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Introduction

Running a League

It was November 2, 2004. The day that George W. Bush was elected to his second term as U.S. president, and just six days after John Henry's Boston Red Sox had shattered the curse of the Bambino by defeating the St. Louis Cardinals in four straight games of the World Series. With the busy and mostly successful season behind him, Commissioner Bud Selig took a breather for his annual medical checkup. For a seventy-year old, Selig was remarkably fit. He told one reporter, "I've never been sick in my life."[1] And, sure enough, his physician, Ian Gilson, finished up Selig's exam and proclaimed the commissioner to be in superb health.

Selig had just completed one year out of six in his extended contract as commissioner. Gilson joked, "I've got to keep you going great for another five years."

Then Selig got up to leave the office. As he approached the door, the doctor intoned, "Come back here. What's that on your face?" The doctor had noticed a blotch over Selig's right eye. The next day, as the Bush family celebrated, Selig visited a dermatologist. Two days later the commissioner learned that he had stage four melanoma. How dire the consequences would be depended on whether the cancer had spread.

Selig's surgery was scheduled for December 6. The month's wait was not easy. On top of his medical anxiety, the latest BALCO (Bay Area Laboratory Cooperative) scandal erupted when the *San Francisco Chronicle* released the supposedly confidential grand jury testimonies of sluggers Jason Giambi and Barry Bonds, each admitting to steroid use. Negotiations with Orioles owner Peter Angelos and the Washington, D.C., city council over terms for the move of the Expos to the nation's capital were heating up.

Selig recounted that one day he took his three granddaughters shopping. He sent them into one store by themselves because, he said, "I was so distraught that I sat in my car and cried."

The surgery lasted three hours. Two lymph nodes were removed. Then Selig had to wait seven days for the final results. On December 13, the surgeon passed along the good news: "You're clear and clean as hell."

Selig's first confrontation with serious illness left him reflective. "We need reminders of what is important. Take some vacation. Calm down." There are few jobs to which this advice better applies than the commissioner of baseball.

Governing a Sports League

The major sports leagues in the United States today each have thirty to thirty-two teams at the top level. Each team has separate ownership. Depending on the league, revenues from the top to the bottom teams can diverge by $100 million or by $300 million. These revenue disparities give the franchise owners very different perspectives on the economics of their leagues and on the strategies for team success. Some owners want more revenue sharing across the teams; some want less. Some want stiff luxury taxes on high team payrolls; some want none. Most owners want a salary cap, but salary caps come in different sizes and shapes.

Some owners are feisty; others are diffident. Some are political; others are not. Some are Republicans; fewer are Democrats. Some own team-related media, real estate, concessions, or other businesses; others do not. Managing and molding thirty different perspectives and thirty different personalities take more than a little skill and patience.

But orchestrating the owners is only step one. There's also the players' union. Although the NFL has had peaceful labor relations since the settlement of the Freeman McNeil lawsuit over free agency in 1993, matters were not always so placid. Nor is there any guarantee that labor peace will continue to prevail in football. Recent collective-bargaining experience in the NBA and the NHL has been turbulent. The basketball owners locked out the players in 1997, before the 1998–2005 labor agreement was signed. The hockey owners locked out the players in 1994 and again in 2004–2005. The entire 2004–2005 NHL season was lost. In baseball, until 2002, when a last-minute settlement averted a work stoppage, the sport had a work stoppage before every labor agreement since 1972. The commissioner must conduct relations with the players' association in a way to minimize disruption in the playing seasons, to project a positive public image of the sport, and to ensure the financial stability of the league.

The commissioner must also deal with corporate sponsors, host cities, congressional inquiries and legislative initiatives, banks, broadcasters, and the fans.[2] Like any business, for a sports league to be successful, it needs a strategy to guide its choices and plan for the future. Having dissension within and between ownership groups, not to mention all the other constituencies that demand attention, sports leagues often seem to operate with a problem-solving or crisis mentality, rather than with a long-term strategic-planning perspective.

