

# 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).<sup>1</sup> 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.<sup>2</sup>

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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.<sup>3</sup>

## 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.<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup>

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-

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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.<sup>7</sup>

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.<sup>8</sup>

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-

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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.<sup>9</sup> Subsequently, the St. Louis CVC filed a \$130 million lawsuit against the NFL.<sup>10</sup> 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.<sup>11</sup>

In their Section II claim, plaintiff alleged that the NFL was a monopolist in a "market for professional football stadiums" and that the NFL had used its power to extract illegal profits from the St. Louis CVC.<sup>12</sup> 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.<sup>13</sup>

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.<sup>14</sup> They alleged that the relocation rules and regulations constituted an output restriction and that the court should find the rules and regulations illegal,

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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*.<sup>15</sup> Rather, the *Raiders I* decision had found that relocations should be judged under a rule of reason standard.<sup>16</sup>

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.<sup>17</sup> 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.<sup>18</sup>

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.<sup>19</sup>

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."<sup>20</sup> 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 (9<sup>th</sup> 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 (7<sup>th</sup> 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, 99<sup>th</sup> 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.<sup>21</sup>

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.<sup>22</sup> 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.<sup>23</sup> That judgment was affirmed by the Eighth Circuit in the fall of 1998.<sup>24</sup>

## 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.<sup>25</sup> 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.<sup>26</sup> For most years more than half of the teams were still in contention with only two weeks remaining.<sup>27</sup> And, in every season, some playoff berths were not filled until the last week of the season.<sup>28</sup> 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.<sup>29</sup>

#### 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-

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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.<sup>30</sup> 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)).

## 8. THE RELEVANT OUTPUT MARKET

The product, NFL football is sold in two ways. It is sold to fans attending games in person (this includes the "gate" and other stadium revenues), and it is sold for exhibition on television. The latter sale is a very important one: In 1994, average media revenues were nearly twice that of gate and stadium revenues.<sup>31</sup> In both types of sale, the NFL competes with many other entertainment products. The products in this entertainment market are not all the same. Rather, they have different characteristics and quality levels. The market is a differentiated-product market.

Consumers of NFL football have many ways to spend their leisure time; they do not have to watch an NFL football game. For instance, a television viewer may elect to watch professional basketball, hockey, baseball, or NCAA football or basketball or attend a concert, see a movie, etcetera. Attendees at games also have a variety of choices as to how to spend their time. Indeed, when NFL fans were asked what they did in their spare time, they indicated that they participate in a vast array of leisure activities.<sup>32</sup> The NFL competes with these other forms of entertainment for the attention of consumers.

The relevant output market must therefore be considered as the national market for entertainment products. The League competes in this market by offering its product, a season of NFL football, for live consumption and national media telecasts and radio broadcasts. The League has no monopoly power in this differentiated-product market, and must compete aggressively to be successful. The League's control of its product is critical for that product's success in the highly competitive output market in which it competes.

That competition is especially strong in regard to television licensing. When considering issues involving the production and sale of television programming, it is important to recognize that the vast majority of television programming is advertiser-supported. This means that advertisers, not viewers are the buyers of television programming. Advertisers purchase time during NFL telecasts in an effort to reach customers who might be interested in buying their product. The value of NFL programming reflects its *demographics*, *reach*, and *cachet* value for advertisers. Advertisers choose to advertise on the NFL because they believe that viewers who see their advertisements on the NFL football programs may be convinced to buy their products. But these same advertisers recog-

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31. See *Suite Deals*, FIN. WORLD, May 9, 1995, at 50.

32. Interviews were conducted by ESPN Chilton.

nize that there are many other programs available on which they can attempt to attract potential customers.

While the NFL is good at attracting audiences with a significant amount of male viewers (particularly, those aged 18-49), many other television programs (including other sports programs, news and prime-time programming) also reach audiences with similar demographics. Each of these programs competes with NFL telecasts for advertising revenues and constrains the NFL from being able to raise its price above the competitive level. Were the NFL to attempt to do so, its advertisers would stop purchasing NFL spots and would instead purchase advertising spots on these other programs.<sup>33</sup>

In the absence of monopoly power, there is no anticompetitive reason to restrict output. In any event, the NFL does not restrict output in this market. To the contrary, all NFL games are televised. Further, there is a history of product innovation, including, for example, the development of *Monday Night Football* or Sunday night cable packages, to raise product quality and enable the NFL to compete more effectively in the output market.

