THE ECONOMICS OF SPORTS LEAGUES AND THE RELOCATION OF TEAMS: THE CASE OF THE ST. LOUIS RAMS

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1. INTRODUCTION

Antitrust courts have long found it difficult to deal with the structure and behavior of sports leagues. Most leagues consist of a collection of separately owned teams that, under a set of collective rules, produce a joint product. Is such a league a single entity or is it a group of cooperating competitors? Are the league's rules anti-competitive? Are they collusive restraints of trade? These are all questions that have challenged the courts.

These matters are made no easier by the fact that they are often presented in a proceeding brought by one of a league's member teams against the league or against the plaintiff team's league partners. In such cases, the plaintiff team often asserts that the league's rules are anti-competitive restraints on the freedom of its members. Evidently, there are situations in which the interests of a league as a whole and those of one or more individual members fail to coincide.

Nowhere has this phenomenon been more evident than in cases involving the relocation of team franchises. In the National Football League (NFL, or the "League"), the most famous cases are those stemming from the move of the Oakland Raiders to Los Angeles (and then back again).[1] Partly in response to those cases, the NFL developed a process for making relocation decisions, a process that sometimes involves a relocation fee paid to the league. That process was challenged in 1997 in a case involving the move of the Los Angeles Rams to St. Louis.[2]

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1. *See* Los Angeles Mem'l Coliseum v. NFL, 726 F.2d 1381 (9th Cir. 1984); National Football League v. Los Angeles Raiders, Case No. CV 95-5885GK (SHx).

2. *See* St Louis Convention & Visitors Comm'n v. National Football League, 46 F.Supp. 1058 (E.D. Mo. 1997), *aff'd*, 154 F.3d 851 (8th Cir. 1998). Franklin Fisher, supported by

To understand the role of such rules requires understanding the economics of sports leagues and the way they are organized. In our previous paper, we set forth the general economic analysis of sports leagues, and it will be useful to briefly review that discussion here before moving on to consider relocation issues in general and the move of the Rams in particular.[3]

2. Externalities and Market Failure

To begin, it is first useful to consider a general concept that is central to the understanding of the economics of sports leagues. That is the subject of what economists call "externalities."

The central propositions of microeconomics explain how markets operate to turn the unfettered individualistic pursuit of private ends to the benefit of the public as a whole. A competitive system leads to the socially desirable result of an efficient allocation of resources and the enhancement of consumer welfare because consumer tastes and resource costs are reflected in the private profit and loss calculus performed by the competing agents in the economy. If there is one proposition that economists have to communicate to the outside world, it is this.

But if there is a second proposition that economists have to communicate to the outside world (and perhaps to other economists who have only mastered the first one), it is one that concerns the circumstances under which the first proposition is false. In particular, markets fail to lead to socially desirable results if there are public costs and benefits that are *not* reflected in the private profit-and-loss calculus of competing agents. When that happens, the actions of one agent impose a cost or confer a benefit on others that the given agent fails to take into account. This phenomenon is called an "externality." Externalities can be positive or negative, depending on whether it is the benefits or the costs that are not taken into account, but this paper concentrates on the case of negative externalities. Examples are easy to come by: A factory that emits air pollutants imposes an externality on the downwind population, or more apt for our purposes is the case of an oil field in which the unfettered attempt by landowners to lift oil before their neighbors (under the "Rule

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Charles River Associates provided extensive expert testimony for the NFL. This paper is based on that testimony.

3. *See* Franklin M. Fisher, et al., *The Economics of Sports Leagues — the Chicago Bulls Case*, 10 Marq. Sports L.J. 1 (1999).

of Capture") leads to major cost increases for everyone and to a serious reduction in the amount of oil that can be economically recovered.[4]

Externalities can be handled by regulation or in other ways. In the case of oil fields, one such way is through unitization — a system in which the entire field is run as a unit. In that case, the externality ceases to exist as such; it becomes internalized, and the private profit and loss calculus of the single field operator appropriately accounts for the public cuts and benefits of his or her actions.

All of this is as relevant to understanding sports leagues as are the performance statistics of players.

3. The Product and Efficient Organization of a Sports League

It appears elementary that whatever product a sports league produces, that product cannot be produced by a single team. Why not?

