Millionaires vs. Billionaires – The 2011 NFL Lockout

“I’m sorry for our fans. I’m sorry for the people who love football. I’m sorry for those who love their teams and take pride in the ownership of their teams”

-DeMaurice Smith
NFLPA Executive Director

Overview

In 1993, the NFL entered a new era of collective bargaining between NFL owners and athletes. Fresh off the league-wide strike and union decertification in 1987, both parties agreed to enter into a new collective bargaining agreement outlining the wage scale and rights of parties involved. The agreement was extended five times since 1993, but in 2008, owners exercised an option to opt out of the current agreement in 2011. Now, with no agreement in place, the 2011 NFL season is in jeopardy as owners are prepared to “lockout” players if no resolution reached by the CBA deadline, resulting in a halt the upcoming season.

History

The NFL’s Players Association (NFLPA) was formed in 1956 as a union for players in the National Football League. NFL legends such as Don Shula and Norm Van Brocklin lead the NFLPA drive fighting for rights such as a league wide minimum wage, team paid for equipment and sustained salary paid through injury periods. Early on however, the NFLPA was mostly ignored by owners because most threats issued by the NFLPA were not credible. That would all change when the United States Supreme Court ruled in Radovich v. National Football League, 352 U.S. 445 (1957) that, unlike Major League Baseball, the National Football League could not be treated as a single entity but rather as separate teams subject to antitrust laws. That meant standards like a league wide salary cap would be considered collusion between competing entities, thus illegal. Even though the NFLPA gained some traction with the Supreme Court ruling, the organization was divided over whether it should act as a professional association or a union. Over issuing years, the NFLPA used the threat of antitrust litigation to win concessions such as better wages and benefit. In 1968, owners finally recognized the NFLPA’s power and agreed to enter into the league’s first collective bargaining agreement. Even with an agreement in place, the scales still tipped heavily in favor of the owners. Over the course of the next twenty years, the NFLPA would duke it out with owners over heavyweight items such as wage compensation, increased benefits and free agency.

In efforts to gain more rights, the NFLPA moved to strike in 1987 but that action was short lived as players did not have the financial stability to support themselves in the absence of owner pay and lack of NFLPA funding support. The following year, the NFLPA moved to decertify as a union, triggering
antitrust infringements on the league. With the union decertified, players could individually sue the league, challenging its free agency rules as an unlawful restraint of trade. The players ultimately prevailed in court, and a collective bargaining agreement was fashioned mirroring many of today’s current deal terms.

The Collective Bargaining Agreement (CBA)

Defined by United States Department of Labor, “collective bargaining is the method whereby representatives of employees (unions) and employers negotiate the conditions of employment, normally resulting in a written contract setting forth the wages, hours, and other conditions to be observed for a stipulated period (e.g., 3 years). The term also applies to union-management dealings during the term of the agreement.”

Under this definition, the NFLPA players don’t have the right to negotiate their own contacts outside of the union. When the NFLPA petitioned to the National Labor Relations board to become certified union in the late fifties, it gave them a government granted monopoly in collective bargaining with the NFL. After the NFLPA issued a player strike in the summer of 1968, owners briefly held a lockout, but eventually agreed into entering a collective bargaining agreement which resulted in small additional concessions reached by players. In the late eighties, NFLPA union decertification led to a significant win for players as the courts sided with players and the era of a “fair” CBA was born. Since this time, the collective bargaining agreement has been revisited several times in efforts to bring about a fair division or wealth and rights. It has been extended five times as revenues soared, the league expanded to 32 profitable teams, and new stadiums were built across America to house them.

Participants in the Game

Owners: In the words of owners, they are looking to “take back their league” by forcing a more favorable deal down the throats of the players. Owners state that high-risk investments made on new stadiums and other capital expenditures have increased over the years and more money for operating expenses is need. Owners were not pleased with the extension back in 2006 and believe that the former NFL commissioner, Paul Tagliabue, was in a weak moment as he preparing to step down from his role of commissioner and 17 year stint of unprecedented labor peace.

Players: They want to keep the CBA in its current form. They say if it ain’t broke don’t fix it. The league is generating an insane amount of revenue and is more popular than ever before (The past two Super Bowls rank No. 1 and No. 2 among most-watched TV programs in U.S. history). They understand that rising overhead costs might justify an increase in the owners’ pie, but aren’t willing to buckle until they have a complete audit of owners’ books.

