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### *American Needle: the Sherman Act, Conspiracy, and Exclusion*

Herbert Hovenkamp  
University of Iowa

## ***American Needle: the Sherman Act, Conspiracy, and Exclusion***

**Herbert Hovenkamp<sup>1</sup>**

Whenever persons join together to create a firm, they necessarily “agree.” But once the enterprise is lawfully formed, the resulting entity is treated as a single actor under §1 of the Sherman Act. This is ordinarily true regardless of the entity's legal form—whether a corporation, partnership, or other association. Under the Supreme Court’s *Copperweld* decision such conduct is deemed “unilateral” even if it involves separately incorporated subsidiaries.<sup>2</sup>

However, at least some decisions of certain organizations—such as trade associations, professional associations, and some joint ventures—are treated as concerted decisions by the members. The Sherman Act itself speaks to this issue of firm boundaries but is not particularly helpful. Sherman Act §6 provides:

The word “person”, or “persons”, wherever used in [the Sherman Act] shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.<sup>3</sup>

When the courts decide whether an association should be considered a single person or a combination two factors stand out. The first is whether the creators or members themselves remain as separate, significant economic actors. The second is whether the challenged act controls or affects the individual market behavior of the members.<sup>4</sup>

Leagues of professional sports teams have faced considerable antitrust litigation over various ethical rules governing players, hiring rules affecting player eligibility and rules governing team location and management decisions, as well as rules limiting a team owner's ownership of other professional teams. In *American Needle* the Supreme Court unanimously held that the National Football League’s (“NFL’s”) exclusive license of NFL teams’ individually owned trademark interests should be treated as an agreement among the teams, not as the unilateral conduct of the NFL. However, the Court also held that the legality of this act, while concerted, should be assessed under the rule of reason.<sup>5</sup> The unanimous decision, written by Justice Stevens, was almost certainly his last antitrust opinion for the Court.

The NFL is an unincorporated association whose membership includes 32 separately owned and separately incorporated football teams. Each team owns its own intellectual property rights, primarily in trademark, to their names, colors, and insignia. Prior to 1963 the individual teams had licensed these rights individually, often to outside manufacturers for use on authorized clothing such as helmets, caps, and jerseys. In that year the NFL created National Football

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<sup>1</sup> Ben V. & Dorothy Willie Professor of Law, University of Iowa.

<sup>2</sup> *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) (parent and its wholly owned subsidiary a single actor for Sherman Act purposes).

<sup>3</sup> 15 U.S.C. §7 (2006).

<sup>4</sup> See 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶1475a (3d ed. 2011) (in press).

<sup>5</sup> *American Needle, Inc. v. National Football League*, \_\_\_ S.Ct. \_\_\_, 2010 WL 2025207 (May 24, 2010).

League Properties (“NFLP”) to assist the teams in developing and marketing their Intellectual Property (“IP”) rights. NFLP granted numerous nonexclusive licenses to various manufacturers, including the plaintiff American Needle. In 2000, however, it began to adopt a policy of licensing exclusively and granted Reebok, a competing manufacturer, an exclusive license to manufacture NFL logoed head wear.

American Needle alleged that the exclusive provision should be treated as a concerted refusal to deal under §1 of the Sherman Act, given that the NFL team members whose individual IP rights were being licensed were all separately owned corporate entities. The district court granted the NFL summary judgment on the conspiracy issue, holding that the teams had “so integrated their operations” that they should be “deemed a single entity rather than joint venture....”<sup>6</sup> The Seventh Circuit affirmed, following its own precedent.<sup>7</sup>

The Supreme Court noted that unilateral conduct is routine and universal, while concerted conduct is exceptional:

[B]ecause concerted action is discrete and distinct, a limit on such activity leaves untouched a vast amount of business conduct. As a result, there is less risk of deterring a firm’s necessary conduct; courts need only examine discrete agreements; and such conduct may be remedied simply through prohibition.<sup>8</sup>

The Court added in a footnote that “if every unilateral action that restrained trade were subject to antitrust scrutiny, then courts would be forced to judge almost every internal business decision.”

In the case at hand, however, the conduct was not unilateral even if the NFL were characterized as a single entity. Rather, it involved a contract with Reebok that contained an exclusivity provision. In any event, the individual NFL teams did not appear to the Court to have the qualities suggesting a “single aggregation of economic power.” They competed with each other “not only on the playing field, but to attract fans, for gate receipts and for contracts with managerial and playing personnel.” Perhaps more to the point, they competed in the market for intellectual property:

To a firm making hats, the Saints and the Colts are two potentially competing suppliers of valuable trademarks. When each NFL team licenses its intellectual property, it is not pursuing the “common interests of the whole” league but is instead pursuing interests of each “corporation itself....”

