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Reorganization of the Professional Sports Franchise

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REORGANIZATION OF THE PROFESSIONAL SPORTS FRANCHISE

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I. INTRODUCTION

At one point in their history, at least four franchises were in public reorganization – the Baltimore Orioles, the Milwaukee Brewers, the Los Angeles Kings and the Pittsburgh Penguins.¹ The financial viability of a sports franchise is driven by a combination of factors: (1) gates receipts, (2) media revenue, (3) venue revenues, (4) player costs, and (5) operat-

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1. TEAM MARKETING REPORT, INSIDE THE OWNERSHIP OF PROFESSIONAL SPORTS TEAMS 61, 85, 290, 310 (1999).

ing expenses.² As in any business, once the expenses begin to exceed the revenues, a financial reorganization becomes a reality. The most recent professional sports franchise in reorganization was the Pittsburgh Penguins in 1998. The events and circumstances in the Penguins reorganization will be used as examples where instructive.³ The circumstances that caused the Penguins' bankruptcy are likely typical of the circumstances that other franchises may encounter. The factors that coalesced into the Penguins' bankruptcy were:

1. The franchise was undercapitalized at its inception in 1991;
2. during the mid-90s player's salaries increased dramatically;
3. home game attendance and revenues declined; and
4. the 1994-95 lockout exacerbated the franchise's financial problems.⁴

As of the petition date, October 13, 1998, the Pittsburgh franchise was unable to pay its players' salaries.⁵

Financial reorganizations fall into two categories - private or public reorganizations. A private reorganization is an agreement between the debtor and its creditors to restructure the debtor's obligations. A public reorganization is a restructuring through Chapter 11 of the Bankruptcy Code.⁶ Any reorganization, whether private or public, generally focuses on improving the debtor's net income. Since net income is a factor of income minus expenses, the means by which a financially distressed debtor is able to reorganize, either formally or informally, is by some form of debt relief. In fact, the primary means to successfully reorganize is to substantially reduce the debtor's expenses.⁷ The debt reduction normally occurs as a result of either debt forgiveness, or converting the outstanding debt to an equity position in the reorganized entity.⁸ Both of these means were used to reorganize the Pittsburgh Penguins' franchise.

2. MARTIN J. GREENBERG, *THE STADIUM GAME* 16 (2000).

3. *In re* Pittsburgh Sports Assocs. Holding Co., No. 98-28174 (Bankr. W.D. Pa) (*Penguins' bankruptcy*).

4. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux at 1, *Penguins' bankruptcy* (No. 98-28174); Record at 489; Second Amended Disclosure Statement to Disclosure Statement by Liberty/Fox KBL, L.P., SMG Pittsburgh L.P. at 2, *Penguins' bankruptcy* (No. 98-28174); Record at 592.

5. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux at 2, *Penguins' bankruptcy* (No. 98-28174); Record at 489.

6. United States Bankruptcy Code, 11 U.S.C. §§ 1-1330 (1994).

7. *See generally In re* Zenith Elecs. Corp., 241 B.R. 92 (Bankr. D. Del. 1999).

8. *In re* Trans World Airlines, Inc., 185 B.R. 302, 313 (Bankr. E.D. Mo. 1995).

Most business reorganizations are private reorganizations.⁹ A private reorganization, however, generally “requires near universal agreement” amongst the creditors, and “is [relatively] limited in the relief it can provide” when compared to Chapter 11.¹⁰ At the time of the creation of Chapter 11, Congress indicated that the first and best solution for a financial reorganization was a private reorganization, and the use of Chapter 11 should be the last resort.¹¹

Congress prefers private reorganization for at least three reasons.¹² First, a private reorganization is quicker than Chapter 11 reorganization.¹³ The Chapter 11 process invariably involves a much greater time commitment by management.¹⁴ The response time for business decisions in Chapter 11 reorganization is much slower because of the requirements of court approval.¹⁵ Time is the most costly element in any reorganization.¹⁶ Additional time increases costs and reduces the value of the creditor’s return because of the time value of money.¹⁷ Second, a private reorganization is more economic than a Chapter 11 reorganization.¹⁸ The structure of a Chapter 11 reorganization anticipates the expenses of attorneys, creditors and equity holder’s committees, and other professionals, in addition to the operating expenses, which accrue during the Chapter 11 case.¹⁹ These are expensive costs and are called administrative expenses.²⁰ Administrative expenses are required to be paid in full at confirmation.²¹ This requirement forces the debtor to accumulate a substantial cash reserve during the reorganization process. For example, the administrative costs in the Penguins’ reorganization were \$19,815,219.00.²² This is always a difficult task to accomplish and can be a serious impediment to a plan’s confirmation. Third, a private reorgani-

9. *In re Colonial Ford, Inc.*, 24 B.R. 1014, 1015 (Bankr. D. Utah. 1982).

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 1016.

14. 11 U.S.C. §§ 503(b)(1)(A), (b)(3)(D), (b)(4), (b)(5).

15. *Colonial Ford, Inc.*, 24 B.R. at 1016.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. 11 U.S.C. § 503(b).

21. 11 U.S.C. §§ 1129(a)(4), (a)(9).

22. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux at 19, *Penguins’ bankruptcy* (No. 98-28174); Record at 489.

zation is generally most sensible.²³ A private reorganization is generally agreed to in a meeting room between the debtor and its creditors, rather than decided in a courtroom by a judge.²⁴ A private reorganization is best resolved through business judgment rather than legal judgments.²⁵

II. PRIVATE REORGANIZATION

Once a sports franchise finds itself in financial trouble, a private reorganization may be the best solution to its problems. A private reorganization is a non-judicial process in which a financially distressed franchise and its significant creditors reach an out-of-court agreement for adjusting the franchise's obligations.

In addition to the reasons noted by Congress, there are a number of other significant advantages to a private reorganization. First, a private reorganization has no public stigma associated with it, as compared to a public declaration of bankruptcy via Chapter 11. A private reorganization is generally a private matter between the debtor and its creditors. Second, a Chapter 11 reorganization is a very public process. Chapter 11 reorganization requires the bankrupt to make sensitive disclosures about its financial operations through court documents. Any papers filed in a bankruptcy case, including the docket, are public records and "open to the examination" by anyone "at reasonable times without charge."²⁶ The franchise, however, does have the means to protect itself. On request of a party in interest, the bankruptcy court does have the authority to "protect an entity with respect to. . . trade secret[s] or confidential research, development, or commercial information."²⁷ This process is called filing documents with the court under seal. In the Penguins' bankruptcy, the franchise's counsel moved to file documents under seal on the basis that disclosure of such information would cause the franchise to lose its competitive advantage vis-a-vis other National Hockey League (NHL) teams with respect to player bargaining and management and promotional contracts.²⁸ The information sought to be filed under seal was players' salaries and contracts, projected player acquisitions and signing costs, financial projections, its operating budget, and tax re-

23. *Colonial Ford, Inc.*, 24 B.R. at 1016.

24. *Id.*

25. *Id.*

26. 11 U.S.C. § 107(a).

27. 11 U.S.C. § 107(b)(1).

28. Emergency Motion for Order Authorizing the Filing of Documents Under Seal at 3-4, *Penguins' bankruptcy* (No. 98-28174); Record at 14.

turns.²⁹ The court granted limited relief permitting the players' salary list to be filed in-camera.³⁰ Third, in Chapter 11, the officers and executives of the sports franchise are required to be examined under oath in a public hearing.³¹ The § 341 hearing subjects the officers and executives of the sports franchise to questioning by the franchise's creditors and a bankruptcy trustee. Fourth, a private reorganization generally poses no risk of turnover of current management. In Chapter 11, "any party in interest" can petition the court to replace current management.³² Fifth, and perhaps most important, the "ownership" of the franchise is likely to remain intact in a private reorganization. On the other hand, in a Chapter 11, the current "ownership" will likely *not* continue in the reorganized debtor without the contribution of "new value" by the current owners.³³ In the Penguins' bankruptcy, none of the plans submitted provided for the continuation of current ownership.³⁴

There are a number of factors, however, that militate against a private reorganization. First, a private reorganization requires the agreement of substantially all of the creditors of the sports franchise.³⁵ The threat of a Chapter 11 process, however, will cause some of the creditors to become more flexible. In fact, it has been asserted that the real purpose of the Bankruptcy Code is to cause reluctant creditors to grant concessions that will lead to a private reorganization.³⁶ Nevertheless, it is a difficult task to get substantially all the creditors to agree to a private plan of reorganization. Second, the debtor may need certain bankruptcy powers in order to successfully reorganize. There are many powers that are available *only* in bankruptcy and are not available in a private reorganization. Third, if the private reorganization results in any cancellation of debt, such cancellation or forgiveness of debt is considered income to the debtor. In Chapter 11, cancellation of debt is not income.³⁷ Fourth, if the sports franchise wishes to issue securities to secure

29. *Id.*

30. Players' Salary List Filed in Camera; Record at 16, *Penguins' bankruptcy* (No. 98-28174).

31. 11 U.S.C. § 341(d).

32. *Id.* § 1104(a).

33. *See infra* § XI.

34. *Id.* Each plan is discussed in § XI of this article.

35. WEIL, GOTSHAL & MANGES LLP, *REORGANIZING FAILING BUSINESSES: A COMPREHENSIVE REVIEW AND ANALYSIS OF FINANCIAL RESTRUCTURING, AND BUSINESS REORGANIZATION 1-10* (1998).

36. *In re TS Indus., Inc.*, 117 B.R. 682, 688 (Bankr. D. Utah. 1990) (citing Richard I. Aaron, *The Bankruptcy Reform Act of 1978: The Full-Employment-for-Lawyer Bill: Par V: Business Reorganization*, 1982 UTAH L. REV. 1, 16 (1982)).

37. I.R.C. § 108(a)(1)(B) (1998).

additional funds, the Chapter 11 process provides exemptions from securities law compliance,³⁸ which are not available through a private organization.