As we shall see below, the NFL's relocation procedure assists this competition. We note, however, that even if such competition were more restricted, the League would still have a legitimate interest in sustaining the quality of its own product. We now consider the League's interests and actions in doing just that.

#### 9. THE NFL HAS A PROCOMPETITIVE INTEREST IN THE NUMBER OF ITS TEAMS<sup>34</sup>

The expansion of the NFL into new locations involves obvious risks that must be considered by the League along with any analysis of potential benefits.

The economic viability of a new team in an untested location is uncertain. The League must decide whether a community has the ability and the commitment to support an NFL team.

The financial impact of expansion must be assessed taking into account that the new team will share in and contribute to NFL revenues that are shared League-wide.

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33. For a more extensive analysis of this point, see Fisher, et al., *supra* note 3.

34. Although the plaintiff in the St. Louis CVC matter alleged only that the relocation rules and regulations were anticompetitive, their economic expert also raised the issue whether the League's expansion policy might also violate the antitrust laws.

The quality of the product may also be put at risk by unlimited expansion. For example, in order to ensure that a new team will be competitive on the field, the League organizes an "expansion draft" – a system of player selection where the expansion team is allowed to select veteran players from other clubs' rosters. Unlimited expansion might well cause the quality of the product to deteriorate, to the detriment of consumers as well as the League. While the NFL's success can increase in the long run if the expansion leads to more interest in the game and the development of more players in the future, the League must balance this possible long-term benefit against the potential short-term dilution of player quality.

Currently, the NFL reaches 100% of television households in the United States and every NFL game is televised. In deciding whether to expand, the League must evaluate whether expansion will benefit viewers and increase the value of NFL programming to NFL advertisers (who are the buyers of the televised product and reflect the interests of those viewers).

In thinking about these matters, so far as the output market is concerned, the League can have no anticompetitive interest in preventing expansion to new locations.<sup>35</sup> The League's interest here coincides with that of consumers making it the best judge of such matters.

#### 10. THE NFL HAS A PROCOMPETITIVE INTEREST IN THE LOCATION OF ITS TEAMS

The NFL also has a procompetitive interest in where its teams are located. The financial success of the League is dependent on developing and retaining fan interest. This, in turn, is dependent on maintaining geographic diversity and franchise stability.

Geographic diversity reflects the national nature of the product, with live games being played *throughout* the country. Because the success of the League depends on fan interest, the League attempts to ensure, to the extent it makes economic sense, that large population bases have access to live NFL football. Moreover, as avid fans are found throughout the country, the League attempts to ensure that teams are spread out

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35. It is possible to construct a case in which League interests and consumer interests do not coincide when what is being considered is expansion into a city that already has a team. Even there, one has to stretch pretty far to obtain such a result.

throughout the country.<sup>36</sup> If all of the teams were to move to the Northeast, for example, fans outside that region would eventually lose interest.

Geographic diversity is also important in competing with other television programming for the patronage of the television networks such as ABC, CBS, FOX, NBC, ESPN, and TNT. The NFL sells national television rights to telecast all NFL regular season and post season games. These rights are a vital source of revenue for the League and its member teams. If NFL franchises were concentrated only in particular regions of the country, national networks would be far less interested in telecasting NFL games.

But the maintenance of geographic diversity is related to the maintenance of competitive balance. The maintenance of geographic diversity requires that the League adopt ways of sharing revenue, and this is done most importantly with revenue from television. If no action were taken by the League, the more profitable franchises would be able to spend more money on players and coaches than could the less profitable ones. This would lead to a decline in competitive balance and to fan interest.

The NFL's interest in the location of its teams, however, extends beyond geographic diversity. In generating and maintaining fan interest, the NFL also is necessarily committed to franchise stability and the fan loyalty that franchise stability encourages and rewards. The League has been subjected to tremendous nationwide criticism from its fans whenever a team has relocated. The NFL's commitment to franchise stability is reflected in the League's history. Of the thirty teams in the League when the Rams relocated, twenty had been in the same metropolitan area since they were established.<sup>37</sup> When the Cleveland Browns moved to Baltimore in 1996 and became the Baltimore Ravens, the League's retention of the Browns name together with its commitment (now fulfilled) to placing a team in Cleveland (complete with the traditional Browns team name and logo) underscored the value that the League places on franchise stability and fan loyalty.

