

Antitrust News & Notes

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Supreme Court Subjects the NFL and Other Joint Ventures to Sherman Act Scrutiny

By Nicole Glauser

On Monday, the United States Supreme Court for the first time in nearly 20 years found in favor of a private plaintiff in an antitrust appeal.¹ In *American Needle*, the Court unanimously held that the NFL's collective licensing activities constitute "concerted action" that is not unconditionally beyond the scope of Section 1 of the Sherman Act.² The Court rejected the NFL's claim that the League's licensing activity is beyond the reach of Section 1 of the Sherman Act when NFL teams join in commercial activity and reversed the Seventh Circuit's controversial decision that the League's collective agreement to license an exclusive apparel vendor could not be challenged under antitrust laws.³ The Court then remanded the case for the lower court to determine whether the concerted action survived the rule of reason.⁴

Prior to the issuance of the Supreme Court's decision, legal scholars and experts agreed that this case was of enormous significance to antitrust analysis of competitor collaborations both within and outside the realm of sports. Some commentators worried that a decision against American Needle would permit the NFL (and other pro leagues) to engage in joint commercial activity without regard to its effect on competition. Other commentators worried that a decision against the NFL teams

¹ *Am. Needle, Inc. v. Nat'l Football League et al.*, ____ U.S. ____, 2010 WL 2025207, at *3 (2010).

² *Id.*

³ *Id.* at **3-4.

⁴ *Id.* at *13.

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could subject any legitimate internal decision the teams (or other kinds of joint ventures) make collectively to antitrust challenge. The Court appears to have carved out a middle ground. The Court clearly held that joint ventures are subject to Section 1 scrutiny, but also indicated that necessary competitive collaborations likely will be analyzed under the rule of reason and that legitimate internal decisionmaking by such entities or groups of entities and agreements that do not eliminate independent decisionmaking from the market are not subject to Section 1 attack.

Background

The dispute between American Needle, an apparel manufacturer, and the NFL arose in 2002, after the NFL did not renew American Needle's nonexclusive license to use NFL and team trademarks on headwear (e.g., knit hats and baseball caps).⁵ Instead, the NFL through its affiliate, NFL Properties, Inc., entered into an exclusive apparel licensing deal with Reebok International.⁶

⁵ *Id.* at *4.

⁶ *Id.*

After its license was not renewed, American Needle responded by filing an antitrust action against the NFL, its teams, NFL Properties, and Reebok, alleging, among other claims, violations of Section 1 of the Sherman Act, which makes “[e]very contract, combination . . . or, conspiracy, in restraint of trade” illegal.⁷ American Needle claimed that each of the 32 individually incorporated NFL teams separately owned its own name, colors, logo, trademarks, and related intellectual property, and therefore the teams’ “collective agreement to authorize NFL Properties to award the exclusive headwear license to Reebok was, in fact, a conspiracy to restrict other vendors’ ability to obtain licenses for the teams’ intellectual property” in violation of Section 1.⁸ The NFL argued that it is a single entity with 32 teams that compete with each other in football but not with respect to the challenged conduct and thus was immune from Section 1 liability.⁹

Relying on circuit precedent, the Seventh Circuit explained that “the question of whether a professional sports league is a single entity should be addressed not only ‘one league at a time,’ but also ‘one facet of a league at a time.’”¹⁰ The court concluded that, in the context before it, since “[c]ertainly the NFL teams can function only as one source of economic power when collectively producing NFL football,” it “follows that only one source of economic power controls the promotion of NFL football” through licensing.¹¹ The Seventh Circuit further noted that, since 1963, NFL teams “license[d] their intellectual property collectively.”¹² The court then held that the NFL teams constitute a single entity for the purpose of licensing their intellectual property, and thus Section 1 of the Sherman Act did not apply.¹³

Analysis

The Supreme Court unanimously found the Seventh Circuit’s reasoning “unpersuasive” and reversed.¹⁴

⁷ *Id.* at *4; see also 15 U.S.C. § 1.

