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Third Circuit Adopts Deferential Approach to Determine Whether Sports Sanctioning Bodies' Exclusive Equipment Requirements and Contracts Violate Antitrust Laws

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On July 23, 2010, the Third Circuit held that a racing circuit's decisions to adopt an exclusive equipment requirement and enter into a corresponding exclusive supply contract with the equipment manufacturer do not violate the antitrust laws. In *Race Tires America, Inc., et al. v. Hoosier Racing Tire Corp. et al.*, No. 09-3989 (3d Cir., July 23, 2010) (Slip Op.), the Court affirmed summary judgment in favor of the defendant, rejecting the plaintiff's claims that competition for race tires was harmed by the circuit's adoption of a rule requiring race teams to use a particular brand of tires.

Race Tires is the second recent decision by the Third Circuit rejecting an antitrust challenge to decisions by sports leagues. [1] The decision raises the standards for asserting antitrust claims concerning exclusive dealing by sports leagues. First, *Race Tires* adopted a "deferential" approach to determine the legality of exclusive equipment requirements. The Court held that where a sanctioning body adopts such requirements freely and has good faith pro-competitive or business justifications for adopting the requirement, it does not violate the antitrust laws. Second, the Court recognized that in the absence of this approach, the cost of defending antitrust claims would chill pro-competitive developments. Third, the Court also recognized that competition among suppliers for league-wide exclusive supply arrangements is beneficial to consumers. This reasoning, coupled with the suggestion by the Supreme Court earlier this Spring in *American Needle* **[2]** that the "quick look" doctrine can be used to dismiss many antitrust claims concerning sports league decisions, may provide additional bases for sports leagues to seek early dismissal of such claims.

BACKGROUND

An affiliated group of racing tire manufacturers (collectively, "STA") challenged Dirt Motor Sports Inc.'s ("DMS") decisions to adopt a "single tire rule" and make Hoosier Racing Tire Corporation ("Hoosier") the exclusive tire manufacturer of its racing organization. DMS, which at the time of its challenged decisions was a publicly traded corporation, owns and organizes several different auto racing circuits. STA alleged Hoosier used coercive methods to procure exclusive dealing arrangements with DMS and other dirt track racing sanctioning bodies in violation of Sections 1 and 2 of the Sherman Act. STA alleged that these exclusive dealing arrangements reduced competition for tires among the racing teams competing in these circuits, allowing Hoosier to obtain a market share of greater than 70% in the market for "racing tires that race on dirt oval tracks" in the United States and Canada.

DMS's adoption of a "single tire rule" was not the first time a racing sanctioning body had done so. DMS and other dirt track racing sanctioning bodies often had chosen to adopt single tire rules requiring cars competing in their races to purchase and use a specific brand and type of tire.

In 2006, DMS held a "Sprint Car Summit" with other sanctioning bodies, promoters, and track operators to address declining driver participation and fans at dirt track racing events. Attendees discussed ways to improve interest in their races, including through improvements in the tires. Later that year, DMS and Hoosier entered into a contract making Hoosier the exclusive tire of DMS' dirt track races. As part of that contract, Hoosier agreed to pay DMS large sponsorship fees and agreed to pay DMS to solicit other sanctioning bodies to adopt a "national sprint tire rule." *Id.* at 19.

STA filed suit in the United States District Court for the Western District of Pennsylvania on September 25, 2007 against Hoosier and DMS. After two years of discovery, on September 15, 2009, the District Court granted the defendants' motion for summary judgment. The District Court held that: (1) "where, as here, a sanctioning body freely decides to adopt a single tire rule, and then freely selects a supplier, no antitrust violation is present as a matter of law – either under Section 1 or 2 of the Sherman Act"; and (2) "STA has not suffered an 'Antitrust Injury' and thus, does not have standing to bring this action." *Id.* at 27-28.

