Paper Trail: Working Papers and Recent Scholarship

Editor's Note: *The Supreme Court's decision in* American Needle *on the future of single entity treatment for affiliated firms invites serious reflection. Professor Hovenkamp examines the decision, and Editor Bill Page comments. Send suggestions for papers to review to: page@law.ufl.edu or jwoodbury@crai.com.*

—*William H. Page and John R. Woodbury*

Recent Papers

Herbert Hovenkamp, American Needle and the Boundaries of the Firm in Antitrust Law
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1616625

In this paper, Professor Herbert Hovenkamp of the University of Iowa examines how the Supreme Court's decision in *American Needle*[1] affects the law governing whether a group of firms should be treated as a single entity incapable of conspiring under Section 1. He agrees with the Court that, apart from a handful of extreme cases that warrant per se illegality or that pose no risk of exclusionary or exclusive activity, cases involving affiliated firms should be judged under the rule of reason.

NFL teams are separately incorporated, but, since 1963, have licensed their IP rights through a joint venture, NFL Properties (NFLP). More recently, NFLP granted an exclusive license to Reebok to use the team logos on hats. That decision cut off American Needle, which sued, alleging that the NFL's action was a horizontal refusal to deal. The lower federal courts held that, at least in the licensing of logos, the NFL teams were a single entity.[2] The Supreme Court, in an opinion by retiring Justice John Paul Stevens, reversed and remanded for analysis of the arrangement under the rule of reason.

Hovenkamp points out that the single entity category is important because it creates a kind of safe harbor for a range of benign conduct. But the stakes are high in defining the category. If, for example, the NFL is a single entity, its unilateral refusals to deal are almost certainly lawful and any vertical exclusive contracts it forms would be subject to a relatively lenient rule of reason inquiry focusing on market share and exclusionary effect. If the NFL teams are separate, then the refusal to deal is concerted and could be judged under either the per se rule or some version of the rule of reason, depending upon the specifics of the restraint.

In *American Needle*, the Court read its decisions on this question to establish that economic substance, not corporate or other form, should govern whether a group of actors is a single entity or "separate decisionmakers" with separate interests. The Court held long ago in *Sealy* that an incorporated joint venture of separate manufacturers that assigned exclusive territories was not

[1] American Needle, Inc. v. NFL, No. 08-661, 2010 WL 2025207 (U.S. May 24, 2010).

[2] American Needle, Inc. v. NFL, 538 F.3d 736, 740 (7th Cir. 2008), *aff'g* 496 F. Supp. 2d 941, 533 F. Supp. 2d 7901 (N.D. Ill. 2007).

a single entity because it was just a shell that carried out the joint decisions of its individual owners.[3] In *Copperweld*,[4] by contrast, the Court held that a manufacturer and its wholly owned and separately incorporated subsidiaries functioned as a single enterprise.

NFL teams, according to the Court, had "separate corporate consciousness[es]" and actually or potentially competed "to attract fans, for gate receipts and for contracts with managerial and playing personnel" as well to sell products under their individually owned logos. This conclusion followed, even though the teams act through NFLP, a separate corporation that distributes revenues among the teams, because the teams remain separate entities with rival interests that at least potentially compete in the licensing of their own IP. A cartel is still a cartel even if it appoints a joint selling agent. True, there are aspects of the NFL that require joint action, but these can be considered in a rule of reason inquiry under Section 1.

Hovenkamp questions whether the single entity issue was of great practical importance in *American Needle*'s challenge to the exclusive contract between NFLP and Reebok. That vertical agreement, he notes, was undoubtedly between separate entities; whether it was an illegal exclusionary practice would depend upon the extent to which it foreclosed competitors of Reebok from a properly defined downstream market. The single-entity issue becomes more important in determining whether the alleged conduct is a concerted refusal to deal or a cartel. In *American Needle*, the rule of reason inquiry (as opposed to per se legality) was appropriate mainly because of the danger of collusion in the licensing process rather than exclusion in downstream markets. The horizontal agreement "facilitates collusion rather than independent bidding for licenses" of team logos, which are "by nature exclusive to each team." Hovenkamp suggests that "[t]here 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 procompetitive rationale should emerge, the rule of reason should be quite sufficient to handle it." For example, the NFL's refusal to admit a team from the USFL was held lawful even though it was concerted.[5] The concern with collusion should determine the nature of the rule of reason inquiry, including the validity of any defenses offered in support of the restraint.

The Court emphasized that, on remand, the "necessity of cooperation" should be one factor in the rule of reason analysis. Hovenkamp asks whether the Court means that the cooperation must be necessary for the individual restraint to succeed or for the joint venture as a whole to succeed. Although the teams must cooperate to schedule the season, there is no similar imperative for marketing their individual IP rights. Does the necessity of cooperation to form a league carry over to the IP context, or should the latter be viewed separately? Does the answer depend on the extent of the nexus between the two?