Other Stakeholders: Parking attendant, the beer guy, the concessions staff, security, ticketing, practice squad, TV Networks, restaurants/bar owners. (12 billion dollars generated revenue by secondary operations, Fantasy Football at 5 billion alone).
Key Issues

**League revenue division:** Revenues (annually 9 billion dollars), including what portion owners should receive up front to help cover costs such as stadium construction and improvement. Under the old deal terms owners received $1 billion off the top and players/owners split the remaining proceeds (8 billion dollars at 60/40 respectively). Currently owners seek to add about $1.4 billion on top of that 1 billion (2.4 billion off top) and seek the same 60/40 player/owner split. Players are opposed to the new breakdown and seek to keep the revenue sharing piece in its current form.

**A rookie wage scale:** Ballooning rookie deals have resulted in a big problem for the league. Unproven players are given giant guaranteed draft day contracts before ever proving their worth in the league. The premise is that these players will have a chance at big contacts later if they are worthy, and team resources can be allocated to deserving veteran players. Currently the league rookie minimum salary is $320,000.

**Benefits for retired players:** Seeking movement towards the improvement of retiree pensions and healthcare for players

**Expansion of season games:** The owners’ push to expand the regular season from 16 games to 18 while reducing the preseason by two games. The new 18 game schedule could potentially increase league revenues by 500 million annually.

Building Mental Models

The NFL is the largest sports league in terms of revenue generated, approximately nine billion annually. It is reasonable to assume that both parties want to eventually cooperate in order to maintain the league’s reputation and revenue stream. However, this same bountiful success has led sides to fight even harder for “fair” sizes because so much money is at stake. To a certain extent, both players and owners must realize that they are dependent on each other for the success (and even existence) of the NFL. While it may be the players that draw crowds and drive popularity (media deals, ticket sales), none of it could happen without the owners who provide management, funding, facilities, other business revenue from team/NFL-branded goods, etc.

In sizing up their relative competition in this game, both players and owners can use the knowledge and rational below to each build mental models in assessing the current situation.

**Player Mental Model**

**Punishment threat:** Players know they lie at the core of what makes the NFL successful. Revenues are mainly generated because fans fill stadiums and tune in on television to watch their talents. Although replacement players are an owner option, there is no true long term replacement for world class talent
that fans come to expect. Players view their “option” to decertify their union as an effective punishment towards owners. The threat of exercising this option is players’ “grim trigger”.

**Credible threat:** Players also have the advantage of decertification being a credible threat since the courts ruled in favor of players after prior union decertification. This tremendously increases player leverage as it allow them to continuously stand firm during the negotiation period, and gives an additional option to exercise should the final deadline pass.

**Waiting game:** Players know that owners have the deep pockets to wait them out. In addition, owners restructured ensuing media deals last year to ensure approximately 4 billion dollars of guaranteed payment to owners (not players) for the upcoming season. These actions led to believe that owners were committing to a lockout strategy. To counter, The NFLPA advised players to save their last three paychecks from the 2010 season in case the entire 2011 season did not happen but it is unseen if may players did this. The NFLPA will also be issuing $60,000 as support to players in event of a lockout. Even with these measures, it is widely believed that these funds will be insufficient to support players’ financial commitments for the upcoming year.

**Lack of trust/transparency:** Owners have been extremely reluctant to open their books to justify the increase in overhead expenses. These restrictive actions have greatly decreased players’ trust in owners because they feel that if owners’ claims are justified, then they should have nothing to hide. It also further shapes players’ desire to get a court resolution rather than continue to negotiate (cooperation). The perceived “owner planned lockout” also adds to this negative image and atmosphere of distrust because ownership is viewed as brandishing its war chest.

**Perceived unfairness:** Players see NFL as wielding too much negotiating power/leverage since they are exempt from anti-trust. They would rather decertify/bring anti-trust lawsuit against owners than settle quickly to get the season started as they think they can get a better deal in court than if they tried to negotiate directly against the NFL. Owners’ attempts to steer the negotiations away from a fixed player salary to one that is has players share in business risk will be difficult given the precedent that has been set by previous players/owners. In fact, any conversation to look at the problem differently or expand the pie to address some of the owners concerns may be limited by the fact that the concept of risk-reward sharing is completely foreign to them. Owners may incur operational risks, but players face health and potential career ending risk every time the ball is snapped.

