HOW NOT TO APPLY THE RULE OF REASON: THE *O'BANNON* CASE

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INTRODUCTION

The case of *O'Bannon v. NCAA*[1] has received significant attention. On behalf of a class of student-athletes, former college basketball star Ed O'Bannon sued the NCAA, challenging rules that prohibited payment for the use of names, images, and likenesses (NILs) in videogames, live game telecasts, and other footage.[2] A Ninth Circuit panel, in a 2-1 decision, found that this restraint had anticompetitive effects and procompetitive justifications.[3] And it considered "less restrictive alternatives," upholding payment for incidental educational expenses beyond tuition and fees, room and board, and required books, but rejecting a deferred $5,000 payment for NILs.[4]

Straddling the intersection of antitrust, intellectual property, and sports law, the *O'Bannon* case presents engaging and complex issues. Much of the complexity, however, is unnecessary. For it stems from a ruling that misconstrued antitrust law. In particular, the Ninth Circuit applied a version of the Rule of Reason that short-circuited the analysis and insufficiently deferred to a district court judge who presided over an exhaustive trial on amateurism.

Based on my review of more than 700 Rule-of-Reason cases in the modern era, Part I of this Essay highlights courts' analyses based on "less restrictive alternatives" and a four-stage burden-shifting framework. Part II highlights the errors with the Ninth Circuit's application of the Rule of Reason. Part III emphasizes the court's error in substituting its conception of amateurism for that of the lower court.

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1. Nos. 14-16601, 14-17068, 2015 WL 5712106 (9th Cir. Sept. 30, 2015).
2. *O'Bannon*, 2015 WL 5712106 at *25–26.
3. *Id.* at *18–22.
4. *Id.* at *22–26.

I. THE RULE OF REASON: CASE LAW

Courts analyzing agreements under antitrust law typically apply one of two modes of scrutiny: "per se" illegality or the Rule of Reason.[5] Some offenses (like price fixing and market division) are so concerning that they are automatically illegal.[6]

In contrast, courts consider the vast majority of agreements under the "Rule of Reason."[7] The *O'Bannon* decision notwithstanding, courts that apply this form of analysis typically assert that they balance a restraint's anticompetitive and procompetitive effects.[8] In reviewing every Rule-of-Reason case between 1977 and 2009, I showed that balancing takes place in the last stage of a four-part burden-shifting approach.[9]

First, a plaintiff must show a significant anticompetitive effect, typically in the form of a price increase, output reduction, or showing of market power.[10] Second, a defendant must offer a procompetitive justification for the restraint.[11] Third, the plaintiff can show that the restraint is not reasonably necessary to attain the restraint's objectives or that there are alternatives less restrictive of competition.[12] The final stage involves balancing anticompetitive and procompetitive effects.[13]

Of crucial importance, the effect of not making the showings at the different stages varies. If the plaintiff cannot show an anticompetitive effect, it loses because there is no harm to competition. And if the defendant cannot show a procompetitive justification, it loses because it cannot offer a reason for the restraint.[14]

In the third stage, by contrast, if the plaintiff does not show that the restraint is not reasonably necessary or that there are less restrictive

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5. ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 52–53 (7th ed. 2012) [hereinafter ANTITRUST LAW DEVELOPMENTS]. A third, limited category consists of a "quick look" Rule of Reason, in which the court presumes harm to competition in the absence of an anticompetitive effect. *E.g.,* NCAA v. Board of Regents, 468 U.S. 85, 109–10 (1984).

6. ANTITRUST LAW DEVELOPMENTS, *supra* note 5, at 52–53.

7. *Id.* at 61.

8. Michael A. Carrier, *The Real Rule of Reason: Bridging the Disconnect*, 1999 B.Y.U. L. REV. 1265, 1267 (1999) [hereinafter Carrier, *Real Rule of Reason*].

9. Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827, 829 (2009) (reviewing 222 antitrust cases); *see also* Carrier, *Real Rule of Reason supra* note 8, at 1272–73 (reviewing 495 antitrust cases). The surveys included every Rule-of-Reason case that a court decided between June 23, 1977 and May 5, 2009. More recent rulings do not alter the conclusions in the text.

10. *See, e.g.*, Capital Imaging Assocs. v. Mohawk Valley Med. Assocs., 996 F.2d 537, 543 (2d Cir. 1993).

11. *See, e.g.*, *id.*

12. *See, e.g.*, *id.*

13. *See generally* Carrier, *Real Rule of Reason*, *supra* note 8, at 1268–69.

14. *Id*.

alternatives, it *does not lose*.[15] A plaintiff's showing at this stage typically allows it to win the case outright, avoiding a balancing analysis. After all, if the plaintiff could show that the restraint is not reasonably necessary to attain the defendant's objective, the restraint could be struck down. And if there is an alternative that is less restrictive of competition but that would allow a defendant to achieve its objective, then that alternative should be used.[16]

II. THE RULE OF REASON: THE *O'BANNON* DETOUR

The Ninth Circuit ignored well-established Rule-of-Reason precedent and the need to consider anticompetitive and procompetitive effects in three ways.[17] First, the court inappropriately held that the plaintiff's failure to prove a less restrictive alternative resulted in the plaintiff losing the case. Second, it misconstrued the scope of the justification to which the alternative would be applied. And third, it eliminated the balancing stage of the analysis.

A. *Effect of Alternatives Step*

The first error involved the effect of the "less restrictive alternatives" stage of the analysis. The court initially considered the first two steps of the Rule-of-Reason analysis. It found that plaintiffs showed a significant anticompetitive effect: NCAA rules "fix the price of one component of the exchange between school and recruit, thereby precluding competition among schools with respect to that component."[18] The court also found that the "'student-athletes . . . are harmed by the price-fixing agreement'" and that "[t]he athletes accept grants-in-aid, and no more, in exchange for their athletic performance, because the NCAA schools have agreed to value the athletes' NILs at zero, 'an anticompetitive effect.'"[19]

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15. Michael A. Carrier & Christopher L. Sagers, O'Bannon v. National Collegiate Athletic Ass'n*: Why the Ninth Circuit Should Not Block the Floodgates of Change in College Athletics*, 71 WASH. & LEE L. REV. ONLINE 299, 305–06 (2015).

16. *See also* 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1507(c), at 430 (3d ed. 2010) ("If the plaintiff satisfies the burden of persuasion" on "showing that the restraint does not substantially serve the claimed legitimate objective or that the objective can be achieved (nearly?) as well by a significantly less restrictive alternative," then "it prevails," whereas if the plaintiff does not make this showing, the court must "weigh and balance the harm against the benefit"); *see also id.* ¶ 1507(a), at 424–28; 11 *id.* ¶ 1912i, at 371.

17. Although the court misconstrued the Rule of Reason, it correctly found that the NCAA's amateurism rules were not exempt from the antitrust laws. *See* O'Bannon v. NCAA, Nos. 14-16601, 14-17068, 2015 WL 5712106, at *10–18 (9th Cir. Sept. 30, 2015) (rejecting NCAA's arguments for exemption based on *NCAA Board of Regents* case, lack of commercial activity, and lack of injury).

18. *Id.* at *19.

19. *Id.* (quoting O'Bannon v. NCAA, 7 F. Supp. 3d 955, 973 (N.D. Cal. 2014), *aff'd in part, vacated in part O'Bannon*, 2015 WL 5712106).

