COMPETITION POLICY INTERNATIONAL

The CPI Antitrust Journal
March 2010 (2)

Joint Ventures and the Sherman Act: The Problem Revealed by *American Needle* and How Best to Address It

Thomas Brown, Katherine Robison, & Ian Simmons
O'Melveny & Myers LLP

Joint Ventures and the Sherman Act: The Problem Revealed by *American Needle* and How Best to Address It

Thomas Brown, Katherine Robison, & Ian *Simmons*[1]

I. INTRODUCTION

The transcript of the oral argument in this year's most watched antitrust case, *American Needle v. National Football League*, captures a struggle about where to draw the line between joint venture activities that must be scrutinized under Section One and those that should not. That the Justices of the Supreme Court seemed uncertain about how to draw such a line while preserving the ability to review the activities of joint ventures under Section One is not surprising given the current state of antitrust law applicable to joint ventures.

Antitrust law holds joint ventures to an exacting standard. Joint ventures are required to defend their formation and their actions under Section One of the Sherman Act. Although pricing decisions of an integrated joint venture may not be subject to *per se* condemnation, all the actions of such a joint venture are, according to mainstream antitrust authorities, subject to scrutiny under Section One.

Antitrust law does not hold other collaborative enterprises to a similar standard. It does not demand that other legitimate cooperative forms of business (such as merged companies or parent and subsidiary corporations) justify each of their post-formation activities. And, although subjecting joint ventures to a more exacting antitrust standard can be reconciled with the text and structure of the Sherman Act, it makes no sense to predicate the level of scrutiny applied on the form of the cooperative venture. At a practical level, this formalism simply encourages firms to by-pass potential opportunities or to pursue them within a more rigid structure.

The solution lies in pursuing a less ambitious agenda for joint venture review. If joint ventures are akin to merged companies, then antitrust review of their activities should more closely follow the law applicable to mergers. As with proposed mergers, the government and private parties should be allowed to challenge the joint venture upon formation to determine whether the joint venture may properly pursue the activities falling within its proposed scope. And if the joint venture were later to expand its scope, activities falling within that revised scope would be analyzed under the same standards that apply at formation. But, once the scope of the venture has been defined, activities falling within that scope cannot be singled out for challenges under Section One. Those activities must be challenged, if at all, under Section Two. Of course, activities falling outside the original scope of the joint venture may still be challenged under Section One.

---

[1] Thomas Brown and Ian Simmons are partners and Katherine Robison is counsel in the international law firm of O'Melveny & Myers LLP. The authors are grateful to Sam Zun for his excellent research assistance. The views expressed in the paper are the authors' own, and any errors are their responsibility.

By stepping back from the overambitious antitrust agenda currently applied to joint ventures, the courts can create the clarity needed to allow joint ventures to fulfill the promise recognized in *Copperweld*—"increasing a firm's efficiency and enabling it to compete more effectively."

II. THE LONG ROAD FROM CANTON, OHIO TO THE SUPREME COURT

The roots of *American Needle, Inc. v. National Football League*[2] can be traced to a meeting that took place on September 17, 1920, in a Canton, Ohio showroom for a long-defunct automobile brand. That Friday evening, the representatives of the Canton Bulldogs, Racine Cardinals, and Massillon Tigers joined with representatives of nine other teams to organize the American Professional Football Association. Those assembled agreed, among other things, to appoint Jim Thorpe as President of the association, to pay $100 in dues, and to award "a silver loving cup" presented to the league by Mr. Marshall of the Brunswick-Dalke Collender Company, Tire Division.[3]

A year later, the American Professional Football Association took on a new name, the National Football League, and a new commissioner, Joe Carr. Carr led the league until 1940, and he slowly consolidated power in the commissioner's office. Under his leadership, the NFL introduced rules permitting the forward pass from anywhere behind the line of scrimmage, roster limits, restrictions on player mobility, standings, and a playoff. Within those constraints, teams operated as private fiefdoms. Each team, for example, negotiated the license of its own broadcast rights. After moving from Cleveland to Los Angeles in 1950, the Rams were the first team to secure a contract to broadcast all of their games, home and away, on television.