Franchise stability protects the identification of a particular team with a particular city and its fans. For example, the City of Pittsburgh is identified with the development of the steel industry. It is doubtful that the "Steelers" would have the same degree of identification with any

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36. According to a study conducted on behalf of the NFL, both NFL fans, in general, and avid NFL fans, in particular, can be found in nearly the same distribution throughout the US as the population as a whole.

37. In contrast, during the short life of the USFL, which failed, there were a very large number of team relocations.

other city. Similarly, the 1849 "Gold Rush" occurred in San Francisco; Houston, not Nashville, is best known for its oil industry; the "Patriots" are historically associated with New England; and the meat packers of Green Bay will always lay claim to the "Packers." Changing team names is not sufficient to address this problem because once a team changes its name (e.g., Browns/Ravens), it takes on a new identity. As a result, the value created by the years of investment by the individual team, the city, and the League as a whole is significantly diminished.

Franchise stability also protects rivalries, which are important to fan interest and fan loyalty. Rivalries such as Pittsburgh versus Cleveland or the Cowboys versus the Redskins do not develop overnight; they are the result of many years of intense competition, fan dedication, and substantial marketing investment by both the teams and the League. Because team rivalries are grounded not only in the traditions of the specific teams, but also in the particular cities and fans, there is a significant chance that rivalries will not continue or renew after a relocation. Relocations therefore can destroy rivalries, undermining fan interest and causing harm to the League as a whole. Note that, while a relocating team that is one half of a rivalry will take account of the effect of rivalry destruction on itself when deciding whether to move, it will not take adequate account of the similar effect on its rival team.

Franchise stability also protects existing investments, and encourages future investments by cities, states, and local businesses that support an NFL franchise. While local governments and business typically negotiate long term contracts to help minimize their exposure to the risk of franchise relocation, they have been unable to eliminate all of this risk. The willingness of cities, states, and local businesses, such as the CVC, to invest in NFL football is influenced by the stability of NFL franchises. Hence rules that promote franchise stability assist the League by providing local governments and businesses with additional security when they invest in stadiums or other League-assisting activities.

#### 11. EXTERNALITIES AND FREE RIDING IN TEAM RELOCATION

The matter of team location is one in which the interests of the League and the interests of particular members will often not coincide. Indeed, this is an area in which externalities are likely to come into play.

To see this, observe that a team considering relocating from City A to City B will be interested in the relative extent of fan interest in the two cities, the related question of the relative support it can expect from public authorities and private businesses, and, of course, in the relative terms on which it can acquire or lease stadium facilities. But, while these mat-

ters will also be of interest to the League, there are other League interests that will not be fully reflected in the individual team's considerations. These are the interests of geographical diversity and franchise stability examined above.

When a team considers moving from A to B, it will not fully take into account the effect that such a move has on the geographic diversity of the League. In the most immediate sense, the move may create scheduling difficulties for the League and, more important, leave a major television market without a franchise (as happened in Los Angeles when the Raiders and Rams both departed in the middle 1990s.) In the longer run, a policy of permitting teams to relocate freely can have adverse impacts on the geographic distribution of teams and this, in turn, can affect fan interest and national television revenue. While each moving team may consider the effects of its move on its own share of such revenue, it will not take into account the effects on the shares of the other members of the League.

The same sort of phenomenon is even more marked in the case of franchise stability. We have already remarked that a team that makes up half of a traditional rivalry will consider only the effects of the loss of such a rivalry on itself in deciding to move; it will not consider the effects on the rival left behind. More generally, a policy of free team movement will lead to a situation in which fan interest drops and fans and local authorities and businesses feel insecure. A particular moving team will not care about this effect on the League generally, but only care about the effect on itself.