Finally, there may be certain factors present, which indicate that Chapter 11 is the only choice available. For example, the sports franchise may need immediate relief from aggressive, creditor activity. The filing of a bankruptcy petition automatically protects the franchise from any creditor activity including lawsuits, foreclosure actions or any other kind of collection activity.³⁹ In addition, filing a Chapter 11 permits the sports franchise to stop making payments on virtually all of its pre-petition unsecured debts.⁴⁰ This practice will immediately improve the cash flow of the franchise. However, there is a downside to not paying the pre-petition debts. Current employees will not be happy about not getting their paychecks for the work they performed pre-petition. In the Penguins' bankruptcy, the Penguins moved the court for authority to pay the pre-petition wages of its employees. The court granted the motion.⁴¹ Further, Chapter 11 will permit the sports franchise to more easily obtain credit because of the favorable bankruptcy provisions facilitating the extension of post-petition credit.⁴² Finally, the sports franchise may need certain avoidance or other powers to successfully reorganize which are only available under federal bankruptcy law and not state law.⁴³ For example, in the Penguins' bankruptcy it was considered essential to be able to reject their current lease and local TV contract in order to reduce their expenses and increase revenues.⁴⁴ This could only be accomplished through Chapter 11.

The final decision by the sports franchise on whether to pursue a private reorganization or a public reorganization will depend upon the foregoing factors. In most circumstances, the sports franchise should initially pursue a private reorganization. Failing that, Chapter 11 will be its fall-back position. There is a caveat, however, if the sports franchise reaches agreement on a private reorganization and subsequently wishes

38. 11 U.S.C. § 1145.

39. *Id.* § 362.

40. *Id.* § 502(6).

41. Order of the Court at 2, *Penguins' bankruptcy* (No. 98-28174); Record at 32.

42. 11 U.S.C. § 364(b).

43. *In re H.I.J.R. Prop. Denver*, 115 B.R. 275, 278 (D. Colo. 1990) (illustrating where a bankruptcy action was necessary in order to utilize the one year preference period available only under federal bankruptcy law).

44. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux at 20, *Penguins' bankruptcy* (No. 98-28174); Record at 489.

to convert to a Chapter 11 reorganization. An unsuccessful private reorganization may preclude a subsequent Chapter 11 filing. In *Colonial Ford*, the debtor owned and operated an automobile dealership. The debtor entered into a private reorganization agreement with its creditors whereby the “creditors reduced their claims and gave [the debtor] nine months to [either] sell or refinance” its dealership.⁴⁵ It was further agreed that if the sale or refinancing did not occur by the end of the nine-month period, a decree of foreclosure would be entered against the dealership. The dealership was unable to sell or refinance in the nine-month period, and the creditors pursued the foreclosure of the dealership. The debtor responded by filing a petition for reorganization under Chapter 11. The court dismissed the Chapter 11 petition on the basis that it was in the best interest of the creditors. The court indicated that the dealership sought to keep the benefits of the private reorganization (the reduction in debt and the nine-month grace period), but avoid the burden (the foreclosure). The court reasoned that the policy of the Bankruptcy Code of encouraging out-of-court workouts is best served by enforcing the private reorganization, rather than permitting a Chapter 11 reorganization to occur. The court held that one reorganization was sufficient. Therefore, the court dismissed the Chapter 11 case.⁴⁶

III. PREPACKAGED CHAPTER 11’S

In the event a private reorganization is not feasible, there is an expedited Chapter 11 process available that is the next-best solution. This process is called a prepackaged Chapter 11.⁴⁷ Oftentimes, an out-of-court attempt at financial restructuring leads to the filing of a prepackaged Chapter 11.⁴⁸ Normally, in a prepackaged Chapter 11 case, the solicitation of the creditor’s votes in favor or against the plan occurs in advance of filing the case.⁴⁹ This will be a normal byproduct of the attempt to achieve a private reorganization. Once the requisite percent-

45. *Colonial Ford, Inc.*, 24 B.R. at 1015.

46. *Id.* at 1014-15, 1021-23.

47. Prepackaged Chapter 11 cases are indirectly authorized by the Code. First, a pre-petition creditor’s committee is permitted to continue to act as the creditor’s committee in the bankruptcy case, if it is a representative group. 11 U.S.C. § 1102(b)(1). Second, the debtor is authorized to file a plan with its Chapter 11 petition. *Id.* § 1121(a). And third, pre-petition solicitations are expressly permitted. *Id.* § 1126(b).

48. *In re Zenith Elecs. Corp.*, 250 B.R. 207, 209 (D. Del. 2000), *aff’d*, 258 F.3d 180 (3d Cir. Del. 2001).

49. *Zenith Elecs. Corp.*, 241 B.R. at 98. “Typically, under [C]hapter 11 . . . , the court approves the debtor’s disclosure statement before [the disclosure statement] and the plan of reorganization [] are sent to [the] creditors” for voting. *Id.* “However, Congress [approved]

ages and amounts to approve the plan⁵⁰ are reached, the franchise's plan of reorganization is filed with the bankruptcy petition. At the same time, a request is made for an expedited hearing. At the expedited hearing, the court will determine whether the disclosure statement used to solicit the acceptances was sufficient and whether the solicitation procedures were appropriate. If the court approves the disclosure statement and solicitation procedure, the court will then determine whether the requirements for confirmation have been met.⁵¹ The time period from filing to confirmation can be less than thirty days.⁵² By comparison, the Penguins' bankruptcy took eight months.⁵³

There are a number of advantages to the prepackaged Chapter 11. First, the prototype for a prepackaged Chapter 11 is the over-leveraged debtor with a relatively limited number of creditors.⁵⁴ A financially stressed professional sports franchise fits that prototype and would be an ideal candidate for a prepackaged Chapter 11. Second, and a very significant advantage for a prepackaged Chapter 11, is that the non-consenting creditors who refused to cooperate in the private organization will be bound by the confirmed plan of reorganization.⁵⁵ Third, the prepackaged Chapter 11 is quicker and less expensive than the conventional Chapter 11.⁵⁶ In a conventional Chapter 11 case, the debtor files a bankruptcy petition, negotiates a reorganization plan with its creditors, seeks court approval of a disclosure statement, solicits acceptances, and seeks confirmation of its plan of reorganization. The prepackaged Chapter 11 anticipates a streamlined bankruptcy process, which involves substantially less time and costs. Fourth, the prepackaged Chapter 11 permits the sports franchise to utilize the many advantages of Chapter 11. For example, the ability to obtain court-authorized post-petition fi-

the validity of" soliciting votes prebankruptcy, and continues the "practice which had developed under Chapter [10] of the Bankruptcy Act." *Id.*

50. 11 U.S.C. § 1126(c). "A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class."

51. *Id.* § 1129(a)(1)-(13).

52. *In re Gaylord Container Corp.*, No. 92-13349B, 1993 WL 188671 (E.D. La. Jan. 15, 1993). An outstanding example of a prepackaged plan that was approved by the court in about thirty days of the filing of the bankruptcy petition is *Trans World Airlines, Inc.*, 185 B.R. 302. The court provides an excellent summary of the steps that must be satisfied in order to secure confirmation of the plan of reorganization.

53. *See generally* Docket, *Penguins' bankruptcy* (No. 98-28174).

54. WEIL, GOTSHAL & MANGES LLP, *supra* note 35, at 12-10.

55. 11 U.S.C. § 1141(a).

56. *See generally* Republic Health Corp. v. Coral Gables, Ltd. (*In re* REPH Acquisition Co.), 134 B.R. 194 (N.D. Tex. 1991).

nancing⁵⁷ and the ability to reject executory contracts and unexpired leases⁵⁸ are only available in Chapter 11.

In a prepackaged Chapter 11, the pre-petition solicitation process must ensure that all creditors⁵⁹ who are affected by the plan will receive a disclosure statement.⁶⁰ If the pre-petition procedure does not guarantee such notice, it will violate due process.⁶¹ The pre-petition disclosure statement is required to contain adequate information.⁶² Adequate information is generally defined as that amount and type of information that is sufficient to permit a creditor to make an "informed judgment about the plan."⁶³ The debtor must be careful to provide adequate information on pre-petition solicitations. There is a safe harbor for good faith solicitations that occur post-petition.⁶⁴ It has not been determined, however, whether the safe harbor provision will protect good-faith pre-petition solicitations on prepackaged Chapter 11 cases.⁶⁵ The specific language of the statute, however, exempts from liability all solicitations made in good faith and in compliance with the Bankruptcy Code.⁶⁶

57. 11 U.S.C. § 364(b).

58. *Id.* § 365(a).

59. A creditor is defined as an "entity that has a claim against the debtor." 11 U.S.C. § 101(10)(A). A claim is very broadly defined, and includes a right to payment or an equitable remedy, "whether or not [it is] reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured." 11 U.S.C. § 101(5). An example of where the creditor was not correctly identified is *In re Pioneer Fin. Corp.*, 246 B.R. 626, 634 (Bankr. D. Nev. 2000). The pre-petition solicitations must be sent to the beneficial holders, not the record holders. For example, where a debtor "solicited only the record holders of [securities bonds] by mailing the solicitation materials to [the] broker dealers, who held the securities in street name," proper notice had not been given. *Id.* The court required that the votes be resolicited using procedures designed to obtain and identify the vote of the beneficial holders. *In re Southland Corp.*, 124 B.R. 211, 227 (Bankr. N.D. Tex. 1991).

60. 11 U.S.C. § 1126(b).

61. See generally *In re Colorado Springs Spring Creek Gen. Improvement Dist.*, 177 B.R. 684 (Bankr. D. Colo. 1995).

62. The pre-petition solicitation process must comply with any applicable non-bankruptcy law or the "adequate information" standard of the Bankruptcy Code for post-petition solicitations. 11 U.S.C. § 1126(b). The only possible applicable non-bankruptcy law would be the disclosure requirements under the federal securities laws. The federal securities laws, however, will only apply in those cases where the franchise intends to issue securities as part of its plan of reorganization. In those cases where there will be no new securities issued, the only compliance required will be with the "adequate information" standard. *Id.* § 1145(a)(1).

63. *Id.* § 1125(a)(1).

64. *Id.* § 1125(e).