Turning to the next stage, the court found that the NCAA offered legitimate justifications. It concluded that "the NCAA's compensation rules serve the two procompetitive purposes identified by the district court: integrating academics with athletics, and 'preserving the popularity of the NCAA's product by promoting its current understanding of amateurism.' "[20]

The Ninth Circuit next turned to less restrictive alternatives. It upheld the first alternative of payment beyond the grant-in-aid scholarship (tuition and fees, room and board, and required books) up to the "cost of attendance" stipend (typically a few additional thousand dollars covering transportation, supplies, and nonrequired books).[21] The court found that "raising the grant-in-aid cap to the cost of attendance would have virtually no impact on amateurism" and that "[n]othing in the record . . . suggested that consumers of college sports would become less interested in those sports if athletes' scholarships covered their full cost of attendance."[22]

But the court rejected the second alternative: a payment of up to $5,000 (deferred until after graduation) for the use of a student-athlete's name, image, and likeness in videogames, live game telecasts, and other footage.[23] It was not willing to "agree that a rule permitting schools to pay students pure cash compensation and a rule forbidding them from paying NIL compensation are both *equally* effective in promoting amateurism and preserving consumer demand."[24] And it concluded that "it is clear the district court erred in concluding that small payments in deferred compensation are a substantially less restrictive alternative restraint."[25] As a result, the court struck down the $5,000 payment.[26]

The court erred in not continuing the analysis to balancing. There is a reason plaintiffs do not need to prove the existence of a less restrictive alternative to win the case. Perhaps, as happened here, there were significant anticompetitive effects and limited procompetitive justifications, but no ready alternative. In that case, the significant harms to competition easily outweigh the defendant's flimsy justifications. The fact that the plaintiff could not avail itself of the slam dunk of a less restrictive alternative in no way precludes it from emerging victorious based on what could be relatively easy balancing.

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20. *Id.* at *21 (quoting *O'Bannon*, 7 F. Supp. 3d at 1005); *see also id.* at *20 ("Although the NCAA's briefs state in passing that the district court erred in failing to 'credit all four justifications fully,' the NCAA focuses its arguments to this court entirely on the first proffered justification—the promotion of amateurism.").

21. *Id.* at *2 n.3.

22. *Id.* at *23.

23. *Id.* at *25–26.

24. *Id.* at *24.

25. *Id.* at *26.

26. *Id.*

B. *Misconstrued Alternative*

The court's second error occurred not in the effect of the plaintiff's alleged failure to show a less restrictive alternative but in the alternative itself. If a court credits only one reason for a justification, the defendant should not be able to reach beyond the accepted reason to offer its own conception of the defense.

In this case, the district court focused on the effect of amateurism in increasing consumer demand for college sports.[27] On appeal, the NCAA tried to expand the effect of its defense in "mak[ing] college sports more attractive to recruits, or widen[ing] recruits' spectrum of choices."[28] But the Ninth Circuit rejected this attempt. In fact, the court found that "loosening or abandoning the compensation rules might be the best way to 'widen' recruits' range of choices," as "athletes might well be more likely to attend college, and stay there longer, if they knew that they were earning some amount of NIL income while they were in school."[29]

Given this failure, the question devolved to the effect of the $5,000 alternative in attaining the sole ground on which the court credited the NCAA's amateurism justification: enhancing consumer demand. Stated differently, Chief Judge Thomas, concurring in part and dissenting in part, observed that "the concept of amateurism is relevant only insofar as it relates to consumer interest,"[30] not as it reflects "the NCAA's preferred articulation of the term."[31]

C. *Neglect of Balancing Step*

The court's third error was to completely ignore the balancing stage of the analysis. My review of more than 700 cases spanning a 30-year period—from 1977 (the date of the first Rule-of-Reason case in the modern era, *Continental T.V., Inc. v. GTE Sylvania Inc.*[32]) to May 2009—led to the unmistakable conclusion that courts applying the Rule of Reason engage in a four-stage framework, examining (1) anticompetitive effect, (2) procompetitive justification, (3) less restrictive alternative or reasonable necessity, and (4) balancing.[33]

In contrast to this long-established analysis, the Ninth Circuit, after observing the presence of anticompetitive and procompetitive effects, "turn[ed] to the *final inquiry*—whether there are reasonable alternatives to

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27. O'Bannon v. NCAA, 7 F. Supp. 3d 955, 975–78 (N.D. Cal. 2014) *aff'd in part, vacated in part O'Bannon*, 2015 WL 5712106.