In 1960, Pete Rozelle became commissioner of the NFL, and he set about to break down the remaining walls separating the fiefdoms. Aided by a newly passed law enabling leagues to negotiate a single contract covering broadcast rates for all teams, Rozelle persuaded the team owners to equally share their broadcast revenue. In 1961, Rozelle negotiated a contract with CBS that paid the league $4.6 million. Two years later, the price for league broadcast rights rose to $14.1 million per year. In 1963, to capitalize on the growing popularity of the sport and the league, the NFL created NFL Properties, Inc. to license the trademarks associated with league teams. And, in 1982, all NFL teams save two, the Miami Dolphins and Oakland Raiders, agreed to make NFL Properties their exclusive licensing agent.

American Needle, an apparel manufacturer based in Illinois, had manufactured headwear bearing NFL team logos since the late 1950s.[4] After becoming the exclusive licensing agent for the NFL, NFL Properties maintained the relationship with American Needle. In December 2000, however, NFL Properties changed its strategy. It granted Reebok a "[t]en year exclusive license agreement, including the NFL and all club marks and logos, for uniforms, sideline apparel, headwear and fitness equipment."[5] American Needle reacted by filing an antitrust suit against the NFL, NFL Properties, and Reebok.

---

[2] American Needle, Inc. v. National Football League, et al., Case No. 08-661.

[3] Professional Football Researchers Association, *Happy Birthday NFL?*, THE COFFIN CORNER Vol. 2, No. 8 (1980), at 6 (reproducing the original minutes from the September 17, 1920 meeting, as prepared by A.F. Ranney), *available at* www.profootballresearchers.org/Coffin_Corner/02-08-038.pdf.

[4] *See* Pet. Brief on Writ of Cert., 2009 WL 3004479, at *8 (Sept. 18, 2009).

[5] *See* Pet. Brief on Writ of Cert., 2009 WL 3004479, at *6.

The district court had little patience for American Needle's claim. After dismissing a *per se* theory on the pleadings, the court limited discovery on American Needle's rule of reason claims to whether the NFL teams constituted a "single entity." And when the defendants moved for summary judgment on the ground that their conduct was insulated from antitrust attack on single entity grounds, the district court granted them summary judgment. It explained that the collective licensing "promote[s] NFL football" and that the NFL and its teams "act[] as an economic unit" when promoting NFL football. It concluded that under *Copperweld*, NFL Properties "should be deemed a single entity" in licensing the teams' intellectual property.[6] American Needle then unsuccessfully appealed to the Seventh Circuit.[7] Like the district court, the Seventh Circuit concluded that the NFL's product—NFL football—can only be created through concerted action for the simple reason that a single team cannot produce a competitive game by itself. Therefore, it reasoned, the NFL teams act as a single source of economic power in the production of NFL football. From this premise, the court made the short jump to the conclusion that NFL teams share an economic interest in collectively promoting NFL football. In the words of the court, "it makes little difference if a team wins the Super Bowl if no one cares about the Super Bowl." And on that basis, it held that the NFL teams also act as a single source of economic power in the promotion of NFL football, which includes the licensing of league logos on apparel and headwear.

Like many unsuccessful appellants, American Needle filed a perfunctory petition for certiorari with the Supreme Court, seeking reversal of the Seventh Circuit's decision. The NFL responded by joining American Needle in urging the Supreme Court to hear the case, though it sought a broad expansion of the single entity doctrine. Having been asked for its views, the Solicitor General urged the Court to decline the party's invitation to weigh in on whether the NFL's actions should be subject to scrutiny under Section One of the Sherman Act.

Rejecting the recommendation of the Solicitor General, the Supreme Court took the case. Not surprisingly, the parties have staked out positions on either end of the antitrust spectrum. American Needle maintains that review under the rule of reason is required for every aspect of league operations. The NFL argues that the league acts as a single entity in all aspects of its operations and so should be wholly immune from antitrust scrutiny.[8] The Solicitor General has argued for something in the middle that would preserve scrutiny for some activities but forgo it for others.