As the court observed, “Agreements made within a firm can constitute concerted action covered by §1 when the parties to the agreement act on interests separate from those of the firm itself.” In this case, “the teams remain separately controlled, potential competitors with economic interests that are distinct from NFLP’s financial well-being.”<sup>9</sup>

Finally, the Court concluded that the NFL’s conduct should be addressed under the rule of reason. “When ‘restraints on competition are essential if the product is to be available at all,’ *per se* rules of illegality are inapplicable, and instead the restraint must be judged according to the

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<sup>6</sup> American Needle, Inc. v. New Orleans La. Saints, 496 F.Supp.2d 941, 943 (N.D. Il. 2007).

<sup>7</sup> 538 F.3d 736, 741 (7<sup>th</sup> Cir. 2008).

<sup>8</sup> *Id.* at American Needle, \_\_\_ S.Ct. at \_\_\_ & n.2, citing 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1464c (2d ed. 2003).

<sup>9</sup> American Needle, \_\_\_ S.Ct. at \_\_\_, citing Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, COLUM. BUS. L. REV. 1, 52-61 (1995).

flexible Rule of Reason.” The Court found that “other features of the NFL” might serve to save such agreements from antitrust attack, even though they do not justify treating it as a single entity.

While the single entity conclusion in *American Needle* is important, the facts did not necessarily raise the issue of antitrust micromanagement that the Court feared. Assuming that the NFL is a single entity the case would best be characterized as exclusive dealing or, more properly, an output contract in which the NFL promised to license to Reebok and no one else. Such agreements are analyzed under the rule of reason and their illegality usually depends on the extent to which the plaintiff has been foreclosed from a properly defined relevant market.<sup>10</sup> For example, *Paddock*, also from the Seventh Circuit, upheld an exclusivity provision in a copyright licensing agreement from the *New York Times*, a single entity, to the *Chicago Tribune*.<sup>11</sup> While §1 of the Sherman Act reaches exclusive trademark licenses, condemnation is very rare and concerns about consumer deception and free riding undoubtedly serve to justify even exclusive agreements that cover a large market share.<sup>12</sup>

One also must wonder whether the NFL or the teams were the appropriate defendant. The plaintiff had included Reebok as a defendant in its complaint,<sup>13</sup> and the exclusivity provision favoring Reebok was the cause of American Needle’s injury. The NFL is not even a competitor in the relevant market, which is probably something like “NFL logoed apparel.” Further, the NFL and its individual teams would presumably be harmed rather than benefitted by the creation of a harmful monopoly in the apparel market. Of course, both the NFL and Reebok were parties to the exclusionary contract under consideration.

When does finding multilateral as opposed to unilateral conduct make a difference? The Sherman Act case law as historically developed makes two important distinctions. *First*, exclusionary conduct, or conduct that is thought to be anticompetitive because it excludes rivals from the market, may be assessed under a different standard depending on whether it is unilateral or multilateral. The most extreme case is the simple refusal to deal, which is very close to *per se* lawful when the conduct is “unilateral,” even by a monopolist.<sup>14</sup> It can be *per se* unlawful, however, if the refusal is characterized as a naked boycott. *American Needle* was not such a case; the conduct challenged there was an output contract, akin to exclusive dealing. *Second*, the historical concern of §1 of the Sherman Act is collusion, or coordinated reductions in output that result in higher prices for consumers. Once again, a “naked” cartel is unlawful *per se*. At the other extreme, however, under United States law a monopolist may lawfully set any price and output it pleases.

While Judge Easterbrook was very instrumental in developing the professional-sports-league-as-single-entity theory, the theory has dubious Chicago School credentials. On the one hand, Judge Easterbrook would like to do away with most of the antitrust law condemning

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<sup>10</sup> See 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶¶1800-1805, 1822-1823 (2d ed. 2005).

<sup>11</sup> *Paddock Publishing, Inc. v. Chicago Tribune Co.*, 103 F.3d 42 (7<sup>th</sup> Cir. 1996), cert. denied, 520 U.S. 1265 (1997).

<sup>12</sup> Note, however, that the soft drink interbrand competition act creates an antitrust immunity for exclusive, territorially limited trademarks provided that there is “effective competition.” 15 U.S.C. §3501. The drafters obviously believed there would be antitrust coverage without this immunity.

