (and thus the lower the monopoly power). This results from the buyer's ability to substitute other goods and services for the good in question in response to any price rise.

Antitrust Policy

Conduct that violates Section 1 of the Sherman Act has two defining characteristics:

- It flows from an **agreement** among competitors
- It is **anticompetitive** (tends to increase price, decrease output, or decrease quality)

Notice, if a sports league is deemed to be a single entity, then agreements among its members cannot violate Section 1 of the Sherman Act

If a sports league is a joint venture, then it is subject to Section 1 scrutiny, but under the rule of reason

Legal Rules and Agreements

Members of a sports league agree to abide by a laundry list of rules

Many of these rules are clearly confining and thereby impose restraints on each member’s freedom to compete in the market

League rules are not automatically condemned by the antitrust laws

Under Section 1 of the Sherman Act, it is only agreements that unreasonably restrain trade that are illegal

Antitrust Challenges by League Members

Many league rules have been challenged by league members, and many of those challenges have failed.

We will discuss the following challenges:

- NCAA Restraints on Broadcasting
- NFL Ban on Public Ownership

NCAA Restraints on Broadcasting

NCAA v. Board of Regents of the University of Oklahoma and University of Georgia Athletic Association

NCAA's television plan for the 1982-1985 restricted the freedom of individual members to negotiate television contracts by limiting the total number of games that could be telecast and restricting the number of times that any one school could appear on television.

The Supreme Court noted that that this limited competition among the NCAA members. However the Court stated that the product was marketed as college football games, and that many of the restricting rules had to be imposed to preserve the character of the product. These rules made a product available that might not exist otherwise, and thus are procompetitive and beneficial to consumers. But did this plan have any procompetitive effects?

NCAA Restraints on Broadcasting

NCAA v. Board of Regents of the University of Oklahoma and University of Georgia Athletic Association

The television plan retrained price and output competition among its member institutions, and thus it had the potential to harm consumers

The NCAA was unable to demonstrate any procompetitive efficiencies that increased the competitiveness of college football broadcast rights. The NCAA also failed to show that its plan enabled it to penetrate the market by offering an attractive package to games

The NCAA argued that televised games would reduce live attendance at games that were not televised. Notice that if games were not televised, some fans who prefer to watch games on television would have to substitute (and choose the less-desirable option of going to the game)

The NCAA failed the rule of reason test (as this is protectionism and not procompetitive)

NFL Ban on Public Ownership

NFL had a policy against public ownership of NFL franchises:

When an owner wants to sell his or her franchise, 75 percent of the NFL clubs must agree on the new owner

Billy Sullivan owned the New England Patriots. He experienced some financial distress for some reasons unrelated to football. He wanted to sell 49 percent of his stock in a public offering. Sullivan was not able to sell this stock publicly, so he decided to sell the whole franchise for $84 million in 1988. Four years later, the new owner sold the franchise for $110 million. Sullivan sued the NFL for the lost profit he could have made if he were able to keep the franchise.

NFL Ban on Public Ownership

The court found that the NFL policy reduced the output of ownership interests in NFL franchises. In fact, the policy wiped out a type of ownership: public ownership of stock. The NFL policy against public ownership is likely to depress resale price of a franchise (as some people may want to own just a small portion of the franchise, and not the whole franchise itself).

The court ruled in Sullivan’s favor. The NFL ban was simply too restrictive.

Antitrust Challenges by Outsiders

American Football League v. National Football League

United States Football League v. NFL

Restrictions on equipment

American Football League v. National Football League

The NFL had conflicting incentives with respect to league expansion

- NFL’s members can extract more concessions from host cities when the threat of moving to another city is credible
- If there are too many desirable cities without NFL franchises, there would be room for a rival league to enter and compete with the NFL

AFL was founded in 1959, which began with franchises in several cities already hosting NFL teams: New York, Los Angeles, and Dallas.

AFL sued the NFL complaining that the NFL had monopoly power when it came to locating franchises.

There were some facts that undermined the AFL’s claims:

- The AFL were founded in 1959 and had a full schedule of games by 1960. It competed successfully for outstanding players and obtained a television contract with ABC

Court found that the NFL did not have monopoly power. The AFL’s antitrust challenge failed

United States Football League v. NFL

The USFL was another new league which began as a spring league

The USFL lost some $200 million during the 1983-1985 seasons, and thus decided to move to a fall schedule and compete with the NFL. When it could not land a network television contract, the USFL went out of business. They sued the NFL for alleged antitrust violations.

The USFL contended that the NFL had monopolized professional football in the United States. A jury agreed with the USFL and found guilty, however, the jury only awarded nominal damages of only $1.

The jury found that the existence of the NFL contracts with networks did not prevent the USFL from offering a product that one or more of the networks might find attractive. The Networks' preference was to sell ad slots on NFL games for more than it could sell ad slots on USFL games.

Antitrust Challenges by Outsiders

Restrictions on equipment

- Deutscher Tennis Bund v. ATP Tour Inc
- Gunter Harz Sports v. USTA
- Gilder v. PGA Tour, Inc.
- Warrior Sports, Inc. v. NCAA