Today it is commonplace to hear the NFL extolled as the ideal league, with its extensive revenue sharing, peaceful labor relations, and massive media contracts. Pete Rozelle, the NFL's commissioner from 1960 to 1989, is often heralded as a forward-looking model executive who pioneered the establishment of the league's revenue-sharing policies and forging owner unity.

Rozelle was a good leader in many ways, but he did not invent NFL revenue sharing. In fact, the NFL shared net gate revenues on a 60/40 basis since the league's inception in 1920. At the time, ticket sales were pretty much the whole revenue story. During the 1940s and the 1950s, the league was more than ably managed by Commissioner Bert Bell. Bell, too, deserves considerable credit. Nor were the NFL's emerging glory years of the late 1950s through the 1980s characterized by great harmony among the owners or by deep respect from all owners for the commissioner. The story of Carroll Rosenbloom, the former owner of the Baltimore Colts and the Los Angeles Rams, amply illustrates this point.

Under the urging of his friend Bert Bell, Carroll Rosenbloom bought the Baltimore Colts in 1953 for $250,000. In July 1972, he did what had never been done before and has never been done since in the NFL, MLB, or the NBA: he swapped his Colts team to Bob Irsay for the Los Angeles Rams. That is, he traded the franchise, not the players in it. It was a nice deal for Rosenbloom. His only problem was that the Rams were performing abysmally on the field, and Rosenbloom was itching for another championship. He did what few NFL owners were willing to do in those days. He signed free agent wide receiver Ron Jesse from the Detroit Lions. Owners were reluctant to sign other teams' free agents because they would be subjected to the so-called Rozelle Rule. This rule allowed for Pete Rozelle to determine the compensation for any free agent signing. Rozelle, if he wanted, could take away two top players from the signing team and award them to the team losing a free agent. Thus, it was a considerable risk and potentially a very costly move to sign a free agent. Rosenbloom did it anyway, and he did it at a time that the Rozelle Rule was being challenged in court (*Mackey v. NFL*) as a restraint of trade—which it indubitably was.

Thinking that the court challenge might induce Rozelle to behave more timidly in awarding any compensation, Rosenbloom took the chance. Rozelle did not respond timidly. He awarded to the Lions the Rams' very promising fullback, Cullen Bryant, and suggested that there would also be future draft picks in the compensation package. Rosenbloom went ballistic and arranged for a new litigation against Rozelle. But luckily for Rosenbloom, the NFL was losing the *Mackey* case, and the judge in that case enjoined the award of Bryant to the Lions. Rozelle relented and lowered the award to one first- and one second-round draft choice.

Rosenbloom still wasn't happy and sought revenge. He hired a private detective to dig up all the dirt he could on Rozelle prior to the next owners' meeting in November. Armed with his detective's report (which apparently had flimsy evidence at best), Rosenbloom launched into a one-hour-plus screaming, threatening diatribe against Rozelle. When he finished, the room was stone silent. After a break, the meeting resumed without Rosenbloom, but the tensions between the two men were to last for some time.

Rosenbloom was not the only owner with whom Rozelle had trouble. Others included Al Davis, Edward Bennett Williams, Robert Irsay, Chuck Sullivan, and Leonard Tose. The NFL also had more than its share of disputes between owners and sometimes between ownership partners in the same franchise. In 2005, the NFL owners were feuding again over the extension of revenue sharing. Like all businesses, sports leagues experience cycles. Smart leaders will never take their success for granted.

The foregoing is not to suggest that Rozelle was an ineffective commissioner. On the contrary, his reputation is basically well deserved. Indeed, amid all the turmoil of the 1970s, including the *Mackey* antitrust case for free agency that the league lost, competition from the upstart rival World Football League, the financial difficulties of Eagles owner Leonard Tose, the real estate struggles of Art Modell, and his conflicts with his co-owner Bob Gries, the owners stood by Rozelle, giving him a ten-year extension in 1977.

Rather, it is to indicate the inherent complexity of a commissioner's job: the need to juggle dozens of balls at once, yet still be able to anticipate and plan for the future. The job only becomes more difficult, as in the case of baseball, when there is less revenue sharing in the league, the union is more militant and cagey, and there is an expectation that the commissioner will be an omnipotent savior.