Beyond such considerations, however, there is another phenomenon (that can be characterized as a kind of externality) involved in team movements made solely in the interests of the moving team. This is the phenomenon of "free-riding." Free-riding occurs when one party takes actions that benefit another without being able to charge for such benefits. Since the incentives for action will not take account of such effects, the result will be inefficient. In effect, unless one gets paid, who will care to sow where another will reap?

In the context of a sports league such as the NFL, free-riding occurs when a team benefits disproportionately from the actions of the League and its member teams, without compensating the League and the other teams for those actions. Free-riding leads to inefficient outcomes because the League and its member teams will not have the appropriate incentives to invest in the promotion and development of the product if a particular team alone is allowed disproportionately to capture the ben-

efits from those efforts. Untreated, free-riding leads to economically undesirable, or *inefficient*, outcomes.<sup>38</sup>

An important example of free-riding arises in team relocation and was illustrated by the St. Louis case. The value of the Rams in St. Louis was created by the promotion and development efforts of the League, not by the Rams. Indeed, the demand in St. Louis was for NFL football, not for the Rams' franchise specifically. Unless the League and its other member teams were appropriately compensated for its efforts to develop that demand, which was reflected in the extraordinary deal that the Rams were offered to move, the Rams would have enjoyed a free-ride, and an inefficient outcome would have resulted. The incentives of the League and its teams to improve its product would be reduced if one of the teams could simply take advantage of such efforts by moving to a city where fan interest was great.

To sum up, in the absence of League relocation rules and regulations, an NFL team owner will have an incentive to move the franchise whenever the citizens of one city will pay more for that franchise than the citizens in the incumbent city. The League also is interested in that phenomenon, but the interests of the League involve other phenomena that the moving team will not take into account. Because those phenomena involve the creation and maintenance of fan interest in the League's product, taking account of them is pro- rather than anticompetitive. It is the League's interest in its product and not the moving team's interests that coincide with those of consumers in general. A policy of permitting a team to relocate whenever it is in its private interest to do so will thus neither be efficient for the League as a whole nor procompetitive, since the League's interests stem from those of the fans and the maintenance of their interest.

Note, in this regard that, with respect to relocations to cities that have no team (such as St. Louis before the arrival of the Rams), the interests of consumers and the League are necessarily aligned, provided the benefits of the relocation are appropriately shared to avoid free-riding. In particular, the League can have no anti-competitive output-restricting interest in preventing such a move. Games in St. Louis cannot materially affect ticket prices in other NFL cities. The number of nation-

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38. Examples of free-riding are plentiful in sports leagues, and include competition for players, national telecasts of games, and franchise relocations. Leagues attempt to reduce the inefficiencies that would otherwise result from free-riding by establishing various rules. It has not been unusual for individual teams, who are prevented from free-riding off the efforts of others, to sue on antitrust grounds.

ally telecast games does not depend on the location of the teams. If a move makes the NFL more attractive to consumers taken as a whole, then it will be in the League's interest to permit it — again providing that a reasonable portion of the gain from the move can be appropriately shared.

A Rule-of-Reason analysis of a league's relocation rules should therefore be an analysis of whether those rules are reasonably designed to prevent the externality and free-riding effects described above. To such an analysis in the case of the NFL, we now turn.

## 12. ANALYZING THE NFL'S RELOCATION RULES AND PROCEDURES

The principal features of the NFL's relocation procedures are as follows. A team that wishes to relocate from A to B must make an application to that effect. Among other things, the application must cover issues of expected profitability in both cities, as well as fan support and the attitude of municipal authorities. The team must also cover the question of the adequacy of the actual and proposed stadiums and the terms of the leases. The team is not limited to the matters listed by the League, but may discuss any other issues that it deems relevant to its case.

The team's application is submitted to the Commissioner who then issues a report to the League's Board. As with other major decisions, a vote to permit relocation outside a team's home territory requires a supermajority of three quarters to pass. The League can, and often does require the team to pay a relocation fee as a condition of the League's approval.

In the case of the Rams application, the Commissioner's initial report raised a number of concerns regarding the various ways that the League, as a whole, might be affected by the proposed relocation. These issues included the potential impact on television viewers of the departure of an NFL franchise from the country's second largest television city (and the loss of one of only two west-coast NFC franchises), the possible disruption to the competitive balance among teams, and the League's right to earn the profits associated with its past efforts to develop that product - the free riding issue. When it came time for the vote, the Rams' initial relocation proposal was rejected. A modified proposal, including, among other things, an indemnity provision and a relocation fee of \$29 million, was approved.

