Bankruptcy of a Professional Sports Franchise and the Implications for the Franchise and Its Players

Kevin R. Schulz
Foley & Lardner LLP

Follow this and additional works at: https://via.library.depaul.edu/jslcp

Recommended Citation
Available at: https://via.library.depaul.edu/jslcp/vol8/iss2/5

This Symposium is brought to you for free and open access by the College of Law at Via Sapientiae. It has been accepted for inclusion in DePaul Journal of Sports Law by an authorized editor of Via Sapientiae. For more information, please contact digitalservices@depaul.edu.
BANKRUPTCY OF A PROFESSIONAL SPORTS FRANCHISE AND THE IMPLICATIONS FOR THE FRANCHISE AND ITS PLAYERS

Kevin R. Schulz,* Foley & Lardner LLP

INTRODUCTION

I am going to take a slightly different approach regarding financial issues in professional sports. Rather than just address the financial challenges facing professional athletes, I will also explore the financial difficulties facing professional sports teams. A number of professional sports teams have filed for bankruptcy in recent years in connection with the sale or potential sale of the franchise. However, their motivations for filing for bankruptcy have varied. I will take a closer look at some of the recently completed bankruptcies involving professional sports teams, specifically: (a) the Chicago Cubs, (b) the Texas Rangers, (c) the Dallas Stars, and (d) the Phoenix Coyotes. I will discuss the motivations for each of those recent bankruptcies and how they differed. While all were in connection with sales,¹ they all had different circumstances.

I will also lend my experiences and insights to discuss ways in which a transaction for the sale of a professional sports team changes once the team enters bankruptcy, and how that affects the team. Specifically, I will offer my personal insight regarding a couple of these deals,

---

* Kevin R. Schulz is a partner with Foley & Lardner LLP. He received his J.D. from the University of Wisconsin and his bachelor’s degree in business administration from the University of Notre Dame.

Mr. Schulz’s practice focuses on mergers and acquisitions (M&A) and commercial transactions, particularly in the food and sports industries. Mr. Schulz regularly represents professional sports teams and their owners and acquirers, including representing Guggenheim Baseball Management in its recent acquisition of the Los Angeles Dodgers (which had not yet been completed when this article was originally presented in March 2012), representing Rangers Baseball Express in its acquisition of the Texas Rangers, representing the Ricketts family in its acquisition of the Chicago Cubs, representing the seller of a significant minority interest in an NFL team, and representing the Milwaukee Brewers in the sale of the club.

Mr. Schulz has presented a number of times on M&A and sports law matters. This article was originally presented at the DePaul Journal of Sports Law & Contemporary Problems 2012 Symposium.

¹ The Chicago Cubs transaction was not actually a sale, but rather a leveraged partnership transaction in which the Ricketts family acquired a controlling interest in the club. However, for ease of reference, the transaction will be referred to in this presentation as a sale.
having represented the Ricketts family in the acquisition of a controlling interest in the Chicago Cubs and the investment group led by Chuck Greenberg and Nolan Ryan in the acquisition of the Texas Rangers. Finally, I will discuss some potential effects of a team bankruptcy on the players and former players from that team.

**Brief Bankruptcy Overview**

I am a mergers-and-acquisitions attorney, not a bankruptcy attorney. Therefore, I will be coming from that perspective. As a result, I will also not be citing a lot of the Bankruptcy Code or providing technical bankruptcy analysis. However, I did want to provide a very basic overview of some key bankruptcy points.

As an initial matter, in each recent example I will be discussing, I am talking about Chapter 11 of the Bankruptcy Code, which contemplates the reorganization of an ongoing business. However, not all sports bankruptcies are successful reorganizations. Some end up in Chapter 7, which contemplates ceasing operations and liquidating the assets of the business. As discussed later, those are far more troubling for players.

Next, when can a company file for bankruptcy? The classic bankruptcy case, and what most people think of, is the company is insolvent and either has more liabilities than assets (i.e., balance sheet insolvency) and/or is unable to pay its liabilities as they become due (i.e., practical insolvency). However, a company does not actually need to be insolvent to go into bankruptcy. Even a solvent company can use bankruptcy so long as it is not using bankruptcy in bad faith—in other words, to accomplish an improper purpose. An example of a proper purpose is to pay creditors in full, as was the case in the Texas Rangers bankruptcy. The Rangers were still able to pay their debts as they became due (although they were starting to face a liquidity crisis) and their assets were greater than their liabilities.