**Player egos:** Players may insist on going to court just to prove a point even if there is a somewhat attractive deal on the table to prove that they cannot be pushed around by owners.

**Precedent:** Following decertification in a prior labor battle, players won in court and therefore are very confident they can again. History has shown that player gains have come more through litigation than collective bargaining. (This is how the NFLPA, as a “trade association” rather than a union, made significant gains in 1993 with the first free agent, Reggie White, acting as lead plaintiff in a class action lawsuit.)

Owner Mental Model:
**Punishment threat:** Owners have an option to “lockout” players if a deal is not reached by the deadline/no extensions agreed upon. This means that owners can prevent employees from working (players won’t get paid until season starts, no training facilities, etc.).

**Credible threat:** Owners threat of lockout is also a credible threat. It has happened before and players also know/suspect that the owners were intending to do so all along based on the favorable media deals owners struck in 2010. The owners don’t mind going the lockout route because they know, at least in the short-run, that their revenues are somewhat protected. Here the threat value of the option is probably more attractive than actually locking players out and disrupting the season and future cash flows.

**Monopoly power:** While the NFL could not exist without the owners coming together to form the league, the fact that they enjoy anti-trust protection under current labor union laws gives them incredible “pricing power” in terms of setting deal terms for players.

**Waiting game:** The owners were playing a waiting game (as mentioned above). They are hoping that the closer it gets to the start of NFL season, the pressure to resolve the lockout will mount and players will become more desperate and flexible at the bargaining table (i.e. due to outstanding personal financial commitments and obligations, approx. 25% of players live check to check).

**Perceived fairness:** Owners are lobbying for a huge change to the compensation structure as they argue rising costs and risks have severely affected profitability. While this may make some economic sense, it also puts players on the defensive and perhaps even less likely to want to negotiate under what they view as unreasonable expectations (i.e. especially without owners’ books/record transparency).

**Benefits of decertification:** Despite the threat of player decertification, NFL owners could also use decertification to their short-term advantage by trying to negotiate with individual players and possibly bring those who are on the fence/more willing to negotiate over to their side and supplement team with replacement players for the rest of this NFL season. In a sense, they could “pit” the weaker players against the more stubborn ones, creating an inner environment of player struggle/resentment.

**Game Analysis: Part 1**

Until recently, the current NFL “market” had settled into equilibrium for the last five periods (i.e. the collective bargaining agreement renewed five consecutive periods). Led by the rumblings of a few, NFL owners are forcing the issue to develop a new agreement. The major issues that are currently under negotiation are regarding revenue/risk sharing, number of games per season, rookie pay scale, retirement/health benefits. Using the game theory principle of “look forward, reason back”, we were able to construct a simplified and highly stylized game decision tree (see below).

The intent of this decision tree is to provide constraints for each party’s decisions. We started by looking at the negotiations as a multi-shot game. In the analysis, we found that there was no clear mutually best response for both parties, and it was essentially a battle of wills to see which side would cave after a series of deal proposals. In order to provide some limits for the negotiations, we estimated...
the payoffs if both parties were to forego negotiations and move towards a lockout (which would then lead to court).

While there are many variables that could have gone into calculating potential payouts/options etc., to make the analysis less complicated and easier to communicate, we made the following assumptions:

1. There is a 70% chance of the players winning a court battle. This is based on their history of winning the previous court battle.
2. There is a 50% chance that the owners are being honest about the increase in their expenditures (i.e. that $2.4 billion is a fair number to seize prior to revenue split with players)
3. The number of games per season, the number of bye weeks, the unrestricted free agency terms, the rookie pay scale, and the retirement benefits were not necessary for this analysis. This is because these factors have a much smaller impact compared to the revenue share.