While it is true that different squads of a single team could play each other, such intramural scrimmaging would lack the interest of a true sports event. Moreover, such scrimmaging, or even teams "barnstorming" outside a league structure, could not provide the interest that an entire NFL season does. An important ingredient in the success of the product is the genuine competition on the field of play and the assurance that fans perceive that competition to be genuine. One team alone cannot produce that. Even if a single team were to scrimmage itself, fans would perceive it to be an exhibition rather than a true contest. It would lack the essential component: genuine competition *on the playing field.* The economic value of a single NFL franchise is due to its membership in the League and derives from its joint participation in the production of the League's product. Even a small number of teams cannot produce the product that is produced by a sports league. That product is a series of games in the context of a league season. The elements of standings, play-offs, and championships are a very large part of what creates fan interest. Those elements require a league with a non-negligible number of teams.

To create and maintain interest in a league's product requires that fans perceive that the seasonal contest is a real one – a contest, so far as possible, among entities that truly compete on the sports field. Teams must be sufficiently independent to ensure that there is no limitation on their incentives to prevail on the field. This requirement stems from the

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4. *See* Eugene Rostow, A National Policy for the Oil Industry (1948).

same source as the fact that a league's product cannot be produced by a single team.

League sports thus demand a form of organization in which some local autonomy is both present and seen to be so. Moreover, there are other, subsidiary benefits from such a form. For example, local knowledge and local contacts are likely to prove very desirable in dealing with local authorities and local media. If such subsidiary reasons are all that is involved, a league might organize as a single entity with local profit centers. But the requirement of demonstratively independent incentives to prevail on the field rules that out. To preserve interest in the league's product, the teams must be seen to act independently in competing for players and for coaches and in competing on the field of play. The interests of the team owners in winning must be both genuine and made manifest in what they do.

As a result, successful leagues are typically organized with separate owners of teams and with certain decisions made at the local level. But not all decisions can be made at that level. Here is where the problem of externalities comes in.

4. Dealing with Externalities

When, in order to produce its product, a league organizes as a set of formally independent teams, it necessarily faces a problem of incentives. The requirement that teams be seen to operate independently must be balanced against the possibility that the incentives to such independent action will lead to results privately profitable for one or more teams but detrimental to the league, and its customers, as a whole.

This is an externality problem. It arises when the profit and loss calculus of particular teams do not fully take into account the costs and benefits to the league as a whole. Were leagues organized as centrally controlled operations, such problems would not exist; in effect, the externalities would be internalized as in the earlier oilfield example.

Many, if not all, of the regulations that leagues impose on their members address externalities. For example, the player draft, restrictions on player trades, the salary cap, and salary minimum rules are all ways of dealing with the externalities that would otherwise occur if teams were permitted to compete unencumbered for players. If individual teams had complete autonomy in the hiring of players, richer owners or owners in more profitable cities would have an incentive to buy up the best players. This would be in their own interest, but it could reduce competitive balance and not be in the interest of the league as a whole, whose interests are aligned with those of consumers. Restrictions on player mobility

in the context of a collective bargaining relationship (e.g., the draft and restrictions on player trades) benefit the League as well as the players by helping to ensure fans that every team can be competitive relative to the other teams. A salary cap attempts to ensure that all teams can afford to field competitive teams. A salary minimum prevents teams from selling off their players and taking the cash.[5] Naturally, a salary minimum is also useful in persuading the players to agree to the salary cap and to other restrictions on movements; it guarantees them a certain share of revenues. All of these rules help a league to produce a product better able to compete with other entertainment products.[6]

All of this points to the conclusion that it is a mistake to think of leagues as collections of economic competitors. Teams compete on the field but cooperate in producing a joint product. While teams compete on certain input markets, that competition is necessarily circumscribed where required in the interest of joint product production. That circumscription often involves externalities — situations in which the incentives of individual teams do not coincide with the procompetitive interests of the league as a whole.

In our earlier paper we examined a situation where the externalities involved television contracts and broadcasting. As we shall see in the present paper, the externality problem also occurs in the relocation incentives of teams and the rules designed to deal with relocation. We first turn to the facts of the relocation of the Rams to St. Louis and the litigation that followed.