There are a number of benefits for a team that utilizes bankruptcy. An immediate effect of bankruptcy is the automatic stay, which gives debtors breathing room from creditors and an opportunity to get the business back in order. Bankruptcy also can be helpful for teams that are struggling financially by forcing financing for the team (so-called debtor-in-possession or DIP financing). This ensures that the team is kept afloat until it is successfully reorganized or sold. The Rangers, for example, took advantage of DIP financing to address their liquidity issues. Another effect of bankruptcy is on the assets and liens on those assets: Section 363 of the Bankruptcy Code allows a debtor to
transfer its assets to a purchaser free and clear of all liens and encumbrances of the debtor’s creditors.

**Recently Completed Bankruptcies of Professional Sports Franchises**

*Bankruptcy to Effect a Sale: Chicago Cubs*

In the Chicago Cubs deal, the motivation for filing bankruptcy was to consummate a bona fide deal. The Cubs’ parent company, the Tribune Company ("Tribune"), was already in bankruptcy, and the bankruptcy filings revealed the Cubs had guaranteed billions of dollars of debt of Tribune. As a result, all of the Cubs’ assets were subject to liens from Tribune’s creditors. The Cubs were also exposed to a claim by the Pension Benefit Guaranty Corporation ("PBGC") that the Cubs were part of a "controlled group" along with Tribune. When combining the Cubs’ contingent liabilities for the Tribune debt and the potential PBGC claim, the Cubs’ liabilities were far greater than their assets. Therefore, the Cubs entered bankruptcy to clean the team’s credit history and wash its assets through bankruptcy—the buyer needed the Cubs’ assets free and clear of all liens.

Tribune had many creditors and, rather than trying to obtain the consent of each creditor, bankruptcy provided for a more efficient tool for effecting the sale to the Ricketts family. Section 1126(c) of the Bankruptcy Code allows a class of creditors to accept a plan if more than two-thirds in amount and one-half in number of allowed claims that have voted on the plan (i.e., rejecting or accepting) accept the plan. This allows the objection of certain creditors to be overridden, which avoids the ability of some creditors to hold up the deal for "hostage" value.

The Cubs bankruptcy was a quick "in and out" bankruptcy, as planned. The reason the Tribune creditors were willing to consent to the transaction, and not hold up the deal, is because it was a bona fide, arm’s length deal where all of the proceeds were flowing up to the parent company (and thus its creditors) anyway.

*Bankruptcy to Effect a Sale: Texas Rangers*

In the Texas Rangers deal, the bankruptcy process was used to force the issue of a sale and allow it to move forward. Bankruptcy was the chosen weapon of the seller because the lenders were holding out. For months, prior to the bankruptcy, the deal to sell the Rangers to our client (following a competitive auction) was stalled because the creditors to the holding company for the Rangers (for which the team
was a guarantor) would not consent to the deal. Instead, they were holding out for the Greenberg-Ryan group to offer better terms.

When the Rangers filed bankruptcy, the team and the Greenberg-Ryan group presented it as a prepackaged bankruptcy in which all of the creditors of the Rangers (as opposed to the holding company of the Rangers, where the level of debt was higher) would be paid 100%. Typically, in a prepackaged bankruptcy (a "prepack") the debtor has the agreement of its creditors before going into bankruptcy, so that approval by the court will be quick and a mere formality. In the Rangers deal, by contrast, the team and the proposed buyer crafted a prepackaged plan without the involvement of the creditors, arguing the creditors' consent was not necessary because they were unimpaired by the plan (i.e., they would be paid 100% of their claims). The holding company and team creditors did not agree with this view, however, and vehemently objected to the prepackaged plan. In response, the bankruptcy judge ordered an auction, and this deal ended up looking more like a typical bankruptcy sale. The drama ultimately played out in a bankruptcy court in Fort Worth, Texas on August 4, 2010 (and the early hours of August 5), which was a surreal experience. As a transactional attorney, I am never in court, so that was odd enough. Combine that with the media and fan interest and it was a very intense process. The dramatic day-long auction for the team between our client and a group led by Mark Cuban (owner of the Dallas Mavericks) and Jim Crane (now the owner of the Houston Astros) culminated in our client submitting the winning bid after midnight, amidst an eruption of cheers and clapping from the spectators. I likened it to a walk-off home run.