⁸ *Am. Needle v. Nat’l Football League*, 538 F.3d 736, 738 (7th Cir. 2008); see also *Am. Needle*, 2010 WL 2025207, at *4.

⁹ *Am. Needle*, 2010 WL 2025207, at **4, 10.

¹⁰ *Am. Needle*, 538 F.3d at 742 (citations omitted); see also *Am. Needle*, 2010 WL 2025207, at *4.

¹¹ *Am. Needle*, 538 F.3d at 743.

¹² *Id.* at 744.

¹³ *Id.*

¹⁴ *Am. Needle*, 2010 WL 2025207, at **3, 10, 13.

Writing for the Court, retiring Justice John Paul Stevens (formerly an antitrust lawyer) described that, unlike Section 2, which covers both concerted and independent action if that action monopolizes or threatens actual monopolization, Section 1 applies only to concerted action that restrains trade.¹⁵ The Court emphasized that the inquiry into whether an entity is capable of conspiring under Section 1 is based on “substance, not form,” and thus it “does not turn simply on whether the parties involved are legally distinct entities” or whether “two legally distinct entities have organized themselves under a single umbrella or into a structured joint venture.”¹⁶ Instead, the key question in determining whether a “contract, combination . . . or, conspiracy” falls within Section 1 is whether the challenged arrangement “embod[ies] concerted action,” that is, does it “join[] together separate decisionmakers” or “independent centers of decisionmaking.”¹⁷ “If it does, then entities are capable of conspiring under Section 1, and the court must decide whether the restraint of trade is an unreasonable and therefore illegal one.”¹⁸

Applying this inquiry to the NFL teams’ collective licensing of intellectual property, the Court held that, “[a]lthough NFL teams have common interests such as promoting the NFL brand, they are still separate, profit-maximizing entities, and their interests in licensing team trademarks are not necessarily aligned.”¹⁹ Indeed, “the teams compete in the market for intellectual property.”²⁰ Citing the two teams in this year’s Super Bowl, Justice Stevens wrote: “To a firm making hats, the Saints and the Colts are two potentially competing suppliers of valuable trademarks.”²¹ As a result, “[w]hen each NFL team licenses its intellectual property, . . . [it is] acting as [a] separate economic actor[] pursuing separate economic interests, and each team therefore is a potential independent center

¹⁵ *Id.* at *5.

¹⁶ *Id.* at **6, 9.

¹⁷ *Id.* at **8-9 (citing *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 769, 773 n.21 (1984)).

¹⁸ *Id.* at *9.

¹⁹ *Id.* at *10.

²⁰ *Id.* at *9.

²¹ *Id.*

of decisionmaking.²² Therefore, the Court held, “[d]ecisions by NFL teams to license their separately owned trademarks collectively and to only one vendor are decisions that deprive the market place of independent centers of decisionmaking and therefore of actual or potential competition.”²³

The Court rejected as unpersuasive the argument that the NFL teams need each other to plan an NFL season, stating that “a nut and a bolt can only operate together, but an agreement between nut and bolt manufacturers is still subject to Section 1 analysis.”²⁴ The Court rejected as irrelevant the fact that the NFL teams shared in profits and losses from NFL Properties, describing that holding otherwise could permit “any cartel [to] evade the antitrust law simply by creating a ‘joint venture’ to serve as the exclusive seller of their competing products.”²⁵ The Court also found irrelevant the fact that since 1963, NFL Properties had “served as the ‘single driver’ of the teams’ promotion vehicle, pursuing the common interests of the whole,” stating that “a history of concerted activity does not immunize conduct from Section 1 scrutiny.”²⁶

The Court also rejected an alternate test for identifying a single enterprise proposed by the Solicitor General and the Department of Justice.²⁷ In an *amicus curiae* brief, the Government suggested that it would treat a joint venture as a single enterprise when the venturers “‘have effectively merged the relevant aspect of their operations, thereby eliminating actual and potential competition in that operational sphere’ and ‘the challenged restraint does not significantly affect actual . . . or potential competition outside their merged operations.’”²⁸ Under this test, the Government argued, the NFL’s choice to “‘offer only a blanket license’ and ‘to have only a single headwear licensee’ might not constitute concerted action.”²⁹ But the