Based on the transcript of the argument, it does not appear that the Court agrees with anyone. During the argument, the justices posed several hypotheticals that seemed calculated to define the boundary between league activities that are so clearly permissible that no antitrust scrutiny is required and activities where scrutiny is required. For example, Justice Kennedy asked whether an agreement to provide quarterbacks with more protection should be subject to scrutiny under Section One since it would provide more benefit to teams that preferred to play a passing-heavy game. And Justice Alioto asked whether the NFL would escape scrutiny for a rule preventing teams from playing games outside of their NFL schedule, such as an additional game

---

[6] Copperweld, 496 F. Supp. 2d 941, 943 (N.D. Ill. 2007).

[7] 538 F.3d 736 (7th Cir. 2008).

[8] Interestingly, the NFL did not take such a broad position in either the Seventh Circuit or its response to American Needle's petition for certiorari. Instead it argued only that the NFL and its member teams must be considered a single entity in at least some aspects of its operations, which would rightfully include the joint licensing of intellectual property given the shared interest in promoting NFL football.

against a rival that would provide those teams with greater revenue. In response to these hypotheticals, the lawyers representing American Needle, the NFL, and the Solicitor General struggled to articulate a legal rule that would block some cases but allow others to go forward.

III. A CENTURY OF TOIL AND TROUBLE: JOINT VENTURE ANALYSIS UNDER THE SHERMAN ACT

That lawyers would struggle with whether and how to apply antitrust law to joint ventures should come as no surprise. Antitrust scrutiny of joint ventures is often described as the most confusing area of the law. Indeed, one court has observed that joint ventures "present a difficult concept for antitrust analysis, defying neat classifications and precise definition and, by extension, well-established rules for evaluating their competitive impact."[9] To be sure, one broad principle governing joint ventures can be discerned—that legitimate joint ventures are not subject to *per se* condemnation. Beyond that principle, however, confusion reigns. Joint ventures, to re-cast Thomas Schelling's famous line, denote the "chance that leaves something to risk": Venture partners may understand and fully proselytize the necessity for a joint undertaking *a priori*, and yet they can take little solace in the state of guidance the law provides in assessing the formation and, perhaps more importantly, the subsequent conduct of the venture.

Judicial scrutiny of joint ventures dates back to the earliest days of the Sherman Act, but it has become clear only recently that legitimate joint ventures are not subject to *per se* condemnation. A trio of Supreme Court cases dating only to the 1970s establishes this principle, *Broadcast Music, Inc. v. CBS* ("*BMI*"), *Arizona v. Maricopa County Medical Society*, and *Texaco Inc. v. Dagher*. *BMI* establishes that joint price activity is exempt from *per se* scrutiny where the firms involved have combined their resources to create a product that could not exist but for the combination.[10] *Maricopa County* holds that *per se* scrutiny does apply to price-setting activities among competitors that arise in the absence of any integrative efficiencies or pooling of risks.[11] *Dagher* completes the triumvirate by rejecting *per se* review of joint price setting where the venture partners, although they had not created a new product, had combined their assets into a single company.[12]

Relief from *per se* condemnation is not to be dismissed, but the rule of reason is more an aspiration than a rule of law. As then Professor and now Chief Judge Easterbrook explained a quarter century ago in his famous article, *The Limits of Antitrust*, the project of building a set of legal rules to govern competition that does more good than harm is quite difficult.[13] Legal rules, because they do not self-correct, must be carefully constructed. And even assuming a perfect set of legal rules, antitrust law will benefit consumers only to the extent that the administrative and compliance costs associated with those legal rules do not exhaust the savings that those rules yield.

If anything, Judge Easterbrook's article underestimates the challenge of producing an antitrust regime that yields net benefit to society as a whole. Prosecution of antitrust claims is not

---

[9] COMPACT v. Metropolitan Gov't, 594 F. Supp. 1567, 1574 (M.D. Tenn. 1984).

[10] 441 U.S. 1, 20-23 (1979) (holding that blanket license offered by ASCAP and BMI relating to 40,000 authors and composers was "to some extent, a different product" from what artists could offer individually and noting that artists remained free to license their individual works outside the licensing organization).