We now show that the ability to charge such a fee, together with the super-majority rule, is in fact a crucial feature of solving the externality and free-riding problems.

As we have seen, the relocation of an NFL team can have negative effects on the League as a whole or on particular team members. In addition, the taking up of a profitable opportunity can be a free-riding effect in which the relocating team preempts for itself an opportunity created by collective action. But, if the move is profitable for the League taken as a whole — and this can only happen if it is procompetitive and hence in the interests of consumers generally — then the move should be permitted. In such a case, there must exist a way to share the benefits brought about by the move so that no League members lose and some gain (the move then represents what economists call a “Pareto-improvement”). That sharing is accomplished largely or completely by means of the relocation fee which thus serves both to offset the harms done by the move and to ensure that free-riding is no longer free but is appropriately priced. (In this connection, it is interesting to note that the League assessed no relocation fee when the Raiders re-relocated to Oakland after the Rams had moved to St. Louis. The League took the view that the Raiders should never have left Oakland in the first instance. One interpretation of this is that a portion of the value of the Oakland market opportunity had been created by the Raiders themselves).

The supermajority rule plays an important role here. When a team relocates, the effects on the other teams are not uniform. In the case of a dissolution of a traditional rivalry, for example, there will be an important special negative effect on the traditional rival who is left behind. Less dramatically, there can be scheduling problems that affect teams in one region more than in others. On the other hand, a team moving to a new location with a larger stadium or the ability to charge higher ticket prices may partly benefit those teams who play at the new location often and thus share in the gate.

Interestingly, the NFL's agreements with the players as to salaries requires that a minimum percentage of certain League revenues flow to the players. When a team moves and total revenues rise, all teams will be obligated to raise salaries by the same percentage, even though the increase in revenues is not evenly spread among them. Evidently, the relocation fee is a way of compensating teams for this as well as other disparities.

But, if relocations could be approved by a simple majority, then some moves might be approved that would not be in the interests of the League as a whole. To see this, observe that, because moves have different effects on different teams, there might be a simple majority of teams only relatively slightly injured by the move. Such teams would feel the

move to be in their interests at a relatively low relocation fee (and a formula for sharing that fee), even though some other teams might be very seriously negatively affected. Then a simple majority vote would approve the move even though, taking everything together, the collectivity of teams lost by it.

On the other hand, requiring unanimity would surely not work, serving to prevent moves that are in the interests of the League as a whole from taking place. If for no other reason, this could happen through hold-up behavior where a particular team or teams would attempt to gain too large a piece of the relocation-generated pie by threatening to withhold their votes.

While there is no way to know that requiring a three-quarters supermajority is the efficient answer to such problems, the correct requirement surely lies between a simple majority and complete unanimity. The NFL's relocation rules and procedures therefore act to control the externality and free-riding problems and permit those moves that are in the procompetitive interests of the League.

In the case of the move of the Rams, the League's system worked well. The operation of the relocation rules and regulations (including a provision for a relocation fee) led to a move that benefited the Rams, the League as a whole, the CVC, and consumers.<sup>39</sup> The fact that the Rams gained was reflected in their willingness to compensate the league for the impact of the move. The fact that the League gained was reflected in the affirmative vote. The fact that the CVC gained was reflected by its willingness to pay for the Rams.

It is important to note that the outcome which was in the consumers' best interest was achieved in this matter: the Rams moved to St. Louis and compensated the League for free-riding and harming other teams. The relocation rules did not prevent this from happening. Indeed, it is precisely because those rules worked that a mutually beneficial outcome was achieved. Output did not decrease as a result of the move. Rather, quality-adjusted output increased with the move. This happened because, as we have seen, the League's interests in such matters are to attract consumers in its competition on the output market. The move and the operation of the relocation rules and regulations were procompetitive in that regard.

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39. In thinking about the expected costs and benefits of a particular move, the League would include in its consideration any potential litigation costs it anticipated that it might incur as a result of a vote to prohibit the move.