65. Although a Prepackaged Chapter 11 Plan normally anticipates a pre-filing solicitation of acceptances, courts have approved a procedure that would combine pre-filing and post-filing solicitations. *In re Sunshine Precious Metals, Inc.*, 142 B.R. 918, 920 (Bankr. D. Idaho 1992). Another option is a "pre-negotiated plan," whereby the details of the plan are negotiated prior to the filing of the solicitation, but the solicitation occurs after the filing.

66. 11 U.S.C. § 1125(e).

Therefore, it is reasonable to conclude that the safe harbor provision will protect the sports franchise when soliciting pre-petition acceptances.

Although the disclosure statement and solicitation process may be legally sufficient, individual pre-petition acceptances of the prepackaged Chapter 11 can be challenged on other grounds. Pre-petition acceptances have been successfully challenged where the ballot did not clearly indicate that the vote was in favor of a proposed prepackaged Chapter 11 plan, as opposed to a plan to be drafted in the future.⁶⁷ Also, pre-petition acceptances or rejections can be disregarded if the acceptance or rejection was not made in good faith.⁶⁸ For example, an acceptance will be disregarded if it was "bought."⁶⁹ Pre-petition rejections will be disregarded where the creditor's motive is improper.⁷⁰ The purchase of claims for the purpose of blocking an acceptance of a plan is not improper.⁷¹ However, if the court finds an ulterior motive, such as the intent to damage a competitor's business⁷² or seeking control over the debtor through the plan process,⁷³ the votes of that creditor will be disregarded. In *In re Lehigh Valley Professional Sports Club, Inc.*,⁷⁴ the league was purchasing claims in furtherance of its strategy to block the vote in favor of the franchise's plan of reorganization. Although not ruling on the issue, the court noted that the debtor was free to request the court to designate the purchased claims on the ground that the rejection of the plan was not in good faith.⁷⁵

Prepackaged Chapter 11 cases are also subject to the same infirmities as a conventional Chapter 11 case. Prepackaged Chapter 11 cases have been unsuccessful when the debtor was unable to prepare an acceptable disclosure statement,⁷⁶ current management was deemed unacceptable to operate the debtor during the bankruptcy case,⁷⁷ final agreement was not reached with the "owners" prior to filing the bankruptcy petition,⁷⁸

67. *Pioneer Fin. Corp.*, 246 B.R. at 628.

68. 11 U.S.C. § 1126(e).

69. *In re Featherworks Corp.*, 25 B.R. 634, 640-41 (Bankr. E.D.N.Y. 1982), *aff'd*, 36 B.R. 460 Bankr. (E.D.N.Y. 1984).

70. *Id.*

71. *In re Allegheny Int'l Inc.*, 118 B.R. 282, 289 (Bankr. W.D. Pa. 1990) (citing *In re P-R Holding Corp.*, 147 F.2d 895, 899 (2d Cir. 1945)).

72. *In re Fitger Ltd.*, 118 F.3d 635 (9th Cir. 1997), *cert. denied*, 522 U.S. 996 (1997).

73. *Allegheny Int'l, Inc.*, 118 B.R. at 289-90.

74. No. 00-11296 DWS, 2000 WL 290187 (Bankr. E.D. Pa. Mar. 14, 2000).

75. *Id.*

76. *In re Vista Del Mar Assocs.*, 181 B.R. 422, 423 (B.A.P. 9th Cir. 1995).

77. *In re Bellevue Place Assocs.*, 171 B.R. 615, 623-24 (Bankr. N.D. Ill. 1994), *aff'd*, 1994 U.S. Lexis 17409 (N.D. Ill. Dec. 6, 1994).

78. *In re AM Int'l, Inc.*, 203 B.R. 898 (Bankr. D. Del. 1996).

and the solicitation process contained irregularities.⁷⁹ In addition, prepackaged Chapter 11 cases will not be successful where one of the secured creditors is aggressively pursuing lift stay actions to pursue state foreclosure and otherwise not being agreeable with the franchise. In such a case, the secured creditor may need to be subdued through the cram down process.⁸⁰ The use of the cram down process takes time and subverts the streamlined, prepackaged approach.

IV. FINANCING THE CHAPTER 11 REORGANIZATION

The success of a Chapter 11 reorganization will depend on the ability of the franchise to be able to obtain post-petition financing. The franchise must be able to pay its current operating expenses in order to be able to reorganize its affairs. The franchise is generally prohibited from enforcing any loan agreements or other financial commitments that existed prior to the filing of the case.⁸¹ In addition, the franchise is prohibited from using any cash that is a secured creditor's collateral unless the secured creditor consents to the use of the cash or the franchise is able to secure court approval to use the cash.⁸² As a result of these bankruptcy protections for lenders, in virtually every reorganization, the franchise will be exceedingly cash-poor at inception. It is essential, therefore, to secure post-petition financing. Oftentimes, post-petition financing is arranged prior to filing the bankruptcy petition through negotiations with a pre-petition lender.⁸³ Failing a pre-petition agreement, there are two post-petition means to secure financing – cash collateral financing and/or post-petition credit.

A. Cash Collateral Financing

Upon the filing of the bankruptcy petition, the sports franchise may have cash in its possession or its bank accounts. The cash will most likely be “cash collateral.” Cash collateral is cash or cash equivalents that are claimed by a secured creditor as collateral.⁸⁴ For example, a secured

79. See, e.g., *Southland Corp.*, 124 B.R. at 220-23.

80. 11 U.S.C. § 1129(b)(2). Simply stated, the cram down process is where the debtor and creditor are unable to reach agreement on the secured creditor's treatment in the plan of reorganization, and the court is required to make a legal determination that the franchise's proposed treatment of the secured creditor is fair and equitable.

81. *Id.* § 365(b)(2)(A).

82. *Id.* § 363(c)(2)(A)-(B).

83. See *supra* § II. Any attempt at a private reorganization should include frank discussions with the franchise's current lenders.

84. 11 U.S.C. § 363(a).

creditor who has a secured position in a debtor's inventory will also have a secured position in the cash generated by the sale of the inventory. For a sports franchise, the cash in its possession will be generated from some form of ticket sales,⁸⁵ advertising,⁸⁶ or concession sales.⁸⁷ In most cases, these revenue streams will be used by the sports franchise as collateral. If so, the cash is cash collateral, and its use is restricted. The cash collateral in the Penguins' reorganization was identified as the proceeds from ticket sales, advertising revenues, and TV revenues.⁸⁸ The debtor may use cash collateral to finance its reorganization, but only if the debtor obtains the consent of the secured party or court approval. Cash collateral financing is preferred over post-petition credit because it avoids the payment of interest and other charges that are associated with the four types of post-petition credit.⁸⁹

In order to obtain court approval to use cash collateral, the sports franchise will be required to provide "adequate protection" to the secured claimant.⁹⁰ Adequate protection is determined on a case-by-case basis. The purpose of providing adequate protection is to protect the secured party against any diminution in the value of its collateral during the reorganization process. The courts will generally authorize the use of cash collateral where the sports franchise has an equity cushion⁹¹ or is able to provide one of the other means of adequate protection.⁹² This is particularly so where the cash collateral is being used to preserve the value of the secured party's collateral.⁹³ In the Penguins' reorganization, the Penguins offered a security interest in the franchise's unencumbered

85. These are revenues generated from luxury suites, club seats, personal seat licenses and individual game ticket sales. See *infra* § IX (A) – (D); GREENBERG, *supra* note 2, at ch. 8.

86. Advertising revenue includes naming rights income and advertising income for location within the facility. See *infra* §§ IX (E) – (F); GREENBERG, *supra* note 2, at ch. 8.

87. See *infra* § IX (G); GREENBERG, *supra* note 2, at ch. 8.

88. Emergency Motion For Order Authorizing Use of Cash Collateral at 4, *Penguins' bankruptcy* (No. 98-28174); Record at 10.

89. WEIL, GOTSHAL & MANGES LLP, *supra* note 35, at 9-31.

90. 11 U.S.C. § 363(e).

91. See generally *Pistole v. Mellor (In re Mellor)*, 734 F.2d 1396 (9th Cir. 1984); *First Nat'l Bank of Boston v. Marine Optical, Inc. (In re Marine Optical, Inc.)*, 10 B.R. 893 (B.A.P. 1st Cir. Mass. 1981); *In re WRB W. Assocs. Joint Venture*, 106 B.R. 215 (Bankr. D. Mont. 1989); *Santa Fe Fed. Sav. & Loan Ass'n v. Oak Glen R-Vee (In re Oak Glen R-Vee)*, 8 B.R. 213 (Bankr. C.D. Cal. 1981).

92. 11 U.S.C. § 361.

93. See, e.g., *In re Grant Broad., Inc.*, 75 B.R. 819, 824 (E.D. Pa. 1987); *Principal Mut. Life Ins. Co. v. Atrium Dev. Co. (In re Atrium Dev. Co.)*, 159 B.R. 464, 471 (Bankr. E.D. Va. 1993); *In re Constable Plaza Assocs., L.P.*, 125 B.R. 98, 103 (Bankr. S.D.N.Y. 1991).

assets as adequate protection.⁹⁴ The court granted the Penguins' motion to use cash collateral, but limited the cash collateral available to only the cash from ticket sales.⁹⁵

B. *Post-petition Credit*

The franchise may need to borrow money or obtain credit in order to undertake any rehabilitation efforts under Chapter 11. The need for the infusion of working capital is usually prompted by the severe financial situation that prompted the bankruptcy filing. The Bankruptcy Code provides four levels of authorized financing.⁹⁶ The first level is unsecured credit incurred in the ordinary course of the franchise's business.⁹⁷ The second level is unsecured debt outside the ordinary course of the franchise's business.⁹⁸ The first two levels are accorded administrative expense treatment, which means they are required to be paid in full on the effective date of the plan.⁹⁹ The third level, which is only available if credit cannot be obtained with the administrative expense priority, is debt that is given priority over administrative expenses, is secured by a lien on unencumbered property, or is secured by a junior lien on encumbered property.¹⁰⁰ The fourth level, again which is only available if credit cannot be obtained at the third level, is a debt secured by a senior or equal lien on encumbered property of the estate.¹⁰¹

There are two options to obtain credit on an unsecured basis. First, the sports franchise is permitted to incur unsecured debt in the ordinary course of its business without court approval.¹⁰² Any creditor who extends credit to the sports franchise in the ordinary course of its business will receive administrative expense treatment.¹⁰³ The determination as to what qualifies as a transaction in the ordinary course of the sports franchise's business is a fact-specific determination and will be made on a case-by-case basis. Ordinary course "generally refers to day-to-day

94. Emergency Motion For Order Authorizing Use of Cash Collateral at 13-14, *Penguins' bankruptcy* (No. 98-28174); Record at 10.