Court pointed out that this test impermissibly elevates form over substance, because “[t]he two choices that the Government might treat as independent action, although nominally made by [NFL Properties], are for all functional purposes choices made by the 32 entities with potentially competing interests.”³⁰

Seeking to allay concerns that may be raised by its ruling, the Court explained that competitor collaborations, like that among the NFL teams, “that need to cooperate are not trapped by antitrust law.”³¹ For example, “[t]he fact that NFL teams share an interest in making the entire league successful and profitable, and that they must cooperate in the production and scheduling of games, provides a perfectly sensible justification for making a host of collective decisions,” even though the challenged conduct “is still concerted activity under the Sherman Act that is subject to Section 1 analysis.”³² Thus, because some restraints on competition may be necessary among athletic teams, including the teams in the NFL, the rule of reason generally applies, and the challenged conduct may be permissible.³³

The Court ultimately remanded this case back to the lower court for consideration of whether and to what degree, in light of all the circumstances, the NFL’s grant of an exclusive license to market NFL-branded apparel is anticompetitive.³⁴ An analysis, the Court perhaps hinted, that might be applied to the NFL without detailed analysis but instead “in the twinkling of an eye.”³⁵ ■

²² *Id.* (quotations omitted).

²³ *Id.* (quotations omitted).

²⁴ *Id.* at *11.

²⁵ *Id.* at *12 (quotations omitted).

²⁶ *Id.* at *10.

²⁷ *Id.* at *12 n.9.

²⁸ *Id.* (quoting Brief for the United States as *Amicus Curiae* at 17) (alterations omitted).

²⁹ *Id.* (quoting Brief for the United States as *Amicus Curiae* at 32).

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.* at *12; see also *id.* at *3.

³⁴ *Id.* at *13.

³⁵ *Id.* at *12.

Federal Trade Commission and the Department of Justice Issue Revised Horizontal Merger Guidelines for Public Comment

By William R. Vigdor

On April 20, 2010, the Department of Justice and the Federal Trade Commission (collectively the “Agencies”) jointly issued revised horizontal merger guidelines (the “Proposed Guidelines”) for public comment. The Agencies explain that the Proposed Guidelines more accurately reflect current Agency enforcement practice than the horizontal guidelines issued in 1992 (revised in 1997) (the “Existing Guidelines”) and the latest economic analysis. There are several notable aspects of the Proposed Guidelines. First, they no longer identify a four step approach to merger analysis; rather, they describe a less structured, fact-specific merger analysis based on the reasonably available and reliable evidence. Second, the Proposed Guidelines appear to diminish the role of formal economic models by making clear that the Agencies will rely on economic theory, business documents, customer statements, and industry participant views more than formal models. Third, the Agencies are increasingly focusing on subsets of customers that may be targeted by the merging parties. Fourth, the role of market definition and share depends on the competitive effects analysis: playing a small role in differentiated products mergers and continuing to play a large role in all other merger analyses. Fifth, the Agencies continue to view efficiencies with skepticism, accepting a relatively small set of efficiencies and imposing a relatively large burden on the parties to “prove” the efficiencies. These changes seem to enhance the likelihood of increased merger enforcement. Yet, the recent enforcement record by the Agencies does not suggest that merger challenges have increased dramatically. We therefore do not see the issuance of the Proposed Guidelines as a major shift in merger enforcement policy. Public comments are due on June 4.