13. COMPETITION FOR INPUTS — IS THERE A “MARKET” FOR NFL FOOTBALL STADIUMS?

While the analysis of the previous section presents our main conclusion, it does not exhaust the issues that must be discussed. This is because of the plaintiff's claim that the NFL's relocation rules and procedures suppressed competition for the leasing (or purchasing) of stadiums. In particular, the St. Louis CVC claimed to be damaged because of the unfavorable terms it obtained in its negotiations with the Rams.

In effect, the plaintiff claimed that the League created and exercised monopsony power (monopoly power as a buyer) in an input market — the supposed “market for stadiums meeting NFL requirements.” To analyze this claim requires first consideration of the appropriate market definition involved. We saw above that market definition in the case of the alleged exercise of monopoly power by one or more sellers requires considering what constrains that power — consideration of the alternatives to which buyers can turn and that other suppliers can quickly provide. In the case of the alleged exercise of *monopsony* power, market definition requires considering what constrains that power — consideration of the alternatives to which *sellers* can turn and that other *buyers* can easily provide.

To begin such an analysis in the present case, one must ask what it is that the owners of football stadiums are actually selling. It is too narrow an answer to this question to look only at the situation after a stadium has been built and negotiations with a particular team are underway. In thinking about this question, it is useful to distinguish private builders of stadiums and public authorities.

Private builders of stadiums are not in a narrowly-defined business of providing only stadiums to NFL teams. Rather they are in the business of large-scale real estate development. Similarly, public authorities building or assisting with football stadiums are not in a narrowly-defined business of attracting NFL teams. Rather they are in the business of making their cities attractive to individuals and businesses, with NFL football only one way of accomplishing this.

Hence, the relevant input market here includes both large-scale private investments in real estate development and public investments designed to make cities attractive. While this includes *existing* and *potential* facilities suitable for a number of activities of which the exhibition of football is one, it also includes other large development projects in which public and/or private developers may invest (for example, The Arch, representing St. Louis as the Gateway to the West, and other local

public goods in which cities may invest such as museums, parks, hospitals, or public schools).

In examining competition in this input market, it is useful to divide the analysis according to whether the facility (the product of the investment) has already been constructed. This simplifies the analysis but in no way implies that there are separate markets for existing and potential facilities.

#### *A. Potential Facilities*

Since both private investment funds and city funds have many alternative uses, the NFL can have no monopsony power over facilities suitable for exhibiting professional football that have not yet been constructed. Stadium investors, both communities and private parties, have a large number of attractive alternative investment opportunities. Stadiums do not offer investors any economic investment return not easily obtained elsewhere.

Focusing on the case of the St. Louis CVC, St. Louis did not have to build the convention center-stadium complex. It could have built the convention facility without the stadium, or it could have devoted its resources to other investments. Municipalities provide a wide array of services to their citizens, and face a number of options when investing in public goods. On an ongoing basis, they must decide how to allocate their budgets between competing projects such as schools, fire and police protection, libraries, trash collection, recreation, and stadiums.

Of course, potential facilities have a negotiating advantage that existing facilities do not have when negotiating lease agreements. In particular, long-term contracting prior to a facility's construction protects all sides given a stadium's large up-front costs and relatively small operating costs.

#### *B. Existing Facilities*

The analysis of existing facilities is more complex because some of these facilities are occupied by teams and some are not. The NFL's relocation rules may provide the owners of occupied stadiums with bargaining leverage over their home teams, since the rules hamper the ability of the teams to move. The plaintiff argued, however, that the rules provide moving teams (in particular, the Rams) with bargaining leverage over empty new facilities and that this was deliberately attained monopsony power. They argued further that the fact that the NFL requires stadiums to meet a number of specialized requirements narrowed the market to NFL-standard stadiums.

Such an argument is confused. If we were considering the alleged monopoly power of a stadium *seller*, then the fact that the NFL has special requirements might be relevant, for it would limit the alternatives available to the buyer. But we are here considering the alleged monopsony power of the NFL as a *buyer*. The fact that it has special requirements does not limit the alternatives available to sellers.

This can be described with the following analogy. Suppose that there is a maker of address labels who, without prior agreement, were to print address labels with a specific name and address on them. Those address labels would meet special requirements, but would be essentially useless to anyone but the addressee. Having printed the labels, the maker could not then reasonably claim that the addressee had monopsony power because he or she had insisted on labels with a specific name and address.