95. Interim Order Authorizing Use of Cash Collateral at 5, *Penguins' bankruptcy* (No. 98-28174); Record at 30.

96. *See generally* 11 U.S.C. § 364.

97. *Id.* § 364(a).

98. *Id.* § 364(b).

99. *Id.* § 1129(a)(9)(A).

100. *Id.* § 364(c).

101. 11 U.S.C. § 364(d)(1).

102. *Id.* § 364(a).

103. *Id.* § 364(a).

business affairs.”¹⁰⁴ If court approval is required and not obtained, the post-petition extension of credit will not be accorded administrative expense status.¹⁰⁵ In addition, the extension of credit may be denied the status of a general unsecured claim.¹⁰⁶ Obviously, when in doubt as to whether the extension is in the ordinary course of the sport franchise’s business, the creditor should require the sports franchise to seek court authorization. Second, after notice and a hearing, the bankruptcy court may authorize the sports franchise to incur unsecured debt outside the ordinary course of the its business.¹⁰⁷ This debt is also accorded administrative expense treatment.¹⁰⁸

If the sports franchise is unable to obtain unsecured credit with the promise of administrative expense treatment, the second level to obtain post-petition credit has three options available.¹⁰⁹ After notice and a hearing, the court may authorize the sports franchise to obtain credit or incur debt (1) “with priority over all administrative expenses,”¹¹⁰ (2) “secured by a lien on property that is not otherwise subject to a lien,”¹¹¹ or (3) “secured by a junior lien on property of the estate that is subject to a lien.”¹¹² The three methods are not mutually exclusive and can be used in conjunction with each other. This type of post-petition financing is generally only available when the debtor has assets or equity in the estate sufficient to pay the requested credit extension.¹¹³ Unsecured creditors will normally object to such an extension of credit because it encumbers what otherwise would be unencumbered assets in the estate. In the Penguins’ reorganization, the court granted loan authority for up to \$2.5 million and utilized all three methods available to secure the loan. The loan was given priority over administrative expenses and secured by a lien on all the franchise’s assets.¹¹⁴

104. *Mass. Elec. Co. v. Keydata Corp. (In re Keydata Corp.)*, 12 B.R. 156 (B.A.P. D. Mass. 1981).

105. *William B. Schnach Ret. Trust v. Unified Capital Corp. (In re Bono Dev., Inc.)*, 8 F.3d 720, 721-22 (10th Cir. 1993); *In re Cascade Oil Co.*, 51 B.R. 877, 881-82 (Bankr. D.Kan. 1985).

106. The claim is not a pre-petition claim, nor is it to be treated as one under § 502 or § 503. Therefore, it may not be a claim in the bankruptcy case.

107. 11 U.S.C. § 364(b).

108. *Id.*

109. *Id.* § 364(c).

110. *Id.*

111. *Id.*

112. 11 U.S.C. § 364(c).

113. WEIL, GOTSHAL & MANGES LLP, *supra* note 35, at 9-8.

114. Order of Court at 2, *Penguins’ bankruptcy* (No. 98-28174); Record at 34.

Finally, if neither of the foregoing methods is sufficient to obtain post-petition financing, the sports franchise may be able to obtain credit secured by a prime or equal lien on currently encumbered property.¹¹⁵ As a condition precedent to the grant of this type of credit, the sports franchise must establish that it has made a reasonable effort to seek alternative sources of credit.¹¹⁶ A showing that the franchise has sought credit from lenders within its immediate geographic area will constitute a reasonable effort.¹¹⁷ Thus, if the court is satisfied that the sports franchise has made a reasonable effort to seek alternative sources of financing, and the current secured creditor's position is adequately protected, the court may relegate the lien of an existing secured creditor to a position equal to or junior to the lien afforded to the post-petition lender.¹¹⁸ In the Penguins' bankruptcy, the court granted the franchise authority for a superpriority lien over existing secured creditors in an amount not to exceed \$20 million.¹¹⁹ Adequate protection was provided to the existing secured creditors by a fifteen percent equity cushion.¹²⁰

It is important to act in advance when seeking court approval of post-petition financing. In *Lehigh Valley Professional Sports Clubs*, the league advanced monies during the season by paying expenses for the sports franchise to permit the team to finish its schedule.¹²¹ The expenses paid were players' salaries, meal money, hotels, transportation, equipment and supplies. After the season was completed, the debtor-team moved the court to characterize the payments made by the league as a post-petition loan. The court denied the debtor-team's motion. The court reasoned that the league should have requested loan treatment before advancing the funds, and that the monies advanced by the league were as much for the league's benefit as the debtor-team's benefit. The court concluded that the league had not acted in good faith and denied the requested relief. The league, however, would be subrogated to the legal position of those creditors that were paid by the league.¹²²

115. 11 U.S.C. § 364(d).

116. *Bray v. Shenandoah Fed. Sav. & Loan Ass'n (In re Snowshoe Co.)*, 789 F.2d 1085, 1088 (4th Cir. W. Va. 1986).

117. *Id.*

118. *See, e.g., In re Lehigh Valley Prof'l Sports Clubs, Inc.*, 260 B.R. 745 (Bankr. E.D. Pa. 2001).

119. Memorandum Opinion, *Penguins' bankruptcy* (No. 98-28174); Record at 259.

120. *Id.*

121. 260 B.R. at 748.

122. *Id.* at 749-50, 752-53. *See also* 11 U.S.C. § 509(a); *In re Lehigh Valley Prof'l Sports Clubs, Inc.*, No. 00-11296DWS, 2000 WL 567905 (Bankr. E.D. Pa. May 5, 2000).

V. THE AUTOMATIC STAY

A. *Scope*

Upon the filing of the bankruptcy petition, an automatic stay arises.¹²³ The automatic stay provides the franchise with relief from creditor activity. In a Chapter 11 case, it protects property that may be necessary for the franchise's fresh start and provides breathing space to permit the franchise to focus on its reorganization efforts. Without the automatic stay, the creditors would dismember the franchise's assets. Any action taken in violation of the stay is ineffective even if the creditor has no actual knowledge of the bankruptcy.¹²⁴

The scope of the automatic stay is extremely broad. It applies to virtually every type of formal or informal action against the franchise or property in the estate.¹²⁵ For example, the Penguins moved for sanctions against the City of Pittsburgh for its councilman's statements regarding the failure of the Penguins to pay delinquent taxes due the city.¹²⁶ The franchise argued that the statements by the councilman were apt to have a negative impact on ticket sales. Although the automatic stay protects the franchise against a broad range of actions and creditor activities, it does not protect related entities such as corporate affiliates, partners, or co-defendants in pending litigation. For example, a suit against officers of the franchise is not automatically stayed by the franchise's bankruptcy filing.¹²⁷ Also, an action may be brought against the general partners of a partnership when the partnership, but not the partners, is in bankruptcy. Similarly, an action can be brought against guarantors of the franchise. The bankruptcy court, however, does have the authority to stay actions against related entities if the creditor's action would substantially interfere with the franchise's reorganization.¹²⁸

The automatic stay protects the sports franchise's property as of the moment of filing the bankruptcy petition.¹²⁹ The primary property of a

123. 11 U.S.C. § 362(a).

124. *Canady v. Crestar Mortgage Corp.*, 109 F.3d 969, 972-73 (4th Cir. 1997); *Schwartz v. United States (In re Schwartz)*, 954 F.2d 569, 571-75 (9th Cir. 1992); *Easley v. Pettibone Mich. Corp.*, 990 F.2d 905, 911 (6th Cir. 1993).

125. *See, e.g.*, 11 U.S.C. §§ 362(a)(1)-(2), (a)(5).

126. Emergency Motion to Enforce Automatic Stay and For Sanctions, *Penguins' bankruptcy* (No. 98-28174); Record at 109.

127. *Steaks to Go, Inc. v. Steak-Out Franchising, Inc. (In re Steaks To Go, Inc.)*, 226 B.R. 32, 33-34 (Bankr. E.D. Mo. 1998).

128. 11 U.S.C. § 105. *See also* *Millard v. Developmental Disabilities Inst., Inc.*, 266 B.R. 42, 44-45 (E.D.N.Y. 2001); *United States v. Seitles*, 106 B.R. 36, 40-41 (S.D.N.Y. 1989), *vacated on different grounds*, 742 F. Supp. 1275 (S.D.N.Y. 1990).

129. 11 U.S.C. § 541(a)(3).

sports franchise is its contract rights and leases.¹³⁰ If a contract or lease is terminated under state law prior to the commencement of the bankruptcy case,¹³¹ the automatic stay will not protect it. Therefore, it is important to determine those contracts and leases that continue to remain the property of the sports franchise as of the commencement of the case.¹³²

One area of immediate concern under the automatic stay is administrative freezes. An administrative freeze occurs when a bank freezes a debtor's bank account upon filing for bankruptcy relief. The Supreme Court has approved this practice.¹³³ The bank will return unpaid checks on the franchise's account.¹³⁴ The franchise will need to contact the bank immediately after filing, if it did not do so in advance, to arrange for the continuation of banking. The continuation will be on behalf of the franchise as debtor-in-possession. An alternative approach is for the franchise to file an emergency motion with the court seeking an order to unfreeze the bank accounts and honor all checks presented.¹³⁵ The court granted such a motion in the Penguins' bankruptcy.¹³⁶ Even though the accounts may become unfrozen, cash collateral will become an issue at this point, since the cash in the accounts will likely be cash collateral.¹³⁷

B. *Lifting The Automatic Stay*

Creditors can seek to lift the automatic stay in the bankruptcy court. If successful, the creditor can continue to utilize the state collection process. There are two grounds available to seek relief from the automatic stay. The first ground for relief from the automatic stay is to establish cause.¹³⁸ The most common basis for granting relief for cause is to establish a lack of adequate protection. The Code, however, does not de-

130. See *infra* §§ VI – IX.

131. *Id.*

132. *Id.*

133. *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 20-21 (1995).