Based only on monetary payouts from the decision tree and with only $2.4B expenses option on table, players would choose to go to court. If options to negotiate and settle on packages other than that with $2.4B expenses, players could be convinced to negotiate if package makes them indifferent between deal and the expected value of going to court.
Game Theory: Midterm Project
Team Playadize: Michael Dansbury, Bryan Mao, Cang Quach, Jackie Tay

Game Analysis: Part 2

In the Short-Run: (Coordination game: Scenario 1)

If both sides have done a decision tree analysis similar to what we have done and made approximately the same assumptions, they would find themselves in a coordination game similar to Battle of the Sexes. In this game, if players think owners are going to lockout, they will choose to decertify. If players think owners are willing to negotiate fairly, they will choose to negotiate. The inverse is true for owners’ actions as well. Here the best responses depend entirely on what the other party is thought to be doing (mutually exclusive best outcomes):

- Does not make any sense for one party to execute on a lockout or decertify if the other party is willing to negotiate on terms to be received fairly
- Payouts here are (0,0) because they will never reach an agreement if one of the two parties is not willing to even engage in discussions
- Game of coordination to avoid ending up with (0,0)

Both parties started in the bottom right box, trying to find a CBA agreement that they could agree on.

- Based on the decisions tree analysis, all agreement options on the table favor the owners leaving the players unhappy
- The players already suspected that the owners were just posturing and had been planning a lockout since 2010
- Result is player move to decertify
In the Short-Run: (Coordination game w/ NFL Owner media agreements: Scenario 2)

The NFL owners tried to gain an upper hand through its modified agreements with media companies for the 2011 NFL season:

- The agreements effectively decrease payout to players in the event of the lockout because while owners would still get paid, players would face some financial pressure without their paychecks and make them more likely to negotiate
- However, as the game matrix shows, this does not change the game as the equilibria remain the same at (Lockout/Decertify) and (Negotiate/Negotiate). The new media agreements thus did not effectively change the game and could be construed as wasted effort by the owners

Third party intervention reverts game back to (Coordination: Scenario 1)

With labor talks clinched in a stalemate the day before the deadline, United States District Court Judge David S. Doty ruled NFL owners acted against the best interests of players when it renegotiated its television deals. The federal judge stated the owner’s agreements violated the CBA because NFL owners were not acting good faith to maximize total revenues for both parties. Therefore, the four billion in guaranteed media revenues owners had earmarked in the event of a lockout was no longer permissible. This ruling is tremendously impactful because it because it significantly reduces owners’ financing for the upcoming season. Furthermore, it also acts as another “win” for players in court and elevates their perceptions about winning another legal battle (i.e. ramifications of decertification). This is a definite
setback from the owner’s standpoint as it diluted the potential “threat” effect of a player lockout. Owners must also recognize that their current bargaining power (albeit now diluted) only confers a short-term advantage. However, while they could survive a lockout for one season to prove a point, it may not be worth the long-term consequences of doing so. TV ratings will inevitably plummet, the NFL’s credibility will be in question, and they would be putting their media deals (or ability to get favorable deal terms) at risk in the future. The 1995 MLB, 1999 NBA and 2004 NHL lockout show evidence of this.

While this does not impact players’ current incomes since they are fixed salaried, both owners and players should be thinking about the long-term impact of a lockout on NFL reputation, ticket sales, and setback on NFL growth, because if there is no NFL, no one will be making any money.

- The game reverts back to scenario 1 because owners no longer have the immense leverage once perceived and theirs payoff are effected given the court ruling. Owners are now back in the position where negotiations may present more favorable terms.

Based on the results of the decision tree and pecuniary/non-pecuniary issues above, it appears that rational move for players is to dig their heels in further and seek justice in court. Owners however will find higher expected values if they seek to negotiate.

Recommendations: Changing the Game (theory and the sport)

In the LR: Game with Nash Equilibrium

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<th>Owners</th>
<th>NFLPL (Players)</th>
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<td>Decertify/Court</td>
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</tr>
<tr>
<td>Negotiate</td>
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</tr>
<tr>
<td>Lockout</td>
<td>(1,3)</td>
</tr>
<tr>
<td>Negotiate</td>
<td>(4,4)</td>
</tr>
</tbody>
</table>
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There is an inherent recognition by both sides that while it may make sense for each to decertify and lockout in the short-run, in the long-run there may be consequences on NFL reputation (i.e. ability to command lucrative media deals, ticket sales). In a multi-round/repeated, long-term game, “profits” are maximized when both parties agree to negotiate and resolve the issue with minimal disruption to the upcoming NFL seasons. The dilemma in the “Battle of the Sexes” game was that the players and owners would have to coordinate on whether they were both going to negotiate or whether they were both going to lockout/decertify. The problem was with the distributive nature of either option, meaning that one party would always have a worse payoff than the other party.