[11] 457 U.S. 332, 356–57 (1982).

[12] 547 U.S. 1, 5-6 (2006) (lawful venture between Texaco and Shell to refine and market gasoline in the Western United States).

[13] Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (Aug. 1984).

limited to state agencies. Although private antitrust plaintiffs must show that the practices they challenge harm "competition as a whole" and not just themselves, they do not bring suits in the public interest. They bring them on their own behalf. As a general rule, antitrust scrutiny only afflicts successful enterprises. When a firm leaves itself open to antitrust critique, private party litigation provides a relatively easy opportunity for every customer, supplier, or competitor to increase their private return.[14]

This is true even where the antitrust "objector" seizes the mantle "consumer." To be sure, the antitrust laws can be thought of as a species of consumer protection law. But antitrust claims frequently arise in two-sided or platform industries. And the economic literature establishes beyond reasonable dispute that costs inflicted on one side of a platform are frequently benefits to the other side. It is indisputable, for example, that reducing the price that merchants pay to accept payments increases the cost consumers incur in making those payments. The law has yet to follow economics in this regard, and courts have allowed antitrust claims to advance even absent proof that the conduct challenged by one distinct group of consumers has made consumers as a whole worse off.[15]

These general problems with the rule of reason are compounded in the area of joint ventures. The rule of reason contemplates assessing and then weighing the relative benefits and burdens associated with a business practice. In the joint venture context, the balance can be struck at the level of the venture, or it can be done at the level of the particular practice. The very embodiment of mainstream antitrust doctrine asserts that antitrust law "has the power both to condemn the original formation and to supervise ongoing activities."[16] This author (Herbert J. Hovenkamp) also claims that decisions about the legality of a venture or its activities are subject to re-examination if the venture partners or the venture become too prominent within a particular industry.[17] And he has elsewhere argued that the legality of a particular practice turns on whether the same benefit could be achieved with a less restrictive alternative.[18] Taken together, these legal standards would seemingly punish any failure on the part of the joint venture to maximize consumer welfare (at pain of treble damages no less).

The transcript of the *American Needle* oral argument nicely illustrates the problem. During the argument, Justice Kennedy pointed out that a rule providing quarterbacks with more protection could have anticompetitive consequences (as it would not benefit teams with strong running games). But subjecting this rule of play to the rule of reason is essentially impossible. For one thing, it is simply not possible to say, with any degree of certainty, whether the world has been made worse off by giving more protection to quarterbacks than other players. Some people are surely better off (the yeses), and some people are surely worse off (the noes). But there is no

[14] *See generally* Frank H. Easterbrook, *Detrebling Antitrust Damages*, 28 J.L. & ECON. 445, 467 (1985) (concluding that private party litigation by customers and competitors alike can result in over-compensation or other non-optimal penalties).

[15] In re eBay Sellers Antitrust Litigation, 545 F. Supp. 2d 1027, 1033 (N.D. Cal. 2008) ("[T]he Court is not aware of any authority requiring a consumer to plead injury to a consumer who is not a party to the lawsuit.").

[16] *See* Herbert J. Hovenkamp, Intra-Enterprise Activity, Joint Ventures and Sports Leagues; Identifying Unilateral Conduct Under the Antitrust Laws, at 4 (Univ. of Iowa Legal Studies Research Paper No. 10-04, 2010), available at http://ssrn.com/abstract=1511170.

[17] *Id.* at 6–7.

[18] *See* Herbert J. Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, 1995 COLUM. BUS. L. REV. 1, 107 ("One of the most important doctrines of the rule of reason is that the restraint must be no broader than necessary to achieve its legitimate goals.").

reliable way to figure out whether there are more yeses than noes or whether the benefit to the yeses from ending the practice outweighs the costs to the noes. Moreover, even if those questions could be answered with some degree of certainty, the (hypothetical) objection to the policy appears to be entirely opportunistic. A differently organized NFL would still need rules governing penalties and modes of play. Although those who object to the current rule might prefer a different rule, some constituency clearly prefers the existing rule to potential alternatives.