28. *O'Bannon*, 2015 WL 5712106, at *21.

29. *Id.*

30. *Id.* at *28 (Thomas, C.J., concurring in part and dissenting in part).

31. *Id.* at *29.

32. 433 U.S. 36 (1977).

33. Carrier, *Real Rule of Reason*, *supra* note 8, at 1268–69.

the NCAA's current compensation restrictions."[34] The court vacated the district court's judgment and injunction relating to the $5,000 payment because "the NCAA's rules have been more restrictive than necessary to maintain its tradition of amateurism in support of the college sports market."[35]

In neglecting balancing, the Ninth Circuit's ruling was not consistent with case law in the jurisdiction.[36] In fact, the court ignored controlling precedent in exactly the same Rule-of-Reason posture. In *County of Tuolumne v. Sonora Community Hospital*,[37] the plaintiff showed an anticompetitive effect, the defendant followed with a justification, the plaintiff then "failed to meet [its] burden of advancing viable less restrictive alternatives," and (relying for support on the authoritative antitrust treatise) *the court then "reach[ed] the balancing stage*."[38]

Balancing also could claim support from the district court's ruling, which concluded that the amateurism defense "[could] not justify the rigid prohibition on compensating student-athletes . . . with any share of licensing revenue."[39] The Ninth Circuit's omission of the balancing stage prevents the consideration of the anticompetitive and procompetitive effects at the heart of the Rule of Reason.

III. AMATEURISM: THE DEFERENCE FAILURE

In addition to misapplying the Rule of Reason, the court applied an inappropriate standard in reviewing the district court's decision.

The Ninth Circuit acknowledged that it was supposed to defer to the lower court. It articulated the well-worn standard of reviewing factual findings under a "clear error" standard that is "deferential."[40] And it

34. *O'Bannon*, 2015 WL 5712106, at *22 (emphasis added).

35. *Id.* at *26.

36. *See, e.g.*, Tanaka v. Univ. of S. California, 252 F.3d 1059, 1063 (9th Cir. 2001) ("A restraint violates the rule of reason if [its] harm to competition outweighs its procompetitive effects."); Hairston v. Pac. 10 Conference, 101 F.3d 1315, 1319 (9th Cir. 1996) (noting that fact-finder "determines whether the restraint's harm to competition outweighs [its] procompetitive effects" and concluding that sports conference's imposition of sanctions on member school was not "grossly disproportionate"); Bhan v. NME Hospitals, Inc., 929 F.2d 1404, 1413 (9th Cir. 1991) (noting that final stage of analysis involves court's "weigh[ing of] harms and benefits to determine if the behavior is reasonable on balance").

37. 236 F.3d 1148, 1160 (2001).

38. *County of Tuolumne*, 236 F.3d at 1160 (emphasis added).

39. O'Bannon v. NCAA, 7 F. Supp. 3d 955, 1001 (N.D. Cal. 2014), *aff'd in part, vacated in part O'Bannon*, 2015 WL 5712106. Similarly, the court found that the NCAA could not rely on its goal of integrating student-athletes into their campus communities "to justify its sweeping prohibition" on NIL compensation. *Id.* at 1003.

40. *O'Bannon*, 2015 WL 5712106, at *9.

professed to "accept the district court's findings of fact" unless it was "left with the definite and firm conviction that a mistake has been committed."[41]

The NCAA's amateurism defense was particularly important here given the expansive scope of the case, the first trial ever devoted to amateurism in college sports. Although the NCAA has relied on the amateurism defense for decades (and the Supreme Court discussed it in dicta in *NCAA v. Board of Regents*[42]), this was the first trial that explicitly examined the issue. And, through 24 witnesses, 15 days, and thousands of pages of trial testimony, the court left no stone unturned.[43] The thorough consideration of the NCAA's shifting versions of amateurism[44] and of the effects of varying levels of payment presents a prototypical example of factual findings entitled to deference.