Sports Leagues as Monopolies

United States sports leagues have been insulated from some normal pressures of doing business because each league essentially functions as a monopoly. There is only one top-level producer of baseball, football, basketball, hockey, and soccer in the United States. Each of these leagues is closed; that is, entry is strictly controlled by existing owners. Like all good monopolists, U.S. leagues artificially restrict output in order to raise the price of their product and the value of their enterprise.

To enter a league, by purchasing either an existing or an expansion team, a prospective owner must be vetted and must receive permission. Once approved, he or she must pay a healthy "ransom," usually between $200 million and close to a billion dollars, depending on the league and the team, to join the elite club.

But there is no divine rule that sports leagues must be closed monopolies. Indeed, outside the United States, soccer leagues are organized as open promotion/relegation structures. Each country has a hierarchy of soccer leagues. The bottom two to four teams in each league get relegated, or demoted, after each season to the next league down, while the top two to four teams are promoted to the next league up. A new team cannot buy its way into the top league; rather, a team is formed and competes at the bottom level. Only through perennial success does the team rise up within the hierarchy, eventually arriving at the highest level. No expansion fee "ransom" is paid to the team owners in the top league.

Furthermore, this system allows teams to be rationally apportioned across all markets. If a large city has only one team and it can support more, an enterprising owner can act on his or her own accord and establish a new team in the city. By this process, it is unlikely in the extreme that any team would develop an inherent advantage, such as the Yankees in New York, that would endure in an open league. London, for instance, hosted six teams in the top-level English Premier League in 2004.

In open promotion/relegation leagues, all teams have an incentive to be as competitive as possible. In U.S. leagues, owners of teams in the bottom half of the standings may take a lackadaisical attitude, believing that since they can't win, they might as well minimize payroll. They will even be rewarded for poor performance with earlier draft picks and, in baseball, with more revenue-sharing transfers from the rich teams. Not so in open leagues. If a team is in the bottom half, it must exert itself to avoid relegation to a lower league, which also entails a sharp drop in revenues. Fans stay interested in the competition to win, as well as in the competition to avoid relegation.

Another feature of open leagues is that since there is no artificial scarcity of teams and no team is guaranteed a permanent berth in the top league, it is not possible for teams to extort public stadium subsidies by threatening to relocate. Sometimes there are public subsidies for stadiums in open leagues, but the process, the proportions, and the purpose differ.[3]

However, owners of teams in closed leagues have no reason to embrace the open league structure, no matter how fan friendly or theoretically appealing it might be. By doing so, the owners would be giving away their market power and surrendering significant franchise value.

Moreover, U.S. leagues do not accept the proposition that they are monopolies. They maintain that they are a single product in the larger entertainment industry and they compete with the industry's other products for the leisure dollar. As the argument goes, when a consumer decides to go to a basketball game, he is simultaneously deciding not to go to a hockey game, a bowling alley, or the opera house. Thus, in this reckoning, basketball competes with these and other entertainment products. At some level of abstraction, this claim is correct, but it is also correct to say that when a fan spends \$100 at a basketball game, it is \$100 that he or she cannot spend on clothing or food. Yet nobody claims that the NBA competes with Stop & Shop or Filene's.

For an economist, the key to understanding monopoly, or more generally, market power, is to identify how closely products are related to one another. The test is to see how a small change in the price of one product affects the consumption of another product. When this relationship is tight, then the products would be considered to be in the same market. Statistical tests indicate that the sports leagues are not in close competition with one another or with other products in the entertainment industry.