134. Upon the filing of the bankruptcy petition, an estate is created. 11 U.S.C. § 541. The automatic stay is in operation to stop the transfer of any estate property. Therefore, banks will not honor checks drawn on bank accounts that are to be paid after the petition date. The banks will simply return the checks to the drawee, who now has a claim in the bankruptcy for the amount of the unpaid check.

135. Joint Emergency Motion for Order Authorizing Maintenance and Use of Prepetition Bank Accounts and for Order Authorizing Debtors to pay Prepetition Wages, Salaries, Commissions, Employee Benefits, Employee Taxes, and to Reimburse Prepetition Employee Business Expenses at 3, *Penguins' bankruptcy* (No. 98-28174); Record at 6.

136. Order of the Court at 2, *Penguins' bankruptcy* (No. 98-28174); Record at 32.

137. See *supra* § IV(A).

138. 11 U.S.C. § 362(d)(1).

fine the term "adequate protection." The Code, however, does recognize three different types of adequate protection.¹³⁹ The three different types are not mutually exclusive. Thus, a franchise could provide adequate protection by offering one or any combination of the three types. Conversely, the failure to provide one of the methods of adequate protection will be cause to lift the automatic stay. In the Penguins' reorganization, the lessor on the Penguins' lease moved for relief from the stay for cause to permit a pending arbitration to go forward.¹⁴⁰ The arbitration was intended to resolve a dispute between the lessor and the Penguins. The court did not find sufficient cause to lift the stay.

One method of providing adequate protection is to make periodic cash payments to the secured creditor.¹⁴¹ The periodic cash payments are made to the extent necessary to compensate a secured party for any decrease in value of its collateral during the bankruptcy.¹⁴² In other words, as the value of the creditor's collateral decreases, the franchise is required to replace that decrease with an equivalent cash payment so that the value of the creditor's interest remains constant.¹⁴³ The second method of providing adequate protection is for the franchise to provide an additional or replacement lien to the extent necessary to compensate the creditor for any decrease in the value of the collateral.¹⁴⁴ The third statutorily recognized means of providing adequate protection is a catch-all provision, which permits the franchise to provide the "indubitable equivalent" to the creditor.¹⁴⁵ Oftentimes, this means that some related third party to the franchise will provide a guarantee to the creditor to protect the creditor's interest. A fourth means of providing adequate protection, which is not in the Code but recognized by the courts, is where the franchise has a sufficient "equity cushion" in the collateral.¹⁴⁶ An equity cushion is a very common form of adequate protection for a secured debt. An equity cushion exists where the value of the collateral exceeds the amount of the creditor's claim against the collateral.¹⁴⁷ In cases where there is a sufficient equity cushion, the courts recognize the

139. *Id.* § 361.

140. Motion for Relief from Automatic Stay at 3-4, *Penguins' bankruptcy* (No. 98-28174); Record at 38.

141. 11 U.S.C. § 361(1).

142. *Id.*

143. *Id.*

144. *Id.* § 361(2).

145. *Id.* § 361(3).

146. *In re C.B.G. Ltd.*, 150 B.R. 570, 571-73 (Bankr. M.D. Pa. 1992); *In re Pub. Serv. Co.*, 88 B.R. 558, 561-62 (Bankr. D.N.H. 1988).

147. *In re Indep. Mgmt. Assocs.*, 108 B.R. 456, 464 (Bankr. D.N.J. 1989).

cushion as providing sufficient protection for the secured creditor. The franchise is not required to provide any other protection. For example, a fifteen percent equity cushion was sufficient in the Penguins' bankruptcy to authorize a superpriority loan.¹⁴⁸

The second ground to seek relief from the automatic stay has two elements.¹⁴⁹ Both elements must be satisfied for the secured claimant to obtain relief from the automatic stay. First, the secured creditor must establish that there is no equity in the collateral the creditor is seeking to foreclose against.¹⁵⁰ A franchise has no equity in the collateral when the total encumbrances against the collateral exceed the value of the collateral. Second, the creditor must establish that the collateral is not necessary for an effective reorganization.¹⁵¹ An effective reorganization means that "there must be 'a reasonable possibility [for] a successful reorganization [in] a reasonable [amount of] time,'" and that the collateral is necessary to that reorganization.¹⁵² It has been held that there is no reasonable possibility of reorganization where the franchise's plan is not feasible, or where the dissent of the creditors indicates that it is unlikely that a Chapter 11 plan can be confirmed.¹⁵³

Oftentimes, as part of a pre-bankruptcy agreement, a debtor agrees not to oppose relief from the stay in the event a bankruptcy ensues. Typically, the creditor providing the debtor in possession financing will require that the debtor agree not to oppose the creditor's relief from the stay in the event the debtor defaults on the loan. Courts are divided on the effectiveness of such waivers.¹⁵⁴

148. See generally Memorandum Opinion, *Penguins' bankruptcy* (No. 98-28174); Record at 259.

149. 11 U.S.C. § 362(d)(2).

150. *Id.* § 362(d)(2)(A).

151. *Id.* § 362(d)(2)(B).

152. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 375-76 (1988) (citing and quoting *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 808 F.2d 363, 370-71 n.12-13 (5th Cir. 1987), *cert. granted*, 481 U.S. 1068 (1987)).

153. *In re 8th St. Vill. Ltd. P'ship*, 94 B.R. 993, 995-96 (Bankr. N.D. Ill. 1988); *Timbers Of Inwood Forest*, 484 U.S. at 379; *Sun Valley Ranches, Inc. v. Equitable Life Assurance Soc'y of the United States (In re Sun Valley Ranches, Inc.)*, 823 F.2d 1373, 1376 (9th Cir. 1987); *Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.)*, 749 F.2d 670, 673-74 (11th Cir. 1984).

154. *In re Powers*, 170 B.R. 480, 482-84 (Bankr. D. Mass. 1994); *In re Cheeks*, 167 B.R. 817, 818-19 (Bankr. D.S.C. 1994); *In re McBride Estates, Ltd.*, 154 B.R. 339, 342 (Bankr. N.D. Fla. 1993); *Farm Credit of Cent. Florida, ACA v. Polk*, 160 B.R. 870, 873-74 (Bankr. W.D. Fla. 1993).

VI. THE FRANCHISE OR MEMBERSHIP AGREEMENT

Membership in a professional sports league is the most valuable asset of the sports franchise.¹⁵⁵ Membership is recognized through a franchise or membership agreement.¹⁵⁶ As part of the Chapter 11 reorganization, the franchise is authorized to assume or reject most executory contracts.¹⁵⁷ A debtor's ability to assume and reject executory contracts is vital to a Chapter 11 reorganization.¹⁵⁸ It is imperative for the sports franchise to maintain its membership in the league by assuming the franchise agreement. Once assumed, the franchise can decide whether it is in its best interest to reorganize itself or assign the franchise agreement to a third party.¹⁵⁹ Therefore, it must be determined whether the membership or franchise agreement is an executory contract subject to assumption.

The Code does not provide a statutory definition of what constitutes an executory contract. Case law reflects that there are currently two interpretations on the meaning of "executory." One interpretation, which is supported by legislative history, provides that an executory contract is one on which performance remains due to some extent on both sides.¹⁶⁰ This interpretation has been refined to mean that a contract is executory where enough performance remains due on both sides that nonperformance by either would qualify as a material breach of the contract.¹⁶¹ This is called the material breach test and is the prevailing standard used by the courts. The second interpretation provides that a contract will be deemed an executory contract if it is in the best interest of the estate to be able to either accept or reject the contract.¹⁶² This is called the functional analysis test. Whether a contract is "executory" is determined as of the time that the court conducts the hearing to assume or reject the contract. A professional sports franchise agreement is an executory con-

155. *Lehigh Valley Prof'l Sports Clubs, Inc.*, 2000 WL 567905, at *8.

156. GREENBERG, *supra* note 2, at 433.

157. 11 U.S.C. § 365(a).

158. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 529 (1984).

159. *In re Wills Motors, Inc.*, 133 B.R. 297, 302-03 (Bankr. S.D.N.Y. 1991).

160. 11 U.S.C.A. § 365 (West 2001); H.R. REP. NO. 95-595, at 347 (1977).

161. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973).

162. *Seymour v. Hamlin (In re Seymour)*, 144 B.R. 524, 529-30 (Bankr. D. Kan. 1992); *In re Sentele Trucking Corp.*, 93 B.R. 551, 555 (Bankr. N.D. Ohio 1988); *Fox v. Hill (In re Fox)*, 83 B.R. 290, 298-99 (Bankr. E.D. Pa. 1988); *Chattanooga Mem'l Park v. Still (In re Jolly)*, 574 F.2d 349, 351 (6th Cir. 1978), *cert. denied*, 439 U.S. 929 (1978).

tract under either interpretation.¹⁶³ Therefore, it can be assumed in the reorganization.

The franchise agreement must not be terminated at the time of the filing of the bankruptcy petition. The events that would justify a league terminating a franchise's membership are contained in each league's Constitution and Bylaws. For example, the NHL has two types of terminations in its Constitution. Membership can be terminated automatically or upon the vote of three-fourths of the league members.¹⁶⁴ Automatic termination occurs if a franchise files a petition for reorganization or disbands its team during the league season.¹⁶⁵ The automatic termination clauses, however, will not have their intended effect. Any automatic termination of the franchise agreement as a result of filing the Chapter 11 petition will not be a valid termination. Such a provision violates the *ipso facto* protection for debtors.¹⁶⁶ Further, it is highly unlikely that an automatic termination would occur as a result of a franchise disbanding its team during the season. Any prudent franchise would file its petition for Chapter 11 relief before ever disbanding its team during the league season. The Penguins, for example, filed their petition during the league season in the hope that Chapter 11 would assist them in completing the season. Thus, it is highly unlikely that the automatic termination for disbanding its team will ever come into operation.