So it was with the St. Louis CVC. Any negotiating leverage possessed by the Rams was created when the St. Louis parties committed the funds to construct and began building the Trans World Dome facility. By deciding to build the stadium facility prior to signing long-term leases with potential occupants, the CVC placed itself in a far weaker negotiating position than would have been the case had the CVC first negotiated long-term leases. This had nothing to do with the Rams or the NFL, or whether or not the League has monopsony power.

Further, with respect to the effects of the NFL's relocation rules and procedures, those rules and procedures do not prevent stadium operators from talking with more than one potentially relocating NFL team (nor do they prevent an NFL team from talking with more than one stadium operator). There simply is no League prohibition against simultaneous bidding by teams for stadiums. Indeed, prior to the move by the Browns, a number of NFL teams discussed with Baltimore the possibility of relocating to that city.

The CVC also could have solicited bids from other parties, but it apparently chose not to do so. Whether that choice was a matter of the negotiations between the CVC and the Rams or a decision by the CVC not to risk losing the Rams to another city, the fact remains that the choice was not imposed by the NFL's relocation rules and regulations.<sup>40</sup>

Existing facilities face what is commonly known as a *bilateral monopoly* situation when negotiating leases with a single NFL team. This is a

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40. Evidence presented at trial showed that the St. Louis CVC believed the representative of the Rams when he told them that if they simultaneously negotiated with other teams, the club would terminate its negotiations with St. Louis. The St. Louis CVC never tested this claim by calling another team after starting negotiations with the Rams.

bargaining situation in which both sides have the ability to influence the terms of the agreements.<sup>41</sup> In the course of negotiations under such circumstances, the two sides must determine how to divide the various revenues and costs associated with operating the facility and exhibiting NFL games there. In such a situation, both parties have an interest in achieving the economically desirable (efficient) outcome. Where they differ is as to how the surplus from doing so is to be distributed.

No output reduction and no economic inefficiencies resulted from the negotiated agreement between the St. Louis Rams and the St. Louis CVC. While the St. Louis CVC would doubtless have preferred a more favorable outcome, their failure to obtain one was of their own doing. There was no evidence that any other NFL team ever considered moving to St. Louis and none that such consideration was prevented by the NFL's relocation rules and procedures.

Even had this not been the case, it would have been wrong to conclude that those rules and procedures were anticompetitive. As we have seen, those rules and procedures are procompetitive in that they assist the production of a consumer-desired product on the output market. The accompanying effects on the input market may shift power in certain bargaining situations, but the shifts go both ways. In any case, even though from the viewpoint of a nail the entire enterprise of building a house is a conspiracy to hit it with a hammer, public policy must take a wider view.

#### 14. SUMMARY OF CONCLUSIONS

We summarize our principal conclusions as follows:

1. It is a mistake to consider the teams of a league as economic competitors in the output market. They compete on the field but necessarily cooperate in producing a joint product.
2. Whether one considers a league as a single entity or a joint venture, the economic and antitrust analysis of franchise relocation issues should be the same. For good reasons, leagues are organized in such a way as to encourage local autonomy, but this, in turn, raises problems of externalities and free-rid-

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41. Alternative uses of the stadium/convention center increased the bargaining position of the CVC with respect to its negotiations with the Rams. Alternative uses, such as conventions, also provide significant benefits to the community as a whole, including increased hotel and restaurant business. In fact, some have suggested that the benefits to St. Louis from alternative facility uses exceed the benefits from NFL football games.

ing where team incentives and the procompetitive interests of the league as a whole are not aligned.

3. Team relocation is an area where such problems arise in several ways. The NFL's relocation rules and procedures deal with such issues sensibly, with the relocation fee playing a central role. They work to ensure that moves will take place if and only if they are in the interest of the League as a whole, and those interests are procompetitive, coinciding with the interests of consumers as a whole.
4. There will sometimes be ancillary effects on competition for inputs. In the case of the NFL's relocation rules and regulations and the competition for stadiums, however, the relevant market far exceeds NFL-suitable football stadiums themselves, and the ancillary effects, if any, of the relocation rules and regulations at most merely shift bargaining power.