5. Chronology of Events

Prior to the start of the 1996 NFL Football season, the Rams moved from Los Angeles to St. Louis to play in Exhibit Hall # 9 of the newly constructed St. Louis Convention and Visitor Center (CVC). St. Louis had committed to build the Convention Center before they had an NFL football team and construction of the stadium was well underway at the time of the city's negotiations with the Rams. In the course of those negotiations, the St. Louis CVC agreed that, should the Rams be assessed a relocation fee by the NFL, the CVC would pay up to a predetermined amount to the Rams as an offset. The Rams agreed, as a condition of receiving permission from the League to relocate to St. Louis, that the team would not sue the League. The St. Louis CVC ulti-

5. As did the Florida Marlins in baseball after winning the 1997 World Series.

6. See our discussion of how leagues deal with externalities with respect to the competition for players, Fisher, et al., *supra* note 3, at 6-8.

mately sued the NFL and all of its member teams (except the Rams), with its antitrust claims focused, among other things, on the relocation fee.[7]

The St. Louis CVC claimed that the NFL relocation policies had caused the city to receive "firesale" lease terms for its stadium or, equivalently, that the NFL's relocation policies had caused the city to greatly "overpay" to get the Rams. The CVC believed that these policies had prevented all of the other teams from negotiating with St. Louis. This belief had little factual basis, since the CVC failed to contact any other team beside the Rams regarding leasing its stadium. It seems more likely, however, that, to the extent that the CVC's lease terms were unfavorable, it was because the city, itself, had placed itself in a poor bargaining position by committing to build a stadium prior to arranging for an NFL tenant.

A brief chronology of the events that transpired prior to the suit is useful. In 1988, the Cardinals left St. Louis for Phoenix. This move occurred after the Cardinals' unsuccessful attempt to convince St. Louis to build a new stadium. St. Louis' disappointed fans also did not believe that Phoenix should be permitted to acquire "their" team.[8]

In response to the Cardinals departure, the City of St. Louis passed a referendum granting the city permission to float new bonds for the purpose of financing a new convention center. Construction began on the St. Louis Convention and Visitors Center in 1993. The CVC facility included a stadium suitable for football. It was hoped that the existence of the new facility would ensure that St. Louis would be selected as one of the two anticipated NFL expansion sites. In the late fall of 1993, Charlotte and Jacksonville were chosen. Lacking an NFL team, St. Louis contacted the Los Angeles Rams with the hope that it could convince the team to "abandon" its fans in Los Angeles and relocate to St. Louis.

On January 17, 1995, the Rams and St. Louis signed an agreement whereby the Rams agreed to relocate to St. Louis at terms very favorable to the Rams. Approximately two weeks later, the Rams notified the NFL of its intent to relocate. At the March 15, 1995 Special Meeting, the League voted to reject the Rams' initial relocation propo-

7. *See St. Louis Convention and Visitors Comm'n.*, 46 F.Supp. 2d at 1058.

8. Indeed, as early as 1985, in response to the Raiders move from Oakland to Los Angeles, Senator Thomas Eagleton, the senior senator from Missouri, and later a trial witness for the St. Louis CVC, sponsored Senate Bill S. 259. Professional Sports Community Protection Act of 1985, S. 259, 99th Cong. (1985). This bill's intent was "to protect the public interest in stable relationships among communities, professional sports teams and leagues." *Id.*

sal. The proposal offered no compensation to the League, either for the benefit to the Rams from the promotion and development efforts of the League and its teams in St. Louis or for the harm to the League and some of its teams from abandoning Los Angeles. The Rams' second proposal, which was approved on April 12, 1995, included several modifications, among these, a relocation fee.

The Rams moved to St. Louis and began playing the 1995/96 season in the St. Louis Convention & Visitor Center. Their record was a disappointing seven wins and nine losses.[9] Subsequently, the St. Louis CVC filed a $130 million lawsuit against the NFL.[10] Had the CVC won its claim, damages would have been trebled. Allegations included a Sherman Act Section I Conspiracy claim, a Section II Monopolization claim, and a tortious interference claim. With respect to the Section I claim, CVC alleged that the NFL Guidelines and Relocation Policies were illegal. According to the CVC, these guidelines and policies constituted a collusive action among twenty-nine separate firms (all of the NFL teams except the Rams). Plaintiff alleged that the purpose of the relocation guidelines and policies was to harm consumers by restricting output and thereby increase profits.[11]

In their Section II claim, plaintiff alleged that the NFL was a monopsonist in a "market for professional football stadiums" and that the NFL had used its power to extract illegal profits from the St. Louis CVC.[12] Finally, in its tortious interference claim, plaintiff alleged that the NFL used wrongful action to deny the plaintiff a business advantage in dealing with the League's thirty teams.[13]

These claims placed several economic issues before the court. One issue was whether, for the purposes of determining the legality of the NFL's relocation rules and regulations, the NFL should be viewed as a single entity, a joint venture, or as thirty separate competing firms. With respect to this particular issue, although plaintiff and defendants jointly stipulated that the NFL was a joint venture (and thus should be judged by a rule of reason standard), plaintiff still attempted to argue that the teams should be thought of as thirty separate, competing firms.[14] They alleged that the relocation rules and regulations constituted an output restriction and that the court should find the rules and regulations illegal,