THIRD CIRCUIT'S ANALYSIS

The Court's analysis focused on three separate issues: (1) whether the sanctioning bodies, including DMS, were subject to "coercion" in choosing Hoosier's tires; (2) whether pro-competitive justifications support the adoption of a "single tire rule"; and (3) whether STA suffered antitrust injury.

The Sanctioning Bodies Were Not Coerced into Adopting Exclusive Contracts

The Third Circuit first looked to whether DMS or the other dirt track racing sanctioning bodies freely adopted single tire rules or whether the rule was imposed by a supplier that dominated DMS's market.

The Court concluded that not only was there no evidence of coercion in the record, the sanctioning bodies preferred adopting a single tire rule. *Id.* at 38. In fact, STA's own expert noted that sanctioning bodies acted "in their own best interest" in adopting a single tire rule. *Id.* Although the Court expressed some concern regarding the exchange of financial support for an exclusive contract with a sports sanctioning body (*i.e.*, payments by Hoosier to DMS for the right to be the exclusive supplier and for DMS to solicit other sanctioning bodies to enter into similar deals with Hoosier), with respect to the exclusive tire contract at issue, the Court concluded "it is no more an act of coercion, collusion, or improper interference…to offer more money to the sanctioning body than it is…to offer the lowest tire prices." *Id.* at 39.

The Court stopped short of holding that coercion is an essential element of an antitrust claim, but concluded "that coercion is a fundamental consideration in the *present* circumstances, namely, where various sports sanctioning bodies have freely adopted their own equipment rules and then freely entered into exclusive contracts with exclusive suppliers." *Id.* at 37 (emphasis in original). However, even in the absence of coercion, the Court concluded that, in this and similar cases, courts must still examine whether decisions to adopt exclusive equipment rules and enter into an exclusive contracts are based on pro-competitive justifications. *Id.*

The Court Adopts a Deferential Rule Where Good Faith Business Justifications Support Exclusive Supply Contracts

The Court recognized that a deferential approach to league-wide exclusive supply contracts is necessary given the waste inherent in defending antitrust lawsuits, the inherent pro-competitive nature of free competition for exclusive league-wide supply contracts, and practical considerations affecting race circuits. Accordingly, the Third Circuit held that "the Sherman Act does *not* forbid sanctioning bodies and other sports-related organizations from freely (*i.e.*, without any coercion or improper interference) adopting exclusive equipment requirements, so long as such organizations otherwise possess, in good faith, sufficient pro-competitive or business justifications for their actions."[3] *Id.*at 43 (emphasis in original).

The court recognized that a rule would help sports league and the courts avoid unnecessary time and expense of defending antitrust claims. As the Court pointed out, this was the second antitrust case involving a racing body's exclusive tire contract with Hoosier, both of which were decided for the racing circuit.[4] The Court noted the a lack of guidance from the courts would leave sanctioning bodies with an untenable choice: (1) adopt more expensive, less efficient and less safe rules or (2) implement the optimum rules for the sport, but face "the crippling expense in defending their legitimate right to promulgate their own rules." *Id.* at 41.

Thus, the Court found that "motorsports sanctioning bodies, as well as similar organizations in other sports, deserve a bright-line rule to follow so they can avoid potential antitrust liability as well as time consuming and expensive antitrust litigation…Contrary to the pro-competitive purposes of antitrust law, this expense may have a very real anti-competitive effect, especially on the smaller sanctioning bodies." *Id.* at 40-41.

In developing its rule, the Third Circuit held that "sports related bodies should be given leeway with respect to their adoption of equipment requirements as well as their related decisions to enter exclusive contracts with the respective suppliers."[5] *Id.* at 41. Although organizations must have good faith justifications for their decisions, they "have the right to determine for themselves the set of rules that they believe best advance their respective sport (and therefore their own business interests), without undue and costly interference on the part of courts and juries." *Id.* at 46.