To get beyond this impasse, owners should try to work towards a game that has a Nash Equilibrium where both have incentive to negotiate. This can be achieved by modifying payoffs/incentives to make decertification/lockout less appealing:

- Address the unfairness issue by making themselves “equal partners” vs. employers (see below)
- Build trust by opening their books and promising not to engage in side deals with media or other clients that are unilaterally beneficial. As a first step, they could agree to an external audit to verify the costs they are claiming. Transparency with operations/costs will help in re-establishing trust with players
- Owners could also work to remove the option/possibility of a lockout for themselves and drive game towards Negotiate/Negotiate → using tactic of commitment
- Provide carrots in the form of monetary incentives or other benefits in return for cooperation at the bargaining table: possible bonus that comes down in value the longer players hold out from negotiations
- Create more value (expand the pie) by getting conversation beyond just monetary payouts by figuring out what each side wants/values from a non-monetary perspective and see whether can create more value that way (getting to (3,3) in the example).

The current structure of player/owner payouts doesn’t appear to be market driven from the viewpoint of owners as they want players to share more in the risk of the league. Perhaps the entire game needs to be played differently. If owners think players should be sharing in business risk of NFL, they need to get players to see how becoming a “partner” instead of just an “employee” would increase their overall payout in the long-run (one argument: NFL is growing rapidly and if they decide to revenue share, could be more lucrative for them).

- Aligned incentives: Owners could pay players a fixed salary (negotiated base) to compensate for their training/injury risk. This compensation could be a bonus based on how well the team and entire league perform financially per season (i.e. revenue generated through season game expansion). This provides an extra incentive to players to have the league to perform well overall and could be the owners’ way of rewarding/incentivizing players’ cooperation
- Fairness: Owners should similarly get a fixed, negotiated “salary” for managing NFL, governed by an independent board (much like a startup company). Here profits (revenue – all salaries – all audited costs) would then be split in some fashion between players and owners
- Considerations: Long shadow of the end-game: The suggestions above are held within a multiple round game since football is played yearly and there is an incentive to cooperate/not defect on
an agreement. However the end-game here is different for players and owners. Player career’s last an average of 3.5 year career, and are therefore incentivized to make as much money as possible in the short-run and may not be as concerned about long-term profits or cooperation.

Closing

Labor negotiation often center on coordination with distributive attributes and is no different here. When you analyze the key sticking points, players simply don’t trust owners in their expense assessments and the lack of record transparency is halting sides from reaching an agreement. Owners initially held a low-risk aggressive strategy by preparing for a lockout with next season’s media revenues in place. Once the courts removed that negotiation barrier, a repeated game ensued (two deadline extensions and final end move) where both failed to coordinate. Unfortunately the trust needed for such coordination in this game was lost long ago and could not be removed.

What Players should do: Seek their day in court, history is on their side and they were willing to make proper revenue concessions given proven owner costs

What Players will do: Decertify and seek their day in court

What Owners should do: Negotiate given higher expected values in various scenarios

What Owners will do: They will go to court, the last thing they want to do is open their books if they don’t have to and the worst they can do is the current deal in please. Owners can fight again another day once they have proper evidence of cost if current claims are not true
APENDIX

Timeline of NFLPA & NFL Owner Relationship History

Background

- (1956) NFLPA formed as a union
- (1968) First collective bargaining agreement signed (NFL subject to Anti-Trust Laws)
- (1987) League wide strike and union decertification
- Players sue/challenging free agency rules as an unlawful restraint of trade and win!
- (1993) NFL enters a new era of collective bargaining between NFL owners & athletes
- (1993 – Recently) The agreement was extended five times

Current Day

- March 3, 2011 - Sides agree to 24-hour extension.
- March 4, 2011 - Sides agree to seven day extension, new deadline March 11
- March 11, 2011 - No agreement reached, Union decertifies and files an antitrust lawsuit

Sources

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