The profitability of sports teams is often not what it appears to be. Franchise owners can take their financial returns in a plethora of ways. First, if the team owner also owns a local media outlet (such as a regional sports channel, as is the case with the Yankees and YES [Yankee Entertainment and Sports Network] and the Red Sox and NESN [New England Sports Network]), the stadium, a concessions company, a real estate firm, a jet or a car rental company, or another enterprise that does business with the team, then he or she can readily shift profits toward the other entity. There are many reasons why an owner may want to do this. In baseball there's an additional reason—to reduce a team's revenue-sharing obligation to the other teams. This technique, known as related party transactions, can diminish a team's reported revenues by as much as tens of millions of dollars annually (though baseball has recently developed an auditing process to curtail this practice).[4]

Second, a sports team can enable an owner to develop new assets. George Steinbrenner developed the YES network from his ownership of the Yankees. When YES was launched in March 2002, it was implicitly valued (based on Goldman Sachs's investment in it) at $850 million—more than the Yankees' franchise was worth at the time.

Third, a sports team gives the owner prominence in the community, which can be used to establish new business connections and political sway. These relationships may open up new investment opportunities, as well as enhance existing ventures.

Fourth, sports team ownership can be an excellent tax shelter. New legislation from 2004 extends the preexisting shelter by allowing owners to amortize all intangible assets of the franchise over a fifteen-year period. While team owners argue that nonsports companies have been allowed to amortize most intangible assets for some time and the new law simply puts them on equal footing with the rest of corporate America, sports teams are different because the overwhelming share of their value is intangible. Their value rests on the fact that each owner has a scarce berth in a popular monopoly league. In reality, this scarcity value does not naturally diminish over time.

Fifth, owners can hide profits by loaning money to the team partnership. The owner then takes part of his or her return by receiving interest on the loaned capital.[5] The same interest payments appear as costs to the team and lower book profits. Owners can also take consulting fees or salaries for themselves or relatives.

Sixth, team owners receive part of their investment return from the perquisites, enjoyment, ego gratification, power, and exposure that come with ownership. The best indication that these indirect returns are present in owning a sports team is the fact that franchise values rise consistently over time. Moreover, the rate of return on franchise ownership has been above the growth rate of the S&P 500 over the last four decades.[6] If the reported financial losses of franchises (excepting the NFL, where all franchises acknowledge profitability) were the whole story, it would defy all the laws of economics for team values to be rising over the years.

That said, it must also be recognized that sports leagues do compete indirectly with one another in some ways. An NBA and an NHL team in the same city, for example, compete to attract a given number of corporations to buy luxury suites, to purchase arena signage, or to establish sponsorships. They also compete indirectly with the growing number of niche sports, video games, and the Internet.

As new entertainment options proliferate, sports leagues do experience competitive pressure. The languid approach that may have worked for sports leagues, particularly baseball, in the past no longer suffices. If an owner assumes that all he or she has to do is field a team and the fans will come to the ballpark, his or her team will fall into obscurity.

Economic theory generally predicts that monopolists will earn higher profits—called monopoly rent—than competitors do. The monopoly rent in sports leagues, however, has been dissipated by two factors. First, the advent of free agency and the strength of the player unions have pushed salaries to a level that enables players to share monopoly rents with the owners. Second, monopoly rents have tended to be capitalized in the inflated value of the franchises. As new owners buy into a league, they pay a higher price for the team than they would if there were no artificial scarcity of franchises. The higher price of the investment generally lowers the rate of return to more normal levels.[7]

The upshot of the foregoing is that the financial lifeline in sports leagues at the beginning of the twenty-first century is considerably tighter than it was in the 1950s or the 1960s. This observation is especially true of baseball, which pretty much sat alone on the U.S. sports pedestal until the 1960s. Furthermore, baseball was granted an exemption from the country's antitrust laws by the U.S. Supreme Court in 1922. This exemption meant that many of baseball's restrictive practices (such as the reserve clause, the minor leagues, control over franchise movements, national television contracts, and prohibitions on municipal ownership, among others) were never challenged or were challenged unsuccessfully.

Thus, baseball had an even greater degree of insulation from competitive pressure. This insulation led to lax and inefficient practices. The baseball commissioner from the 1920s through the mid-1970s at least had to worry little about good management and business practices. The emergence of free agency and a more competitive environment, however, began to alter the picture since the late 1970s. As we shall see, the commissioner's role eventually was expanded. As the commissioner's job grew to include economic management, revenue disparities across the teams exploded, creating even greater friction and still less unity of vision among the owners. The commissioner's functions, then, were increasingly complex as his objectives were intractable. Few commissioners were up to the task.