The Court then found that DMS's single tire rule was based on good faith pro-competitive justifications, and that sanctioning bodies, track operators, and racing teams all believed that a single tire rule creates more exciting races, promotes parity, ensures equal access to a uniform product, leads to increased safety, and lowers the costs of tires to race teams. *Id.* at 44. Although the record demonstrated higher sponsorship fees offered in exclusive tire contracts correlated with higher tire prices for the racing teams who purchased the tires, the suppliers' sponsorship fees were found ultimately to benefit the race teams through year end bonuses and by providing the financial resources necessary to allow the racing circuits to function. *Id.* at 39-40, n.2. Further, to the extent the race teams – the direct consumers of the tires in question – do not agree with the single tire rule, they are free to "vote with their trailers" and join competing racing circuits. *Id.* at 46.

No Antitrust Injury

Finally, the Court held that STA had not suffered antitrust injury because any harm it suffered was as a competitor of Hoosier, but there was no harm to competition in general. The Court first noted that, in general, competition among businesses to serve as an exclusive supplier should be encouraged. *Id.* at 46. The Court emphasized that although DMS's bidding process was not perfect, STA in fact competed with Hoosier and various other suppliers for the exclusive supply contract at issue.

The Court also noted that STA itself had previously advocated for the very type of "single tire rule" that it now sought to condemn. *Id.*at 44. STA had responded to RFPs for exclusive tire contracts and, in at least one case, was successful in securing an exclusive tire contract with a racing body. *Id.* at 47. Thus, the exclusive tire contracts at issue did not have the effect of lessening competition in the market for dirt racing tires, but simply shifted the competition from the individual race team level to the sanctioning body level, and STA had a fair opportunity to compete in that market.

FUTURE IMPACT ON SPORTS LEAGUES AND TEAMS

The *Race Tires* opinion is noteworthy in several respects:

- First, it adopts a deferential rule with respect to the narrow issue of a sports league's adoption of exclusive supply contracts, provided the league freely adopts such contracts and can offer pro-competitive justifications for doing so. It remains to be seen whether courts in other circuits will adopt this principle in similar circumstances.
- Second, more broadly, this case is one more in a series of recent cases affirming the right of sports organizations to set the rules and regulations defining their "on the field" product.
- Third, the Court recognizes that the burden on sports organizations in defending antitrust challenges to their core business decisions chills pro-competitive developments and runs contrary to the purposes of the antitrust laws. This supports a shift towards early vetting of antitrust claims and placing the burden on antitrust plaintiffs to meet a higher evidentiary threshold, as recognized by the Supreme Court in *American Needle*.

- Finally, it demonstrates the difficulty a would-be supplier – much like a jilted distributor – may have in proving antitrust injury.

[1] Read about the Third Circuit's prior opinion affirming ATP Tour, Inc.'s successful defense at trial of antitrust and other claims.

[2] *American Needle v. NFL*, __ S. Ct. __, 2010 WL 2025207, at *12 (May 24, 2010) (suggesting that "depending on the concerted activity in question" the Quick Look approach may be applied in favor of antitrust defendants).

[3] The Court, citing *American Needle*, emphasized that its holding did not create any antitrust "immunity" for sports leagues *Id.* at 43.

[4] In *M&H Tire Co. v. Hoosier Racing Tire Corp.*, 733 F.2d 973 (1st Cir. 1984), the First Circuit rejected a similar challenge to several race tracks' adoption of a single tire rule and exclusive contract with Hoosier.

[5] Notably, the Court cited *American Needle* in support of the proposition that "the courts have generally accorded sports organizations a certain degree of deference and freedom to act in similar circumstances." *Id.* at 41-42; *see American Needle*, 2010 WL2025207 at *12 ("The fact that NFL teams share an interest in making the entire league successful and profitable, and that they must cooperate in the production and scheduling of games, provides a perfectly sensible justification for making a host of collective decisions. "). This suggests that courts may read *American Needle* as supporting such deference in the future even though the specific holding in *American Needle* rejected the NFL's position regarding its status as a single entity for purposes of Section 1.

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