In the absence of clear legal guideposts, judicial analysis of joint ventures frequently retreats to formalism. Indeed, in *United States v. Visa U.S.A., Inc.*, Visa and MasterCard objected to a decision striking down their respective exclusivity rules on the ground that the lower court had applied a stricter standard to their policies based solely on their choice of corporate form. The argument, however, made no headway. The appellate court, far from criticizing the lower court for resting its decision on a formalistic ground, embraced the formalistic distinction:

> The basic flaw in the analogy is that it depicts Visa U.S.A. (or MasterCard) as a single entity (like Coca-Cola) demanding a restrictive provision in its contract with a supplier of services to it. Visa U.S.A. and MasterCard, however, are not single entities; they are consortiums of competitors. They are owned and effectively operated by some 20,000 banks, which compete with one another in the issuance of payment cards and the acquiring of merchants' transactions. These 20,000 banks set the policies of Visa U.S.A. and MasterCard. These competitors have agreed to abide by a restrictive exclusivity provision to the effect that in order to share the benefits of their association by having the right to issue Visa or MasterCard cards, they must agree not to compete by issuing cards of Amex or Discover. The restrictive provision is a horizontal restraint adopted by 20,000 competitors.[19]

Resting a decision to strike down a particular practice simply because one firm has chosen to organize itself as a joint venture rather than in a more conventional unitary structure heads directly back to the premise on which antitrust supervision of joint ventures is based—that there is greater reason to be concerned about the impact on consumer welfare from collaborations among competitors than more traditionally organized firms. Although frequently asserted, this proposition does not appear to have ever been supported in the context of joint ventures. The text of the Sherman Act does draw a distinction between unilateral and concerted action. But the broad language of the Sherman Act does not have to be read to require greater scrutiny of the precise decisions made by joint ventures. And the resort to judicial formalism simply has the effect of leading firms to house their collaborations in more permanent (and less flexible) structures such as outright mergers.

IV. A SIMPLE PROPOSAL FOR SIMPLIFYING THE ANALYSIS OF JOINT VENTURES

All business forms face difficulties posed by the rule of reason. But joint ventures face a particular problem. The unfounded hostility towards joint ventures fuels an overly ambitious antitrust agenda. When it comes to joint ventures, antitrust law seeks to accomplish four separate things:

- Review the formation of joint ventures to ensure that they do not threaten to impair the interests of consumers;

[19] 344 F.3d 229, 242 (2d Cir. 2003).

- Scrutinize changes to joint ventures, including adoption of policies restricting the ability of participants to compete with each other or the network itself;
- Ensure that joint ventures are not simply fronts for illegal price fixing; and
- Analyze the operation of joint ventures to ensure that benefits to consumers outweigh any harm.[20]

In the absence of any justification for the tradition of hostility toward joint ventures, the appropriate path would appear to be excising the fourth topic from the antitrust agenda for joint ventures. Simply deleting the task of ensuring that joint ventures are always working to maximize consumer welfare would dramatically simplify the task of reviewing joint ventures. **This would reduce the inquiry to distinguishing what is core to a joint venture from what is ancillary.** And this is a pretty straightforward exercise. If an action falls within the original scope of the venture, then the plaintiff challenging that action must show that the venture as a whole leaves consumers worse off (the Section Two analysis). If the challenged action falls outside the scope of the original venture (e.g., after formation, the co-venturers decide to limit their ability to compete with the venture), then the plaintiff need only show that the new action yields more competitive harm than good (the rule of reason analysis).

The burden would be on the joint venture to prove that the challenged activity falls within its scope, which would have the added benefit of encouraging joint ventures to clearly define their scope at formation. Requiring a clearer definition of the scope of the venture from the beginning would allow the government and private parties to more effectively challenge the joint venture at its formation. It would also provide the joint venture with clearer guidance regarding what activities it may properly engage in without fear of facing costly and protracted litigation at some unknown point in the future.