<sup>13</sup> See Complaint, 2004 WL 3123822 (N.D.Ill. Dec. 1, 2004).

<sup>14</sup> See, e.g., *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004); and see 3B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶771-774 (3d ed. 2008).

exclusionary conduct.<sup>15</sup> On the other, even most Chicago School scholars are concerned about collusion. A single entity conclusion in *American Needle* would have given the teams free reign to engage in collusion while having relatively little impact on exclusionary practices that did not facilitate collusion.

The advantage of the rule of reason formulation that the Supreme Court adopted is that it preserves the best elements of both exclusion and collusion concerns. With respect to exclusionary practices, a multilateral standard is more aggressive than a unilateral standard precisely because of the dangers of collusion. That is, we might want to scrutinize an exclusive contract involving a joint venture of distinct sellers at the upstream end more closely than one with a single-market dominating firm in that position, but it would not be because of the exclusionary impact. Rather, it would be because the agreement among multiple upstream actors facilitates collusion rather than independent bidding for licenses, whether exclusive or nonexclusive. Further, respecting collusion, a finding of separate entities enables us to pursue harmful collusive behavior while a single entity finding makes an output reduction in and of itself unreachable.

Further we should not lose sight of the fact that the property interests here are team trademarks, a product that, unlike a jointly developed patent, is by nature exclusive to each team. There is no obvious reason why a group of football teams should be permitted to cartelize the licensing of their marks any more than a group of competing restaurants should be and, if a pro-competitive rationale should emerge, the rule of reason should be quite sufficient to handle it.

Whether the NFL is a single entity or a “combination” of its separate teams, rule of reason analysis of the exclusive contract at issue involves many of the same questions along with some different ones. The plaintiff will very likely have to show a relevant market and foreclosure, although truncated market analysis may be appropriate for a sufficiently suspicious restraint. Indeed, some dicta in the Court’s unanimous opinion may breathe new life into a “quick look” analysis of suspicious restraints that can occur “in the twinkling of an eye.”<sup>16</sup> Defenses may be offered. In the multiple entity case there will be additional questions pertaining to the justifications for coordinated rather than individual contracting, and these differences could also be significant. There may or may not be significant competitive concerns arising from joint contracting, and there may or may not be defenses for such contracting. For example, in *NCAA* the Supreme Court characterized the restraint as “naked,” notwithstanding its inclusion in the *NCAA* joint venture arrangement, whose structure was not being challenged. The Court also condemned the *NCAA* restraint on truncated power analysis even though it proclaimed that it was applying the rule of reason.<sup>17</sup> Of course, *NCAA* involved an express output limitation (limiting each team’s nationally televised games to four annually) while *American Needle* involves an exclusivity provision which may or may not reduce output depending on the explanations for it.<sup>18</sup>

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<sup>15</sup> E.g., Frank Easterbrook, *When Is It Worthwhile To Use Courts To Search for Exclusionary Conduct?*, COLUM. BUS. L. REV., 345. (2003).

<sup>16</sup> *American Needle*, \_\_\_ S.Ct. at \_\_\_, quoting *NCAA*, 468 U.S. at 109 n. 39, which was in turn quoting Phillip E. Areeda, *The Rule of Reason in Antitrust Analysis: General Issues* 38 (Federal Judicial Center, June, 1981).

<sup>17</sup> *NCAA*, 468 U.S. at 109 (“[t]his naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis”).

<sup>18</sup> For example, exclusivity provisions can increase output if they produce additional incentives to the firms who are given the exclusive rights.

Also significant is the fact that *American Needle* involves a trademark license, and the justifications for restricted trademark licensing are weighty, particularly if issues of origin or quality control are present.<sup>19</sup> Of course, even if exclusive trademark licenses are desirable, each separate NFL team could have granted its own individual exclusive licenses, and apparel manufacturers could then compete for one or more of these contracts. Individual contracts by each team granting exclusive (or nonexclusive) licenses might be a more competitive or “less restrictive alternative” that could address legitimate free rider and trademark concerns.<sup>20</sup>

The Supreme Court justified its remand for rule of reason analysis by relying on *NCAA*, which stated that the *per se* rule should not apply in situations where “a certain degree of cooperation is necessary if the type of competition that petitioner and its member institutions seek to market is to be preserved.”<sup>21</sup> That invites the question whether one applies the “necessity” analysis to each restraint individually, to the joint venture as a whole, or to some amalgamation of the two. It seems quite likely that the NFL could survive if its team members licensed their separately owned IP rights individually, each setting its own terms. Indeed they had done just that for many years, and exploration of that history and the reasons for the change might be relevant under the rule of reason inquiry.