The district court heard undisputed evidence about football players "accept[ing] Pell grants in excess of their cost of attendance" and tennis recruits earning "$10,000 per year in prize money."[45] The court's conclusion about the effectiveness of the deferred $5,000 payment was, as Chief Judge Thomas explained, "based on testimony from at least four experts—including three experts presented by the NCAA."[46] Relying on this evidence (with "no evidence to the contrary"[47]), the district court concluded that "permitting schools to make limited payments to student-athletes above the cost of attendance would not harm consumer demand for the NCAA's product."[48] Such a finding was particularly likely if "the student-athletes were not paid more or less based on their athletic ability or the quality of their performances and the payments were derived only from revenue generated from the use of their own names, images, and likenesses."[49]

Any "potential impact on consumer demand" would be "further minimize[d]" by holding the licensing revenue in trust "until after student-

41. *Id.* (quoting FTC v. BurnLounge, Inc., 753 F.3d 878, 883 (9th Cir. 2014)). *See also* 11 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1913(b), at 375 (3d ed. 2010) ("[T]he existence of a viable less restrictive alternative is ordinarily a question of fact.").

42. 468 U.S. 85, 117–119 (1984).

43. Steve Berkowitz, *O'Bannon Trial: Case vs. NCAA in Hands of Judge*, USA TODAY (June 28, 2014, 12:38 AM), http://www.usatoday.com/story/sports/college/2014/06/27/obannon-antitrust-case-vs-ncaa-trial-closes/11576223/ [http://perma.cc/Y2DH-TC5Q].

44. *O'Bannon*, 7 F. Supp. 3d at 1000 ("[T]he NCAA has revised its rules governing student-athlete compensation numerous times over the years, sometimes in significant and contradictory ways . . . . [and] even today [it] does not consistently adhere to a single definition of amateurism.").

45. *O'Bannon*, 2015 WL 5712106, at *27 (Thomas, C.J., concurring in part and dissenting in part).

46. *Id.*

47. *Id.* at *29.

48. *O'Bannon*, 7 F. Supp. 3d at 983.

49. *Id.*

athletes leave school."[50] In fact, former student-athletes "are already permitted to receive compensation for the use of their names, images, and likenesses in game re-broadcasts and other archival footage of their college performances as long as they enter into such agreements after they leave school."[51] Again based on an exhaustive trial, the court unmistakably concluded that consumer demand for football- and basketball-related products "is not driven by the restrictions on student-athlete compensation but instead by other factors, such as school loyalty and geography."[52]

Rather than crediting even some of these factual findings, the Ninth Circuit relied on *its own* armchair conceptions of amateurism. For example:

- "[I]n finding that paying students cash compensation would promote amateurism as effectively as not paying them, the district court ignored that not paying student-athletes is *precisely what makes them amateurs.*"[53]
- The panel found it to be a "self-evident fact that paying students for their NIL rights will vitiate their amateur status as collegiate athletes."[54]
- The court found that "[t]he difference between offering student-athletes education-related compensation and offering them cash sums untethered to educational expenses is not minor" but "is a quantum leap."[55]

One of the basic principles of judicial review is that appellate courts should defer to the factual findings of a lower court that has directly observed the evidence and is in a position to assess credibility. The Ninth Circuit did not do so.

CONCLUSION

As the most important decision ever on amateurism in college sports, the *O'Bannon* decision will continue to garner significant attention. And there are weighty issues implicated by the case. But a failure to apply long-established antitrust law should not add to the complexity. At a minimum, the Ninth Circuit's ruling on the deferred $5,000 payment should be overturned for a fuller balancing of anticompetitive and procompetitive effects.

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50. *Id.*

51. *Id.* at 983–84.

52. *Id.* at 1001.

53. O'Bannon v. NCAA, Nos. 14-16601, 14-17068, 2015 WL 5712106, at *24 (9th Cir. Sept. 30, 2015).

54. *Id.*

55. *Id.* at *26.