9. Four years later, the St. Louis Rams went on to win the 1999/2000 Super Bowl.
10. *See St. Louis Convention & Visitors Comm'n*, 46 F.Supp. 2d at 1058.
11. *St. Louis Convention & Visitors Comm'n*, 154 F.3d at 855-57.
12. *Id.* at 856.
13. *See id.*
14. The NFL also preserved its position that the League was a single entity.

per se. In fact, as Judge Jean Hamilton stated, the *Raiders I* court had previously addressed this question and found that the relocation rules and regulations, in and of themselves, were not illegal, *per se*.[15] Rather, the *Raiders I* decision had found that relocations should be judged under a rule of reason standard.[16]

A second economic issue was whether or not the NFL had monopoly power in any relevant marketplace. Plaintiff's liability expert defined two relevant product markets: a market for professional football stadiums and a market for NFL football.[17] Defendants argued that neither alleged market constituted a relevant market for antitrust purposes since both alleged markets excluded other products that constrained the exercise of any alleged monopoly power.[18]

The final issue before the court was whether the NFL restricted, in any way, the NFL teams with whom the city of St. Louis might speak. This was a factual question, and the court found no evidence that the NFL did this, although the plaintiff alleged that such a restriction was an inevitable effect of the league's relocation rules.[19]

Trial began on October 6, 1997. Among the witnesses called by the plaintiff was former Senator Thomas Eagleton who testified that the NFL's relocation policies harmed cities and fans. This testimony was in direct contradiction to the justification for Senate Bill S. 259, sponsored in 1985 by Senator Eagleton, himself. As Senator Eagleton noted in the bill he had sponsored, the intent of the bill was "to protect the public interest in stable relationships among communities, professional sports teams and leagues."[20] Much of the language in Senate Bill S. 259 is vir-

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15. Los Angeles Mem'l Coliseum v. NFL, 726 F.2d 1381 (9th Cir. 1984).

16. Similarly, Judge Easterbrook stated that the "NBA is sufficiently integrated that its superstation rules may not be condemned without analysis under the full Rule of Reason." Chicago Professional Sports Ltd. Partnership v. National Basketball Ass'n, 95 F.3d 593, 600 (7th Cir. 1996). Judge Easterbrook further noted that for plaintiff to prevail, they must establish "that the NBA possesses power in a relevant market, and that its exercise of this power has injured consumers." *Id.*

In the CVC case, had the parties not stipulated that the NFL was a joint venture, the court might have been asked to determine whether, for these purposes, the NFL should be viewed as a single entity. Were the NFL determined to be a single entity, for these purposes, a Section I claim would make no sense, as a single firm cannot conspire with itself.

17. Plaintiff's Complaint alleged only one monopoly market, a market for NFL quality stadiums. As such, it is unclear why plaintiff's expert alleged that both the output market and input market were at issue. We address both in order to respond to the allegations of the CVC's expert witness.

18. *Id.*

19. *St. Louis Convention & Visitors Comm'n*, 154 F.3d at 851-855.

20. Professional Sports Community Protection Act of 1985, S. 259, 99th Cong., (1985).

tually identical to the language in the NFL's Relocation Guidelines which the St. Louis Convention and Visitors Commission (CVC) was challenging, as it existed at the time of the trial and continues to exist today.[21]

At the close of the plaintiffs' case, Judge Hamilton dismissed both the Section II monopolization claim and the tortious interference claim and expressed severe misgivings about the rest of plaintiff's case.[22] At the close of the defendants' case, Judge Hamilton dismissed the Section 1 count of the case and directed a verdict in favor of the NFL.[23] That judgment was affirmed by the Eighth Circuit in the fall of 1998.[24]

6. The Nature of the NFL Product

We show below that the NFL competes against other forms of entertainment, and that television viewing is particularly important in that competition. Regardless of the extent of that competition, however, the NFL has a legitimate interest in the quality (measured by consumer appeal) of its own product. We therefore begin with a discussion of that product and the ways in which quality is maintained.

The NFL produces NFL football. That product consists of a series of professional football games played by the thirty-one NFL teams over the course of an NFL season. The season culminates with the Super Bowl where the champions of the American and National Football Conferences play one another to determine the ultimate champion. The season ends with the NFL's Pro-Bowl, featuring the best players in the League.