The Court emphasized, in determining that the rule of reason should apply, that the IP rights at issue in the case were team logos owned by the teams individually. That would imply that the NFL's decisions about the NFL's own trademark would be unilateral. Hovenkamp suggests, however, that virtually all of the league's licensing decisions should be viewed as concerted and subject to the appropriate degree of scrutiny under the rule of reason. In both *Sealy*[6] and *Topco*,[7] for example,

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[3] United States v. Sealy, Inc., 388 U.S. 350 (1967).

[4] Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984).

[5] Mid-South Grizzlies v. NFL, 720 F.2d 772 (3d Cir. 1983).

[6] 388 U.S. 350 (1967).

[7] United States v. Topco Assocs., 405 U. S. 596 (1972).

the Court properly treated an association's use of its common trademark as concerted action, although it wrongly applied the per se rule. The rule of reason would also be appropriate if the NFL's research arm were to develop and patent a new product, although, Hovenkamp notes, joint action might be more justifiable in that case than in the trademark case "because excessive licensing by one firm could dissipate the value of the patent to other firms."

Under *Copperweld*, separately incorporated firms owned by a common parent are a single entity, but most courts hold that separately incorporated franchises contractually related to their franchisor are separate entities, even if they are created solely to promote the business of the franchisor. Thus, the decision of McDonald's itself, say, to run a national advertising campaign, is unilateral, but joint actions of McDonald's franchisees are concerted. If McDonald's "imposed" resale price maintenance, the restraint would entail a vertical agreement even though the restraint was an "exercise[] of the franchisor's own property rights rather than those of individual franchisees, and "even though the only purpose for incorporating a particular MacDonald's franchisee is to serve as part of the MacDonald's franchise." Like the franchisees, Hovenkamp notes, 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.

For joint ventures, Hovenkamp argues, the extremes of per se illegality and single-entity status (virtual per se legality) are only rarely appropriate. The former course is appropriate for "naked conduct that is not integral to the delivery of the joint venturer's product." The latter course is only appropriate where the venture "is conducting its own business rather than being involved in the separate business of its individual team members." According to Hovenkamp, *American Needle* implicitly denies single-entity status to Visa and Mastercard joint ventures and local real estate boards, all of which "have structures that tend to be looser than that of the NFL, permitting more individualized business decision making by separate members." This conclusion follows regardless of corporate form, so long as the constituent firms retain individual business operations, as in *Sealy*, and do not fully align corporate interests, as in *Copperweld*. The decision also denies single-entity status to relationships between franchisors and franchisees, between patent owners and their licensees, and between a hospital and its physician-officers, where the officers retain individual competing practices.

American Needle is, however, consistent with *Dagher*,[8] which granted single-entity status to a "joint venture of two oil producers that produced, sold, and priced gasoline from a common facility" under the producers' separate brands. The key distinction between the cases was that the joint venture participants in *Dagher* "ceased all of their separate operations in the western United States and made sales of gasoline only through the venture."

Hovenkamp suggests that *Chicago Professional Sports*,[9] which held that the NBA was a single entity, may still have some validity. In that case, Judge Easterbrook held that the NBA was a single entity, at least for some purposes, because, unlike the NCAA, it creates its constituent

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[8] Texaco, Inc. v. Dagher, 547 U.S. 1 (2006).

[9] Chicago Prof'l Sports Ltd. P'ship v. NBA, 95 F.3d 593 (7th Cir. 1996).

teams solely to produce basketball games, even though the teams retain distinct ownership. He noted, however, that

> [s]ports are sufficiently diverse that it is essential to investigate their organization and ask *Copperweld*'s functional question one league at a time—*and perhaps one facet of a league at a time*, for we do not rule out the possibility that an organization such as the NBA is best understood as one firm when selling broadcast rights to a network in competition with a thousand other producers of entertainment, but is best understood as a joint venture when curtailing competition for players who have few other market opportunities.[10]

For Judge Easterbrook, a contractual provision between the NBA and NBC that limited the number of games the Chicago Bulls could broadcast on WGN was not a concerted action of the league's members. This restraint was different from *American Needle* because the Bulls' side contracts at least potentially affected the ability of the league to maximize profit. Nevertheless, Hovenkamp argues, the same NBA issue should now be resolved under the rule of reason: "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." Rule of reason analysis allows the Court to weigh these concerns, while single-entity treatment makes them per se legal. ●

—WHP

[10] *Id.* at 600 (emphasis added).