There are ten events that can be the basis for termination by a three-fourths membership vote.¹⁶⁷ The ten events are: (1) a violation of the Constitution or Bylaws; (2) failure to pay dues or other indebtedness when due; (3) failure to fulfill its contractual obligations, including but not limited to payment of the player's salaries; (4) wagering or countenancing of wagering by its officers or employees on any hockey game; (5) permitting any betting upon any premises owned or controlled by the member; (6) involved in any way in manipulating the score of any

163. *In re Monus*, 1995 WL 469694 (Bankr. N.D. Ohio 1995).

164. Response of the National Hockey League to Debtors' Emergency Motion For Order Authorizing Debtor-In-Possession Financing Pursuant to 11 U.S.C. §§ 105, 362, 364(C)(1), 364(C)(2), 364(C)(3), and 364(d) and Bankruptcy Rules 2002, 4001 and 9014 at Exhibit A, at 6, *Penguins' bankruptcy* (No. 98-28174); Record at 135 (NHL Const. § 3.9).

165. Record at 135 (NHL Const. § 3.9(a)).

166. 11 U.S.C. § 365(e)(1). For a more detailed discussion of *ipso facto* protection, see the end of this subsection.

167. Response of the National Hockey League to Debtors' Emergency Motion For Order Authorizing Debtor-In-Possession Financing Pursuant to 11 U.S.C. §§ 105, 362, 364(C)(1), 364(C)(2), 364(C)(3), and 364(d) and Bankruptcy Rules 2002, 4001 and 9014 at Exhibit A, at 6-7, *Penguins' bankruptcy* (No. 98-28174); Record at 135 (NHL Const. § 3.9(b)).

game; (7) failure to participate in league governance; (8) failure to present its team for play according to the league schedule; (9) failure to comply with any order of the Board of Governors; and (10) any attempt to transfer its franchise membership other than in accordance with league rules.¹⁶⁸ These events are a valid basis for terminating the franchise's membership. However, if the franchise files its petition before the league vote, the automatic stay will enjoin any further action by the league, including the vote.¹⁶⁹ On the other hand, if the vote occurs before the petition is filed, the franchise agreement will be validly terminated under state law.¹⁷⁰

A franchise agreement that has been validly terminated pre-petition is not an executory contract.¹⁷¹ If validly terminated, it cannot be revived.¹⁷² In addition, a valid termination is not subject to attack as a fraudulent conveyance or preference.¹⁷³ However, if any of the contractual time to cure remains at the time of filing the petition, the franchise agreement will be considered an executory contract, and subject to cure and assumption.¹⁷⁴ In addition, if the franchise agreement was improperly terminated, the bankruptcy courts can reinstate it.¹⁷⁵

The franchise must assume or reject any executory contract in its entirety.¹⁷⁶ In other words, the franchise may not assume favorable provisions while eliminating unfavorable ones. The Code, however, does not provide any standard for the court when addressing the assumption or rejection request. The primary standard used by the courts is the business-judgment rule.¹⁷⁷ Under the business-judgment rule, the assump-

168. *Id.*

169. *Id.*

170. *Id.*

171. *Post v. Sigel & Co. (In re Sigel & Co.)*, 923 F.2d 142, 145 (9th Cir. 1991); *Days Inns of Am. Franchising, Inc. v. Gainseville P-H Prop's., Inc. (In re Gainesville P-H Prop's., Inc.)*, 77 B.R. 285, 295-96 (Bankr. M.D. Fla. 1987); *Richfield Co. v. Herbert (In re Herbert)*, 806 F.2d 889, 893 (9th Cir. 1986); *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1212 (7th Cir. 1984), *cert. denied*, 469 U.S. 982 (1984).

172. *See generally In re Maxwell*, 30 B.R. 982 (Bankr. N.D. Ill. 1983), *rev'd*, 40 B.R. 231 (N.D. Ill. 1984).

173. *In re Egyptian Bros. Donut*, 190 B.R. 26, 30-31 (Bankr. D.N.J. 1995) (citing *Haines v. Regina C. Dixon Trust (In re Haines)*, 178 B.R. 471, 475 (Bankr. W.D. Mo. 1995)); *Callia v. Original Great Am. Chocolate Chip Cookie Co., Inc.*, 1994 WL 151091, at *4 (E.D. La. April 13, 1994).

174. *In re Masterworks, Inc.*, 100 B.R. 149, 151 (Bankr. D. Conn. 1989).

175. *Comp III, Inc. v. Computerland Corp.*, 136 B.R. 636, 639 (Bankr. S.D.N.Y. 1992).

176. *Steaks To Go, Inc.*, 226 B.R. at 38.

177. *Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1099 (2d Cir. 1993), *cert. dismissed*, 511 U.S. 1026; *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1309 (5th Cir. 1985) (citing and quoting Group of Institutional

tion or rejection will be approved upon a showing that the action will benefit the franchise.¹⁷⁸ For example, in the Penguins' reorganization, the franchise's contract with Ticketmaster was assumed to permit the franchise to continue to sell tickets.¹⁷⁹ Rejection of an executory contract results in the claim being treated as a pre-petition breach.¹⁸⁰ Any provision in a contract whereby the franchise agrees not to reject an agreement in the event of bankruptcy is unenforceable.¹⁸¹

The franchise may assume an executory contract that is in default.¹⁸² Therefore, even if the franchise has committed a terminating event under the league Constitution or Bylaws, and assuming the league vote did not occur before filing the petition, the franchise can still assume the franchise agreement. However, the franchise must cure the default, provide compensation for any losses, and "provide [] adequate assurance of future performance" under the franchise agreement.¹⁸³ This is important because the foundation of any reorganization will require the assumption of the franchise agreement with the league.

Certain defaults, however, are not curable. In the event the franchise fails to maintain operations¹⁸⁴ or is involved in any illegal activity,¹⁸⁵ the default will be deemed an incurable one. The effect of an incurable default is to render the franchise agreement non-assumable in the reorganization. The practical effect is the death knell for the franchise. It is also important to note that a default cannot be declared because of the franchise's insolvency or filing of a bankruptcy petition.¹⁸⁶ In addition,

Investors v. Chicago, Milwaukee, St. Paul & Pac. R.R., 318 U.S. 523, 550 (1943)); *In re Prime Motor Inns*, 124 B.R. 378, 381 (Bankr. S.D. Fla. 1991).

178. *Orion Pictures Corp.*, 4 F.3d at 1099.

179. Motion for an Order Under 11 U.S.C. § 365 Authorizing Assumption of Executory Contract with TicketMaster – Pittsburgh, Inc. at 2, *Penguins' bankruptcy* (No. 98-28174); Record at 178.

180. 11 U.S.C. § 365(g).

181. *In re Trans World Airlines, Inc.*, 261 B.R. 103, 113, 115 (Bankr. D. Del. 2001).

182. A contract in default must be distinguished from a contract that has been terminated. A contract that has been validly terminated according to the terminating events specified in the contract cannot be assumed. *Sigel & Co.*, 923 F.2d at 144-45; *Moody*, 734 F.2d at 1215-16. A contract in default is one that has not yet been terminated, but one of contracting parties is in breach.

183. 11 U.S.C. § 365(b)(1)(A)-(C); see also *In re JLS Shamus, Inc.*, 179 B.R. 294, 297 (Bankr. M.D. Fla. 1995).

184. *In re Vitanza*, 1998 WL 808629 (Bankr. E.D. Pa. Nov. 13, 1998); *In re Lee West Enter., Inc.*, 179 B.R. 204, 209 (Bankr. C.D. Cal. 1995); *In re Deppe*, 110 B.R. 898, 904-05 (Bankr. D. Minn. 1990).

185. *Caribbean Gulf Refining Corp. v. Quinones Ruiz* (*In re Quinones Ruiz*), 98 B.R. 636, 638-39 (Bankr. D. PR. 1988).

186. 11 U.S.C. § 365(b)(2).

there can be no forfeiture or loss of any rights under the franchise agreement as a result of the franchise's insolvency or the filing of its bankruptcy petition.¹⁸⁷

Certain contracts may not be assumed or assigned under the Bankruptcy Code.¹⁸⁸ If the franchise agreement is one of them, a Chapter 11 reorganization cannot occur. The courts have developed three views when identifying those contracts that can not be assumed and assigned. The narrowest view is that the franchise may not assume or assign a contract that qualifies as a personal service contract without the consent of the other party.¹⁸⁹ A personal service contract involves a special relationship, knowledge or skill, which under state law is deemed non-delegable.¹⁹⁰ A common example of the personal service contract exception is when the bankrupt is an artist commissioned to produce a work. Under such circumstances, the bankrupt is not permitted to assume and assign the contract to some other artist for performance. The primary purpose behind the personal service exclusion is to ensure that the non-debtor party is not denied the benefit of his bargain.¹⁹¹ The personal skills are considered to be the essential part of the bargain. A debtor's rights under a patent license have been held to be personal and non-delegable.¹⁹² On the other hand, virtually every franchise agreement has been held not to be a personal service contract.¹⁹³ Even where the franchise agreement specified that a particular person was required to manage the franchise, that was not sufficient to convert the franchise agreement into a personal service contract.¹⁹⁴ The issue whether membership in a professional sports league through a franchise agreement is a personal service contract has been raised, but not yet answered.¹⁹⁵ Most likely, the professional sports franchise agreement will not fall

187. *Id.* § 365(f)(3).

188. *Id.* § 365(c).