The team trademarks in this case were, by their nature, individual.<sup>22</sup> But suppose that the NFL members were a group of business firms that had engaged in joint research and development leading to a single valuable patent. In that case the patent would very likely be commonly owned, but should we treat a refusal by the organization to license the patent to outsiders as a unilateral act? The issues are fundamentally different because excessive licensing by one firm could dissipate the value of the patent to other firms. Once again, this suggests the correctness of proceeding in such cases under the rule of reason.

One key factor, which the Court repeatedly emphasized, is that the NFL teams are independently owned businesses with separate economic interests that do not necessarily coincide with those of the venture as a whole. Most critically, the individual teams have incentives to behave as competitors vis-à-vis one another, while the organization may have incentives to maximize joint profits by behaving as a cartel. This conclusion also has a flip side: The individual members may have an incentive to free ride on the investment of other members, while the organization has an interest that each member do its part. These concerns can be particularly relevant to the subject of intellectual property licensing.

As the Supreme Court understood, these attributes of joint venture activity counsel against both extremes of antitrust analysis, except in very small sets of cases at the outer boundaries. At one extreme is *per se* illegality, which the Supreme Court adopted all too readily in decisions like *Topco*.<sup>23</sup> At the other extreme is finding a single entity for the sale of intellectual property rights owned by the individual teams, which the Seventh Circuit adopted too readily in *American Needle*.

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<sup>19</sup> See, e.g., 3 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION §§18.5 - 18.6 (4<sup>th</sup> ed. 2009) (quality control by licensor over licensee’s output).

<sup>20</sup> On less restrictive alternatives in rule of reason analysis, see 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶1505 (3d ed. 2011) (in press).

<sup>21</sup> NCAA, 468 U.S. at 101.

<sup>22</sup> The team logos are highly distinctive and can be compared with one another on multiple internet sites. See, e.g., <http://www.sportslogos.net/league.php?id=7>; or <http://www.nfl.com/teams>.

<sup>23</sup> United States v. Topco Associates, Inc., 405 U. S. 596, 609 (1972).



*American Needle* entails that many other multi-enterprise structures are also reachable under §1. For example, the historical Visa and MasterCard joint ventures and county or municipal real estate boards all have structures that tend to be looser than that of the NFL, permitting more individualized decision making by separate members.<sup>24</sup> Recently incorporated MasterCard and Visa IPOs reorganize these joint ventures as corporations, with member banks who participated in the older joint ventures remaining as shareholders, although with limited voting rights. However, these shareholders also have significant independent businesses and a rule that limits their business will be treated no differently than it was under the old structure.<sup>25</sup> Whether or not these member banks are able to vote on day-to-day business decisions, the corporation's directors are obliged to maximize the corporation's value, which occurs when it achieves the cartel-like output.<sup>26</sup>

*American Needle* makes clear that corporate form under state law does not matter. The all-important difference between *Copperweld* and *Sealy*<sup>27</sup> is that *Copperweld* involved multiple corporations with common ownership, presumably by passive shareholders who did not have independent competitive interests. By contrast, *Sealy* involved a single corporation owned by firms in the mattress manufacturing business in competition with one another, and *Sealy*'s licensing restrictions limited their independent business. While *Sealy* may be properly criticized for not applying the rule of reason to an ancillary territorial restraint, it was properly evaluated as concerted activity. To the extent that a MasterCard or Visa shareholder also has an independent business interest whose economic decisions are restrained by the IPO, conspiratorial capacity exists. As is the case with the NCAA and the NFL, the fact that the entity was lawfully formed indicates that its acts that do not affect the individual business conduct of its shareholders will be treated as unilateral. However, any action that limits the activities of shareholders or others as independent businesses would be reachable under §1.

The decision also suggests that decisions finding that franchisors and franchisees, or patentees and their licensees, are single entities, must be re-examined.<sup>28</sup> Of course, the second qualification that the Supreme Court listed, whether the relevant decision controls the individual member's behavior, still applies. For example, Visa's decision to hire a new financial officer, or the MacDonald's franchisor's decision to have an annual meeting in Charleston remain unilateral decisions, not because the individual members of these groups lack a separate market presence, but because these decisions have no impact on the individual conduct of the members.

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<sup>24</sup> MasterCard and Visa filed a joint amicus brief in support of the NFL's position. See 2009 WL 4247980.