Antitrust and the Commissioner's Powers

In baseball, the commissioner's role has been intricately tied up with the sports antitrust exemption from the start. When the commissioner's post was first created on January 12, 1921 (thirty-seven days after the District of Columbia Court of Appeals ruled that baseball was exempt from the nation's antitrust laws, though sixteen months before this decision was sanctioned by the U.S. Supreme Court), the commissioner was given plenary powers to govern the game. Yet it was understood at the time that his main function would be to clean up the game's image by ridding it of gambling. The commissioner also became the arbiter of disputes around the player reserve clause and disputes between teams. In this capacity, the commissioner made decisions—such as deciding whether a player would play for one team or another—that could be construed to be abridging the free labor market rights of both players and owners. Still more suspect of antitrust violation would be the commissioner's decisions to ban a player from baseball even when the player had been found innocent of a gambling accusation in a court of law. To be sure, as the following testimony suggests, the commissioner made a host of judgments that might invite antitrust scrutiny.

Thus, for a commissioner to be able to carry out his mandate to "act in the best interests" of baseball in any circumstance, the antitrust exemption was seen as fundamental. Until 1957, the other, and still emerging, team sports believed that they benefited from the same treatment under the law as baseball. In February of that year, however, the Supreme Court, in *Radovich v. NFL*, declared football to be subject to antitrust statutes and asserted that baseball's exemption was "unreasonable, illogical and inconsistent."[8]

Once the *Radovich* decision indicated that they were operating under a misapprehension, the NFL, the NBA, and the NHL hastily dispatched their commissioners to the U.S. Congress in search of legislative protection. At hearings before both the House and the Senate Judiciary Committees during the summers of 1957 and 1958, the commissioners of all four major sports argued that the exemption was necessary for them to be able to act in the best interests of their sports.

This is how then NFL commissioner Bert Bell made the case to the Senate hearing as he laid out the various functions of his office:

> I should like to say a few words about my authority as commissioner of the National Football League. Long ago, when the league was first created, it was recognized that if professional football was to deserve public support and if each of our players was to be an example for young people to follow, then football would have to be above reproach. To achieve this we require that

> our players, owners, coaches, officials, and even those who do the broadcasts live up to a high standard of ethics and honesty.
>
> Someone must see that this program is followed, so the commissioner enforces this code.
>
> The league will not permit a person to own an interest in more than one football team. Nor will it permit an owner, a player, [a] coach, or an official to own stock in or to lend money to another team. Because there are situations of doubtful ethics which cannot be spelled out ahead of time, the commissioner is also empowered to punish for "conduct detrimental to professional football." This means that the commissioner must take action for similar breaches of ethical standards.
>
> Likewise, to assure maintenance of high ethical standards the league requires the commissioner to pass upon those who sponsor the broadcasts and telecasts of our games and to select, from among a panel of names submitted to him, the persons who broadcast the games.
>
> In addition, the commissioner may also be called upon to act as an arbitrator. For example, where there is a dispute which involves a player, coach, or employee, the services of the commissioner are available in the role of umpire or arbitrator if the parties desire to avail themselves of his services. He also is designated as the arbitrator where the dispute involves questions of policy.[9]

Soon thereafter, baseball stood this argument (the antitrust exemption was necessary to support the commissioner) on its head, telling Congress that the commissioner, with his plenary powers, looked out for the best interests of fans and assured that monopoly abuses would not occur. Thus, the commissioner became an argument to support baseball's exemption.[10]

This claim regarding the commissioner's role is, of course, subject to empirical inquiry. Has the commissioner, in fact, defended the consumers' best interests over the years? As we shall see, many questioned whether this claim was ever valid. Whatever thin plausibility this assertion may have had in the past, when Bud Selig, the long-standing owner of the Milwaukee Brewers, was made acting commissioner in 1992, the contention lost its last shreds of credibility.