As we mentioned above, the League's product must be produced by the League as a whole. The NFL as a whole works to ensure that the quality of NFL football generates fan interest. To this end, the NFL works to attract the highest quality football players and to arrange for an organized and efficient method for the even distribution of these players to all of the NFL teams. Relative competitive balance is a critical component to the NFL's (or any league's) popularity. Fans must believe that their team is a potential champion — i.e., that their team has a reasonable opportunity to win each game and also to compete for the championship. Team standings, winning streaks, rivalries, playoffs, championships, and the like also are a very important part of what

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21. *See* National Football League, *NFL Constitution and Bylaws*, § 4.3 (1984).

22. St. Louis Convention & Visitors Comm'n v. NFL, 1997 U.S. Dist. LEXIS 23499 (E.D. Mo 1997).

23. *Id.*

24. *St. Louis Convention and Visitors Comm'n*, 154 F.3d at 851.

makes NFL football such a successful entertainment product. Among the various methods the NFL has established to achieve its goal of reasonable competitive balance among the member teams is revenue sharing. For example, the NFL negotiates national television contracts on behalf of all of the member teams, with revenues shared equally among all of the teams. In this way, all NFL member teams have the resources to field a competitive team. The NFL has been successful in maintaining competitive balance. For example, between 1980 and 1995, for all but two seasons, over forty percent of the NFL regular season games were decided by seven points or less.[25] Moreover, during that same period typically around two thirds of the NFL teams were still in Super Bowl contention with only three weeks remaining in the season.[26] For most years more than half of the teams were still in contention with only two weeks remaining.[27] And, in every season, some playoff berths were not filled until the last week of the season.[28] Yet another indication of the evenness of NFL play is that approximately half the time, at least one team that finished in last place in its division in one season finished in first place in the following season.[29]

7. Principles of Market Definition

We now consider the question of the output market on which the NFL product competes. (In a later section, we take up the question of the input market — the market that includes the leasing of stadiums.) We begin with reviewing the basic principles of market definition.

The question "What is *the* market?" is not a well-defined one in economic analysis outside antitrust. As used in antitrust analysis, its answer consists of considering the products and producers that constrain any attempt to exercise alleged monopoly power (by a seller), defined as the power to charge supranormal prices by restricting output or output quality. When the market is defined too narrowly, there is a tendency to overstate monopoly power; when the market is defined too broadly, there is a tendency to understate monopoly power. In defining a market, therefore, one must be careful to identify those factors that, in fact, serve to constrain the power of the entity or group of entities being consid-

25. *See* The Official National Football League 1996 Record & Fact Book 251 (1996).
26. *See id.*
27. *See id.*
28. *See id.* at 239.
29. The rise of the St. Louis Rams to win the Super Bowl in 2000 is itself an example of the evenness of play.

ered.[30] Too narrow a market definition makes conclusions based on market share meaningless.

One type of constraint that limits or eliminates monopoly power is demand substitutability — the alternatives available to buyers. These alternatives operate in the following manner: Suppose the company or group of companies being examined attempted to raise prices above competitive levels and earn excess profits. They could not profitably raise prices if buyers could readily substitute the products of other companies.

A second type of constraint that can serve to constrain or eliminate monopoly power is supply substitutability — the ability of suppliers who do not currently make demand-substitutable products to enter quickly and make such products in the event of an attempt by the alleged monopolist to charge supranormal prices. Obviously, supply substitutability differs from ease of entry in degree rather than in kind.

When defining a market and considering monopoly power, one must be careful in analyzing product differentiation and differences in quality. Markets which include products that differ in aspects other than price are called *differentiated-product* markets to highlight the fact that even though the products are not exactly the same, they still compete against each other for consumers' time and dollars. Prices in differentiated-product markets say nothing about monopoly unless differences in quality levels have been accounted for. For example, suppose that a Chrysler Jeep Grand Cherokee costs more than a Ford Explorer, but the Jeep has lots of features that the Ford is missing. If that is the case, then it would be a mistake to conclude on this basis that the higher price of the Jeep necessarily reflects monopoly power.

The point here is that the ability to charge a high price can be the reward for producing a high-quality product that is attractive to consumers. This ability is not monopoly power. Monopoly power in an output market involves the ability to charge high prices *without* offering superior products. It involves the power to charge high prices by restricting output, not by offering what, in terms of enhanced quality, is a larger output than would be the case if a lower quality product were offered.

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30. This is consistent with the approach of the Department of Justice and Federal Trade Commission *Horizontal Merger Guidelines*, which define a market in terms of the smallest collection of companies that could (if acting together) profitably raise prices significantly for a non-negligible period of time (U.S. DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, *Horizontal Merger Guidelines* (1992)).