Summary of the Proposed Merger Guidelines

Overview

The Proposed Guidelines outline the “principal analytical techniques, practices and enforcement policy” of the Agencies. There is no single uniform analytical structure used to evaluate all horizontal mergers. Rather, it is a fact-specific process that incorporates a range of analytical tools based on the “reasonably available and reliable evidence.” The “unifying theme” of the Proposed Guidelines is that “mergers should not be permitted to create, enhance or entrench market power or facilitate its exercise.” Market power is the ability to increase price, reduce output, reduce product quality and variety, reduce innovation and, in a newly added description, make it more likely that firms will profitably and effectively engage in exclusionary conduct. The Proposed Guidelines make clear that concerns may arise when direct customers or consumers or both are harmed, as compared to the Existing Guidelines that tend to focus on consumers.

Evidence of Adverse Competitive Effects

This section of the Proposed Guidelines summarizes the key evidence used by the Agencies and its sources. In consummated mergers, the Agencies use the same analytical techniques that they use in analyzing non-consummated mergers and the Agencies believe they can challenge such a transaction even if anticompetitive effects have not manifested themselves.

The Agencies explain that they look to “natural experiments” when analyzing mergers. A natural experiment is, for example, the effect of recent entry, exit, expansion, or contraction in the relevant or a comparable market. Other evidence includes market shares and market concentration, historical head-to-head competition between the merging parties, and the disruptive role of one of the parties. Sources of evidence include the merging parties, industry participants (with additional weight being given to customers), and other industry sources.

Targeted Customers and Price Discrimination

The Proposed Guidelines add this section and highlight that the effects of a merger on classes of customers will be considered if targeted customers can be charged a different price for a product than other customers (price discrimination). For this condition to exist, there must be a class of customers that suppliers can identify and charge a different price and favored customers cannot resell discounted products to disfavored customers.

Market Definition

Markets are defined to determine the area of competition in which to analyze the merger and it has a product and geographic component. The Proposed Guidelines maintain the hypothetical monopolist test, which asks if the only seller of the products in a candidate market “likely would impose at least a small but significant and non-transitory increase in price [a SSNIP] on at least one product in the market, including at least one product sold by one of the merged firms.” The SSNIP typically involves a 10 percent increase over prevailing prices. Historically, the agencies have used less than 10 percent in many energy industries, including gasoline marketing (1 cent per gallon), terminal services (50 basis points per gallon), and pipelines (based on the pipeline fees, not delivered product price).

If the Agencies believe that there is a subset of customers for whom a hypothetical monopolist can impose a SSNIP, the Agencies may define the market around that class of customers. The Agencies also may define markets more narrowly when sellers and buyers negotiate prices. For geographic market, the Agencies will define markets around the location of the sellers, unless sellers set different prices based on geographic location, in which case the market will be defined based on the location of the customers.

Market Participants, Market Shares, and Market Concentration

The Agencies may calculate shares and concentration using the Herfindahl-Hirschman Index or HHI. The HHI is the sum of the squared market share of each competitor. The Agencies typically investigate mergers in which the

change in the HHI is greater than 100, and the post-merger HHI is greater than 1500 (six or fewer equally sized firms). The Agencies will presume the merger is likely to enhance market power if the merger increases the HHI by more than 200 points and the post-merger HHI is greater than 2500 (four or fewer equally sized firms). Shares are assigned to existing competitors, vertically integrated firms (to the extent the shares reflect their competitive significance), firms that have previously committed to entering and firms that “would very likely provide rapid supply responses with direct competitive impact” in response to a SSNIP.

Unilateral Effects

In the recent past, most mergers have been challenged under this theory. Perhaps this is why the section has been expanded substantially. Unilateral effects result from the elimination of competition between the two merging firms. The Proposed Guidelines identify four possible unilateral situations: differentiated products; bargaining and auctions; homogeneous products; and reductions in innovation and product variety. The key concern in a merger among differentiated products producers is that the parties produce products that the customers believe are the closest substitutes for each other, and industry members cannot or will not reposition their products to replace the lost competition. In such mergers, the Agencies do not rely on the HHI but on the value of sales diverted from one merging party to another in response to a price increase.