Bankruptcy to Effect a Sale: Dallas Stars

The Dallas Stars were owned by the same holding company that owned the Texas Rangers, and, therefore, faced many of the same creditors the Rangers faced. The Stars used the bankruptcy process as a way to cleanse the Stars' assets of the claims of those creditors. However, unlike the Rangers, which tried to have a prepackaged plan (without an auction) approved in bankruptcy, the Stars went into bankruptcy with a "stalking horse bidder" to see whether that bid could be topped. A stalking horse bidder sets a baseline bid for the auction and gets a breakup fee if its bid is topped. The rationale for paying a breakup fee is that no bidder would otherwise want to spend the time and effort to put together a deal with the team if another bidder can piggyback off of those efforts and top that deal. In the
Rangers deal, the Greenberg-Ryan group ended up as the stalking horse bidder in the bankruptcy auction.

Therefore, the Stars were like a typical bankruptcy sale, with the team trying to sell to the highest bidder in an auction, with the buyer acquiring the assets free and clear of all liens. Although the team was part of an auction, ultimately there ended up being no other bidders; so, in the end, the Stars were sold to the stalking horse bidder, Tom Gaglardi.

Bankruptcy to Effect (or Block) a Sale: Phoenix Coyotes

The Phoenix Coyotes bankruptcy was a little different than the other three examples. Here, the Coyotes’ motivation for filing for bankruptcy was to stop the NHL from taking over the team and selling it to the League’s preferred buyer, Jerry Reinsdorf. With an NHL executive on his way to Phoenix to advise of the NHL’s plans for the franchise, the Coyotes filed for bankruptcy. The Coyotes wanted to use bankruptcy as a way to block the NHL’s efforts and to force through a sale of the Coyotes to its preferred buyer (Jim Balsillie, the former head of BlackBerry maker Research in Motion), who intended to move the team to Hamilton, Ontario.

The NHL responded by stripping then owner Jerry Moyes of his rights as an owner. The NFL, NBA and MLB all filed amicus curiae briefs on behalf of the NHL, warning that any ruling favoring a sale to Balsillie would allow any owner to use bankruptcy to sell a team and move it against a league’s will. Ultimately, the court determined the Coyotes could not use bankruptcy as a way to circumvent the NHL’s rules by trying to force a sale to the team’s preferred buyer when the NHL opposed that.

In the Coyotes deal, bankruptcy can be seen as a tool from the perspective of the seller that was trying to sell the team to its preferred buyer, or as an impediment from the perspective of the NHL, which saw bankruptcy thwart its efforts to sell the Coyotes to its preferred buyer. Eventually, the NHL and the team owner agreed to have the NHL buy the team, which took the Coyotes out of bankruptcy, and the NHL has been trying to sell the team ever since.

Considerations for Franchise in Entering into Bankruptcy

– What Does Bankruptcy Do to the Deal?

There are a number of considerations for a professional sports team considering entering into bankruptcy. First, the team must consider the practical perspective. A sale in bankruptcy is more expensive.
Bankruptcy is, after all, litigation, and litigation is very expensive. For example, depending on the bankruptcy, there could be depositions, document requests, motions, hearings, etc. Bankruptcy can also be more time-consuming, especially for the seller. For example, the bankruptcy estate of the former Texas Rangers entity is still in bankruptcy a year and a half after the sale. Another practical consideration is confidentiality. Although some information can be filed under seal and with protective orders, bankruptcy makes publicly available terms of the deal that would have never otherwise been made publicly available. For example, the entire acquisition agreements for the Cubs and Rangers deals are publicly available because of those bankruptcies. Incidentally, this is another reason why the leagues, whose information is otherwise private and confidential, do not like bankruptcies of their member teams.

In addition to the practical perspective, a team considering bankruptcy must also consider the legal perspective. Some terms of the deal need to change to account for the bankruptcy. And, as much as the buyer and the seller may agree on everything before going into bankruptcy, once the deal is in bankruptcy, their fate is in the hands of a bankruptcy judge, who has broad discretion and may, and in some cases is obligated to, consider the perspectives of third parties (such as creditors). Therefore, in bankruptcy, events might not go as planned, and the parties need to try to account for that ahead of time in their deal documents.