The position taken by the government in *Dagher* supports a move toward the proposed standard. There the government advocated treating legitimate joint ventures as single entities with respect to operations within the anticipated scope of the venture. Because the Shell/Texaco joint venture effectively merged all of the companies' operations in the relevant downstream market, the two companies were "not independent participants in the downstream markets and therefore **were incapable of forming a horizontal agreement . . . with respect to operations in those markets.**"[21] Therefore, in setting the price for their two brands of gasoline, the companies were "acting solely in their capacity as owners of a marketplace participant" and, therefore, should have been regarded as a single entity.[22] As such, the specific acts of the joint venture in the downstream gasoline market could not be singled out for scrutiny.[23] And the court ultimately agreed, holding that the joint venture must be considered a single entity with "discretion to determine the prices of the products it sells."[24]

---

[20] Although the third objective evidences a legitimate concern—i.e., any rule permitting joint ventures should not swallow the ban on price fixing—sham joint venture cases have been few and far between in the more than hundred year history of the Sherman Act. Herbert J. Hovenkamp, Intra-Enterprise Activity, Joint Ventures and Sports Leagues; Identifying Unilateral Conduct Under the Antitrust Laws, at 7 (Univ. of Iowa Legal Studies Research Paper No. 10-04, 2010), available at http://ssrn.com/abstract=1511170.

[21] *See* U.S. Amicus Brief on Writ of Cert., 2005 WL 2237543, at *18 (Sept. 12, 2005) (emphasis added).

[22] *Id*. at *18-19.

[23] *See* U.S. Amicus Brief on Pet. for Writ, 2005 WL 1254203, at *11 (May 26, 2005) ("There is no reason to apply *per se* analysis, rather than the rule of reason, to a single aspect of the joint venture arrangement . . . ."). The government has since apparently stepped back from its position that specific acts of the joint venture should not be

Subjecting activities within the legitimate scope of the joint venture to scrutiny under Section Two, if at all, would be a marked improvement over requiring a full-blown Section One analysis of each venture activity. Although a rule of reason Section One case bears some resemblance to a Section Two case in the definition of the relevant market, the assessment of barriers to entry, and the analysis of the purpose and effect of the restraint, the latter differs in significant respects from the rule of reason. For one thing, although economists may not typically distinguish between "market" and "monopoly" power, the law certainly does, and the showing required for the latter is typically more onerous. For another, so far as we are aware there are no "quick look" monopolization cases, whereas there are "quick look" rule of reason cases.[25] Finally, we would wager that most antitrust lawyers have a better sense of what conduct denotes "exclusionary" practices under Section Two in the presence of "monopoly" power, then they have of what restraints are "unreasonable" under a short cut or full blown rule of reason analysis. When one couples the more concrete—and admittedly onerous—Section Two conduct standards with the pleading requirements of *Twombly* and *Iqbal*, venture partners should have greater predictability as to how venture conduct will be gauged going forward. Is this in the words of Tom Bingham, Senior Law Lord, a "shifting of the goal posts" for claimants? Most certainly it is. It also most certainly, though, is a movement towards clarity—the other side of the coin from flexible common law rules.[26]

---

singled out for scrutiny. In its amicus brief in *American Needle*, it argued that while "the [Seventh Circuit] was correct that each 'facet' of the league's operation must be considered separately, its analysis of the particular facet at issue here . . . was flawed and incomplete." *See* U.S. Amicus Brief on Writ of Cert., 2009 WL 3070863, at *8 (Sept. 25, 2009). The government proposed a two-step test to be applied to any challenged aspect of the joint venture's operations. *Id.* at *17 (see *supra* § I). This may or may not evidence the government's attempt to preserve its ability to review joint venture activities piecemeal in an effort to periodically determine whether joint ventures are acting to promote consumer welfare. But regardless of the government's motivation, the test is certainly a step back towards requiring a rule of reason analysis for every joint venture activity whereas *Dagher* seemed to evidence a step away from such a requirement.

[24] Dagher, 547 U.S. at 7.

[25] *See*, *e.g.*, *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986).

[26] *See* TOM BINGHAM, THE RULE OF LAW 44–46 (2010).