Unilateral effects may occur in a bargaining or auction situation when the merging firms are often the leading and runner-up bidders. Output suppression will occur, according to the Proposed Guidelines, in homogeneous goods markets, the merged firms have large shares, a large share of their output will benefit from the price increase, margin on the suppressed output is low, rivals are unlikely to react by expanding output, and demand elasticity is low. This theory is often applied in power generator mergers.

The reduction in innovation is most likely to occur when a merger combines “two of a very small number of firms with the strongest capabilities to successfully

innovate in a specific direction.” Similarly, the Agencies will examine whether a merger would reduce redundant product variety or reduce the product variety to the detriment of consumers.

Coordinated Effects

Coordinated effects analysis focuses on market-wide responses to a merger that result in blunting of incentives to cut prices or enhancement of the incentives to accommodate rivals. The Agencies likely will identify coordinated effects from a merger when concentration levels are moderate or high, the market at issue is vulnerable to coordination, and the Agencies identify a plausible theory as to how the merger would reduce competition. “Plausible theories” are not described. While the Proposed Guidelines articulate when markets are vulnerable to coordination (e.g., transparency of transactions terms and customers; homogeneous products; use of meeting competition clauses; easy customer switching among suppliers; small and frequent sales; and inelastic demand), the Agencies will presume the market is vulnerable to coordination if there is a history of express coordination or unsuccessful invitations to collude.

Powerful Buyers

The Proposed Guidelines explain how the Agencies reaction to the “power buyer defense.” Parties often assert that mergers cannot increase prices when customers are large because such customers can protect themselves. The Proposed Guidelines state that the Agencies will not presume that buyer size alone forestalls anticompetitive effects from a merger. Rather, the Agencies examine the choices available to buyers to protect themselves. Even if powerful buyers have ways of protecting themselves, the Agencies will examine the effects of the merger on smaller customers.

Entry

According to the Proposed Guidelines, a merger is unlikely to reduce competition if entry is “timely, likely and sufficient in its magnitude, character and scope to

deter or counteract the competitive effects of concern.”

The Agencies will consider the history of entry and exit and their effect on competition in the market. Entry analysis considers the necessary scale to compete (typically called minimum viable scale) and all the steps necessary to enter, including planning, designing, permitting, construction, and market acceptance. To be timely, entry must rapid, although “rapid” is not defined and the two year time frame of the Existing Guidelines has been omitted. The likelihood of entry depends on the “assets, capabilities, and capital” needed to enter the market and risks of entry, including the cost of exit. In examining sufficiency, the Agencies normally look to ensure that entry will replicate the size and strength of at least one of the merged firms.

Efficiencies

The Agencies continue to credit efficiencies that are substantiated, merger specific (i.e., cannot be obtained through practical means other than the merger), and are not inextricably linked to anticompetitive effects. The Agencies note that the greater the anticompetitive effect, the greater the parties’ burden to substantiate the efficiencies, the greater the size the efficiencies must be, and the larger share of the efficiencies that must be shared with customers. Efficiencies must be disproportionately large relative to the anticompetitive effect in mergers to monopoly or with very high concentration levels. Marginal cost savings continue to carry the greatest weight.

Failure and Existing Assets

Acquisitions of failing firms may be approved by the Agencies if the parties show:

- (1) the allegedly failing firm would be unable to meet its financial obligations in the near future;
- (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and
- (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.

Mergers of Competing Buyers

The Proposed Guidelines add a section discussing mergers between competing buyers. The Agencies apply the same analysis to these transactions as with mergers between sellers, but do not evaluate buy-side issues based “strictly, or even primarily, on the basis of effects in the downstream markets in which the merging parties sell.”

Partial Acquisitions

The final section of the Proposed Guidelines discusses partial acquisitions. Such transactions have been more common as private equity and hedge funds acquire interests in businesses. In evaluating partial acquisitions, the Agencies examine whether the transaction would reduce competition by: (1) allowing the acquirer to control or influence decisions of its rival; (2) reducing the incentive to compete against an affiliate, even absent the acquisition of control or influence; and (3) sharing information. ■

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