Finally, a team considering bankruptcy must also consider the media perspective. Professional sports teams have loyal followings and will generate a lot of publicity, so a team will want to get out in front of the story to properly frame the bankruptcy. Therefore, it is a good idea for the team to have a public relations firm assisting it. For example, in the Cubs deal, the parties made clear that the bankruptcy was a very technical/legal filing and that the Cubs were in solid financial health.

**Potential Effects of Team Bankruptcy on Players (and Former Players)**

Besides the effect of bankruptcy on the team itself, there are also potential effects on the players and former players from that team. A lot of these potential effects depend on the nature of the bankruptcy, whether the applicable league is well established, or whether it is failing and the member team will cease operations and be liquidated.

One potential effect of a team bankruptcy is on player payroll. Some teams file bankruptcy because they are in jeopardy of missing
payroll for their players. That is another reason why DIP financing is so important for a team in bankruptcy. Even if a player is paid, late payment could still create cash flow issues for the player. My experience has been with teams from the major sports. However, not all teams and leagues are so well established. Some fledgling teams and leagues are more at risk. Therefore, if a team or league goes under (Chapter 7), then the professional athlete is at risk of being without a job altogether, which is obviously a huge concern for him or her.

Players and former players also need to be concerned about any underfunded pension obligations of the team in bankruptcy. Depending on how well a plan's investments do, a defined benefit plan (as opposed to a defined contribution plan) might not accrue sufficient assets to meet its future obligations. If that is the case, then the plan is underfunded. This is obviously a concern for players and former players relying on the pension benefits for retirement. Although the plan assets themselves cannot be reached by team creditors, the team may terminate the plan if it is too expensive to maintain (or if the team ceases operations and liquidates). The PBGC will assume responsibility for the plan under those circumstances and pay some benefits, but only up to a certain statutory limit, potentially leaving players and former players well short of what they believed they would receive under the team's pension plan.

Players and former players will also want to ensure that various benefits and other perks from the team will continue to be honored following bankruptcy. For example, in the Cubs bankruptcy, former shortstop Shawon Dunston filed a claim for college tuition in the event he ever decided to attend. Apparently, the Cubs had promised him that benefit in his very first contract when the team signed him out of high school. With respect to a team's treatment of health insurance and other benefits, a lot will be governed by the applicable league and its collective bargaining agreement with the players union. However, that will be no comfort for a player or former player if the team or league actually folds.

Another concern for players and former players is the potential effect of bankruptcy on deferred compensation. Deferred compensation is money that a team guarantees it will pay a player but for which actual payment is pushed into the future. For example, in the Rangers bankruptcy, the largest unsecured creditor was Alex Rodriguez (“A-Rod”). Obviously, A-Rod had a vested interest in ensuring the team would continue to pay him his deferred compensation in the future.

Possible team relocation is another potential effect of bankruptcy on players. We have the tendency to put professional athletes on such
pedestals that we forget they still have families and lives outside of their jobs. Therefore, if a team will be relocated, players have to think about uprooting their families. For example, if the Coyotes had been sold to Jim Balsillie, as the owner wanted, then the team would have moved from Phoenix to Canada.

A team bankruptcy can also potentially impact contract negotiations with players and free agent signings. A team will have a budget in bankruptcy (which may not permit lavish spending) and may require court approval for signing contracts. In addition, potential acquirers of the team will not want a lot of long-term, back-end-loaded contracts on the books. Also, money may not be available to re-sign a player in a contract year or a free agent hoping to land with the team in bankruptcy.

Finally, there is the potential of a team bankruptcy being a general distraction for players. This is certainly legitimate if a team or league may fold and the player will lose his or her job and benefits. For viable teams and leagues, though, aside from the distractions of a potential relocation or for a player hoping to sign a big deal, the media and public frequently speculate that a team's financial situation is affecting its players' performance. Is this really true? In the season the Rangers filed for bankruptcy, for example, they were one of the best teams in baseball and went on to their first ever World Series. I think players tend to be focused on their own performance, and not on team finances, at least for teams in established leagues. The process is far more stressful for front office personnel who do not have guaranteed contracts and face job uncertainty as a result, and who are oftentimes saddled with the administrative burdens of bankruptcy in addition to their normal job duties.

Conclusion

Team bankruptcies are very complicated and can be motivated by many different factors. However, regardless of the motivations of the team in entering bankruptcy, from the professional athletes' perspectives, their concerns, at least their financial concerns, will depend, in large part, on the strength of the league in which the team operates.