189. *Abney v. Fulton County (In re Fulton Air Serv., Inc.)*, 34 B.R. 568, 571-72 (Bankr. N.D. Ga. 1983); *In re Bronx-Westchester Mack Corp.*, 20 B.R. 139, 143 (Bankr. S.D.N.Y. 1982); *Varisco v. Oroweat Food Co. (In re Varisco)*, 16 B.R. 634, 638 (Bankr. M.D. Fla. 1981); *In re Taylor Mfg., Inc.*, 6 B.R. 370, 371-72 (Bankr. N.D. Ga. 1980).

190. *In re Alltech Plastics, Inc.*, 71 B.R. 686, 688 (Bankr. W.D. Tenn. 1987).

191. WILLIAM L. NORTON, JR., *NORTON BANKRUPTCY LAW & PRACTICE* §39.20 (2d ed. 1993).

192. *Alltech Plastics*, 71 B.R. at 689.

193. *In re Optimum Merchants Servs.*, 163 B.R. 546, 554-54 (Bankr. D. Neb. 1994); *Leonard v. General Motors Corp. (In re Headquarters Dodge, Inc.)*, 13 F.3d 674, 684 (3d Cir. 1993); *In re Sunrise Rests., Inc.*, 135 B.R. 149, 153 (Bankr. M.D. Fla. 1991); *In re Tom Stimus Chrysler-Plymouth, Inc.*, 134 B.R. 676, 679 (Bankr. M.D. Fla. 1991).

194. *Tom Stimus Chrysler-Plymouth, Inc.*, 134 B.R. at 678-79.

195. *Lehigh Valley Profl Sports Clubs, Inc.*, 2000 WL 567905.

within the personal service exclusion. Therefore, it would be assumable and assignable under the narrow view.

The broad view recognizes any and all restrictions on assignment whether by statute, contract or otherwise.¹⁹⁶ In other words, if the franchise agreement required the consent of the league in order to assign the franchise, that clause would be valid in the reorganization proceedings. It is generally understood that in order to transfer ownership of a franchise, league consent is required.¹⁹⁷ Under the broad view, the franchise would be able to assume the membership agreement as debtor-in-possession.¹⁹⁸ However, the debtor-in-possession would not be able to assign the franchise agreement to a new entity without the consent of the league.¹⁹⁹ For example, the debtor-in-possession in the Penguin's reorganization was a corporation. The plan that was confirmed by the court provided that the reorganized entity would be a limited partnership. Further, the plan provided that the franchise agreement would be assumed and assigned to the new entity.²⁰⁰ Therefore, the plan indicated that League consent was one of the conditions of its confirmation. The League cannot, however, unreasonably withhold its consent.²⁰¹

The middle view is a combination of the first two. The middle view adopts the personal service exception, and recognizes any and all restrictions on assignment whether by statute, contract or otherwise, but only on contracts of significant public importance.²⁰² Courts have held defense contracts²⁰³ and airport contracts²⁰⁴ to be contracts of significant public importance. On the other hand, a shopping center lease that pro-

196. *In re West Elecs. Inc.*, 852 F.2d 79 (3d Cir. 1988); *In re Pioneer Ford Sales, Inc.*, 729 F.2d 27, 28-29 (1st Cir. 1984).

197. GREENBERG, *supra* note 2, at 433; See also Response of the National Hockey League to Debtors' Emergency Motion For Order Authorizing Debtor-In-Possession Financing Pursuant to 11 U.S.C. §§ 105, 362, 364(C)(1), 364(C)(2), 364(C)(3), and 364(d) and Bankruptcy Rules 2002, 4001 and 9014 at Exhibit A, at 6, *Penguins' bankruptcy* (No. 98-28174); Record at 135.

198. *City of Jamestown, Tenn. v. James Cable Partners (In re James Cable Partners)*, 27 F.3d 534, 537-38 (11th Cir. 1994); *In re James Cable Partners*, 148 B.R. 59, 61-62 (Bankr. M.D. Ga. 1992).

199. See, e.g., *Ford Motor Co. v. Claremont Acquisition Corp. (In re Claremont Acquisition Corp.)*, 186 B.R. 977, 983-84 (Bankr. C.D. Cal. 1995); *In re Van Ness Auto Plaza, Inc.*, 120 B.R. 545, 547 (Bankr. N.D. Cal. 1990).

200. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux, *Penguins' bankruptcy* (No. 98-28174); Record at 489.

201. *Leroy's Horse & Sports Place v. Racusin*, 182 F.3d 926 (9th Cir. 1999); *Claremont Acquisition Corp.*, 186 B.R. at 984-85; *Van Ness Auto Plaza, Inc.*, 120 B.R. at 547-48; *In re Spare Consol. Assets Corp.*, 360 F.2d 882 (2d Cir. 1966).

202. *In re Headquarters Dodge, Inc.*, 1992 WL 437432, at *6 (D.N.J. 1992).

203. *West Elecs. Inc.*, 852 F.2d at 83.

hibited the tenant from assigning the leasehold without the landlord's consent was held not to be of significant public importance.²⁰⁵ Therefore, the Chapter 11 tenant was able to assign the leasehold over the landlord's objection, despite the fact that the lease expressly required the landlord's consent to assign. Although a franchise agreement does not generally constitute a contract of public importance,²⁰⁶ a community's participation in the activities of a professional sports franchise is likely to be considered by the courts as a matter of significant public importance. If so, under the middle view, the franchise will be able to assume the membership agreement as debtor-in-possession,²⁰⁷ but may not be able to assign the franchise agreement to a new entity without the consent of the league.²⁰⁸ Again, consent cannot be unreasonably withheld.²⁰⁹ In the Penguins' reorganization, the implementation of the confirmed plan was conditioned on the NHL's consent to the assignment of the membership agreement to a new entity.²¹⁰ Upon assignment, the franchise is relieved of liability for any post-assignment breaches of the contract.²¹¹ However, the assignment does not relieve any guarantor of the original contract from liability arising from a post-assignment breach.²¹²

Pre-petition loan contracts, credit contracts, and other forms of financial accommodations are also not assumable in bankruptcy.²¹³ Lenders are not required to make financial advances or loans pursuant to a pre-petition credit agreement because of the franchise's changed financial status. Rather, the franchise needs to arrange for post-petition financing.²¹⁴ However, a pre-petition contract to extend credit or to make a financial accommodation that is entered into in anticipation of bankruptcy is assumable post-petition.²¹⁵ Such a contract is treated as a typi-

204. Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re Braniff Airways, Inc.*), 700 F.2d 935, 943 (5th Cir.1983).

205. *In re Federated Dep't Stores, Inc.*, 126 B.R. 516, 518-19 (Bankr. S.D. Ohio 1990).

206. *Headquarters Dodge*, 1992 WL 437432, at *7.

207. *James Cable Partners, L.P.*, 27 F.3d at 537; *James Cable Partners*, 148 B.R. at 61-62.

208. *Van Ness Auto Plaza, Inc.*, 120 B.R. at 546-47; *Claremont Acquisition Corp.*, 186 B.R. at 984.

209. *Worthington v. General Motors Corp. (Claremont Acquisition Corp.)*, 113 F.3d at 1032; *In re Fashion World, Inc.*, 44 B.R. 754, 757-58 (Bankr. D. Mass. 1984).

210. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux, *Penguins' bankruptcy* (No. 98-28174); Record at 489.

211. 11 U.S.C. § 365(k).

212. *Wainer v. A.J. Equities, Ltd.*, 984 F.2d 679, 684 (5th Cir. 1993).

213. 11 U.S.C. § 365(c)(2).

214. *See supra* § IV.

215. *TS Indus. Inc.*, 117 B.R. at 687.

cal executory contract, and thus subject to assumption or rejection.²¹⁶ In addition, if the pre-petition contract provides that the creditor consents to the post-petition assumption of the debt financing agreement, such consent will be enforceable in bankruptcy.²¹⁷ Again, the courts wish the parties to pursue a private reorganization first, then a public one, if necessary.²¹⁸

The franchise may assume or reject executory contracts at any time before confirmation of the plan, unless the court sets an earlier time.²¹⁹ In most cases, the assumption or rejection of executory contracts in Chapter 11 is addressed in the plan of reorganization. During the period before the assumption/rejection decision is made, the executory contract remains in effect.²²⁰ The non-bankrupt party to the contract is required to comply with its obligations until the assumption/rejection decision is made.²²¹ The fact that the contract or lease may ultimately be rejected does not excuse performance. If the non-bankrupt party wishes to accelerate the assumption/rejection decision, it must request a hearing from the court.²²²

Finally, *ipso facto* clauses are not enforceable in bankruptcy.²²³ An *ipso facto* clause is one that causes a contract to terminate upon the franchise's insolvency or bankruptcy.²²⁴ A franchise's insolvency or bankruptcy is a common ground for termination of the franchise's membership in the league.²²⁵ Such a contract clause or provision in the league's membership agreement, Constitution, or Bylaws is unenforceable in the franchise's bankruptcy. In conjunction with such a clause, it is also commonly provided that the member agrees not to contest the automatic termination in any court proceeding.²²⁶ This kind of a provi-

216. *Id.*

217. *In re Prime, Inc.*, 15 B.R. 216, 219 (Bankr. W.D. Mo. 1981).

218. *Colonial Ford, Inc.*, 24 B.R. at 1015.

219. 11 U.S.C. § 365(d)(2).

220. Douglas W. Bordewieck, *The Postpetition, Pre-Rejection, Pre-Assumption Status of an Executory Contract*, 59 AM. BANKR. L.J. 197, 200, 211-13 (1985).

221. *Id.* at 200.

222. 11 U.S.C. § 365(d)(2).

223. *Id.* § 365(e)(1).

224. *Id.* § 365(e)(1)(A) - (B).

225. For example, the NHL Constitution provides for automatic termination of the franchise's membership in the event of filing a bankruptcy petition. Response of the National Hockey League to Debtors' Emergency Motion For Order Authorizing Debtor-In-Possession Financing Pursuant to 11 U.S.C. §§ 105, 362, 364(C)(1), 364(C)(2), 364(C)(3), and 364(d) and Bankruptcy Rules 2002, 4001 and 9014 at Exhibit A, at 6, *Penguins' bankruptcy* (No. 98-28174); Record at 135 (NHL Const. § 3.9(a)).