<sup>25</sup> See Victor Fleischer, *The Mastercard IPO: Protecting the Priceless Brand*, 12 HARV. NEGOTIATION L.REV. 137 (2007). The larger banks actually own shares with no voting rights or only limited voting rights, but the corporation operates so as to maximize the value of the firm, which in this case would be the cartel output.

<sup>26</sup> For example, suppose that a cartel of cement producers created a corporation in which they received shares in proportion to their size. The individual members gave up all their shareholder voting rights but the board of directors, as any board, is charged with maximizing the firm's value. The cartelists have effectively created a cartel ringmaster that will very likely make the cartel perform more effectively than it had before. *American Needle* makes clear that an antitrust tribunal need not be tripped up by this legal form.

<sup>27</sup> *United States v. Sealy, Inc.*, 388 U.S. 350 (1967) (condemning incorporated joint venture that was effectively controlled by shareholders for benefit of their separate businesses).

<sup>28</sup> E.g., *Williams v. I.B. Fischer Nevada*, 999 F.2d 445, 447-48 (9th Cir. 1993) (per curiam) (franchisor and franchisee single entity foreclosing franchisee's challenge to employee switching limitation, which clearly affected the business decisions of individual franchisees). *Levi Case Co., Inc. v. ATS Prods. Inc.*, 788 F. Supp. 428, 431-32 (N.D. Cal. 1992) (interpreting *Copperweld* to hold that patentee and its licensee could not conspire to monopolize market for technology covered by the license agreement).

Finally, *American Needle* also tends to ratify those decisions involving hospitals that find the possibility of conspiratorial capacity when officers of the hospital also own separate practices and use their position on the hospital board to exclude rivals.<sup>29</sup>

The parent of the issue in *American Needle* is *Chicago Professional Sports*, which the Supreme Court did not cite. There, Judge Easterbrook for the Seventh Circuit ultimately decided that the NBA was more like a single entity than a cartel of independent teams.<sup>30</sup> However, the case for separate entities was stronger in *American Needle* than in *Chicago Professional Sports*. It involved a broadcasting contract between the NBA and television network NBC which limited the number of “side” broadcasting contracts that individual teams could make. Significantly, each game involves a pair of teams, so any broadcasting required an understanding about revenue division. The NBA as manager of the contract had an interest in maximizing the revenue of the NBA as a whole. Separate contracts for games such as the Bulls had on the side with the local television channel, WGN, naturally siphoned revenue away from the NBA as a group; however, the NBA was able to charge a fee to the Bulls for engaging in such side contracting. In sum, while a certain amount of coordination was necessary for the underlying NBA broadcasting contract, competition for individual contracts was also possible, and in a previous decision the court had rejected an argument that the Bulls were engaged in harmful free riding on the NBA and its broadcasting contract.<sup>31</sup>

While the issues are not exactly the same we would nevertheless treat the teams in *Chicago Professional Sports* as multiple entities and apply the rule of reason to the restraint. That result is perhaps not compelled by *American Needle*, but it is certainly consistent. Further, while there was more essential integration in the *Chicago Professional Sports* situation, there was not so much more as to render individualized competition impossible or make it harmful, particularly given the NBA’s ability to charge licensing fees for side contracts.

Certain activities of professional sports leagues belong entirely to the central organization and the individual teams have no role to play. For example, the NFL may decide whether to build a new building for its headquarters, hire new employees for the NFL organization, or license out its own distinctive “NFL” trademark. For such activities the teams are not in any obvious position to compete against each other. At the other extreme, the intellectual property rights in *American Needle* were owned and separately developed by the individual teams. Purchasers of football caps have a choice between caps bearing the insignia of the Minnesota Vikings, San Francisco 49ers, or Dallas Cowboys, and there is no obvious reason why these caps cannot be manufactured by separate apparel manufacturers in competition with each other. To be sure, both coordination and exclusivity may ultimately prove to be beneficial, but such analysis is classic material for antitrust’s rule of reason respecting joint activity. A finding of multiple entities leaves the issue open to antitrust inspection, and this is important when serious opportunities for anticompetitive collusive behavior exist.

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<sup>29</sup> E.g., *Weiss v. York Hosp.*, 745 F.2d at 786, 828 (3d Cir. 1984), cert. denied, 470 U.S. 1060 (1985).

<sup>30</sup> *Chicago Professional Sports Ltd. Partnership v. NBA*, 95 F.3d 593 (7th Cir. 1996).

<sup>31</sup> 961 F.2d at 674-677.