226. Response of the National Hockey League to Debtors' Emergency Motion For Order Authorizing Debtor-In-Possession Financing Pursuant to 11 U.S.C. §§ 105, 362, 364(C)(1),

sion would also be unenforceable in bankruptcy to the extent it seeks to validate an *ipso facto* violation. Interestingly, it has also been suggested that working capital requirements or minimums may also violate the *ipso facto* prohibition.²²⁷

VII. THE LEASE OR SPORTS FACILITY AGREEMENT

A typical condition of league membership is that the sports franchise has a facility to play its home games.²²⁸ In most cases, the franchise satisfies this requirement by a lease agreement with the owner of a sports facility. This lease, however, has become more than a mere conveyance of property.²²⁹ In the sports law nomenclature, this lease has matured into a sports facility agreement.²³⁰ The sports facility agreement is a revenue sharing agreement whereby the facility owner and the sports franchise agree to share the revenue and expenses generated by the facility.²³¹ It is intended to balance the competing interests between the owner of the sports facility and the sports franchise. The revenue generated by the facility is allocated between retiring the facility's construction costs and the sport franchise's revenue.²³² There are no standard terms for the allocation of the various revenue streams.²³³ Each sports facility agreement is negotiated independently and the allocation of revenues will depend significantly on the unique situation of each facility owner and sports franchise.²³⁴ For bankruptcy purposes, however, the sports facility agreement is still a lease.²³⁵

364(C)(2), 364(C)(3), and 364(d) and Bankruptcy Rules 2002, 4001 and 9014 at Exhibit A, at 10, *Penguins' bankruptcy* (No. 98-28174); Record at 135 (NHL Const. § 3.13).

227. *In re Great Northwest Recreation Ctr., Inc.*, 74 B.R. 846, 855-56 (Bankr. D. Mont. 1987).

228. See generally GREENBERG, *supra* note 2.

229. *Id.* at 568

230. *Id.*

231. *Id.* at 25.

232. *Id.* at 271

233. *Id.* at ch. 8.

234. *Id.* at 24.

235. Residential and nonresidential leases of real property are treated differently under the Code. Therefore, a threshold question is whether the lease is a nonresidential lease of real property. The focus of the inquiry is not whether it is a commercial or consumer lease. The focus is on the type of activity being conducted on the premises. If the lease involves any type of residential use, it will be construed to be a residential lease. For example, a nursing home operation has been held to be a residential lease. *E.g., In re Care Givers, Inc.*, 113 B.R. 263, 268 (Bankr. N.D. Tex. 1989). The legislative history, which discusses the meaning of nonresidential real property, is replete with references to shopping centers as nonresidential property. *Id.* at 266-67. A sports facility lease is similar in nature to a shopping center lease. Therefore, the sports facility lease should qualify as a nonresidential lease of real property.

A modern sports facilities generally costs between \$200 million and \$400 million.²³⁶ It is normally financed through a combination of public and private financing, which means the development authority is typically a quasi public/private partnership.²³⁷ The current breakdown on average cost contribution for stadium construction is 71% public and 29% private.²³⁸ It appears that the future trend for sports facility construction is moving to a more private and less public support.²³⁹ This trend will result in additional financial stress on sports franchises.

The lessor in the sports facility lease is generally the party that owns and operates the sports facility. One-third of the sports facilities are owned by the sports franchise.²⁴⁰ Obviously, in those cases there is no lease or sports facility agreement. In the other two-thirds of facilities, the franchise's bankruptcy will involve a lease agreement. The lessee in the sports facility lease is the sports franchise that has been granted the right to use the facility. In ninety-three percent of the cases, the lessee for a professional sports franchise is either a limited partnership or a corporation.²⁴¹ This will typically be the legal entity in Chapter 11 seeking to reorganize. In the Penguins' case, it was a corporation.

As part of the Chapter 11 reorganization, the franchise is authorized to assume or reject unexpired leases.²⁴² The primary standard used by the courts when reviewing the assumption/rejection decision is the busi-

236. GREENBERG, *supra* note 2, at 54.

237. *Id.* at 182.

238. The source of public monies for stadium construction is tax revenue, government grants and/or land contributions. *Id.* at 186-190. The source of private monies for stadium construction is cash equity contributions, up front naming rights, concessionaire fees and premium seating deposits. *Id.* at 186.

239. *See generally id.* at ch. 4.

240. *Id.* at 108.

241. *Id.* at 115.

242. 11 U.S.C. § 365(a). If the debtor in a bankruptcy case is the lessor, the lessee (sports franchise) is given exceptional rights under the Bankruptcy Code. The lessor may reject any unexpired lease, but the sports franchise has the option of either treating the lease as terminated, or remaining in possession of the premises for the remainder of the lease term, plus any extension. In other words, the rejection of the lease would not deprive the sports franchise of its rights to occupy the premises. Further, the lessor may not sell the assets under § 363 free and clear of the sports franchise's interest. The rejection by the lessor does, however, terminate the duty of the lessor to perform its obligations under the lease. For example, the lessor is relieved of its obligation to provide utilities, elevators, janitorial services, and supplies. The sports franchise that elects to remain in possession remains liable for the rental payments specified in the lease. However, the sports franchise may offset against those rental payments any damages caused by the non-performance of the lessor's obligations under the lease. The lessee's sole remedy is the right to offset.

ness judgment rule.²⁴³ Under the business judgment rule the assumption or rejection will be approved upon a showing that the requested action will benefit the estate.²⁴⁴ Upon the filing of the Chapter 11 petition, the franchise is required to perform all its obligations under the lease.²⁴⁵ In the Penguins' reorganization, the lessor moved the court to force the Penguins to perform the lease obligations that were not being performed post-petition.²⁴⁶ The lessor is similarly obligated, unless the franchise is in default under the terms of its lease.²⁴⁷ In such event, the lessor is not required to provide services or supplies until the lessor is compensated under the terms of the lease for any benefits already provided.²⁴⁸

The franchise has sixty days following the filing of the petition to decide whether to assume or reject its lease.²⁴⁹ The failure of the franchise to assume the unexpired lease within the sixty-day period or to request an extension of time²⁵⁰ to decide whether to assume or reject within the sixty days results in the lease being automatically rejected.²⁵¹ Compliance is mandatory.²⁵² The lessor's acceptance of rent during the sixty-day period does not constitute a waiver or relinquishment of the lessor's rights under the lease or the Bankruptcy Code, or constitute a waiver of the automatic rejection.²⁵³

Based on the economics of the lease, the franchise will reject the lease, assume the lease for itself or, if able, assume and assign the lease to a new entity. If the franchise believes it can secure more favorable lease terms, it should reject the lease.²⁵⁴ The franchise's ability to reject an unexpired lease is considered essential to relieve its estate of burden-

243. *In re Fashion Two Twenty, Inc.*, 16 B.R. 784, 787 (Bankr. N.D. Ohio 1982); *In re Marina Enters., Inc.*, 14 B.R. 327, 333 (Bankr. S.D. Fla. 1981).

244. *Orion Pictures Corp.*, 4 F.3d at 1099.

245. 11 U.S.C. § 365(d)(3).

246. Motion to Compel Debtor to Comply with 11 U.S.C. § 365(d)(3) in Connection with the Penguins Lease at 6, *Penguins' bankruptcy* (No. 98-28174); Record at 229.

247. 11 U.S.C. § 365(b)(4).

248. *Id.*

249. *Id.* § 365(d)(4).

250. On going negotiations between the lessor and the franchise to reach a settlement on the lease will constitute cause sufficient to extend the period to assume or reject the lease. *In re DWE Screw Prod's., Inc.*, 157 B.R. 326, 329 (Bankr. N.D. Ohio 1993).

251. 11 U.S.C. § 365(d)(4).

252. *REPH Acquisition*, 134 B.R. at 198-99; *In re Ok Kwi Lynn Candles, Inc.*, 75 B.R. 97, 99-100 (Bankr. N.D. Ohio 1987).

253. *In re Lew Mark Cleaners Corp.*, 86 B.R. 331, 334 (Bankr. E.D.N.Y. 1988).

254. Upon rejection, however, it will be essential to obtain a replacement lease. The failure to have a facility to play home games will be an event that will terminate the franchise's league membership. *Lehigh Valley Prof'l Sports Clubs, Inc.*, 2000 WL 567905; see also *supra* § VI.

some obligations.²⁵⁵ In the Penguins' reorganization, it was essential to reject the sports facility lease in order to reduce its monthly lease payments. Any contractual provision in a lease whereby the franchise agrees not to reject the lease in bankruptcy is unenforceable.²⁵⁶ Rejection of the lease will be treated as a pre-petition claim, and the lessor's claim for the remaining rents due under the lease will be subject to a statutory maximum.²⁵⁷ There is, however, a detrimental side effect to rejecting the lease with the sports facility. A rejection in which the franchise is the lessee under a primary lease and sublessor under a sublease causes the subleases to be rejected as well.²⁵⁸ The franchise has almost certainly entered into many subleases with its patrons and may not wish to cause those subleases to be rejected.²⁵⁹

If the franchise decides to assume the lease, the franchise must assume the unexpired lease in its entirety and may not assume favorable provisions while eliminating unfavorable ones.²⁶⁰ The franchise may not assume the lease if it is in default unless the franchise cures the default, provides compensation for any losses and provides adequate assurance of future performance.²⁶¹ Cure requires the payment of all rental arrearages at the time the lease is assumed.²⁶² A default does not include one based on the franchise's insolvency or filing of the bankruptcy petition.²⁶³ Finally, the franchise will assume and assign the lease where the reorganization anticipates a new entity owning the sports franchise. The franchise may be permitted to assign the lease despite a clause to the

255. *Bildisco & Bildisco*, 465 U.S. at 528.

256. *Trans World Airlines, Inc.*, 261 B.R. at 118.

257. 11 U.S.C. § 502(b). The landlord's claim is a general, unsecured claim. The purpose of the statutory cap is to fairly compensate the landlord for its loss without allowing such a large damage claim so as to deprive the other creditors of some recovery. The statutory cap provides that the landlord's claim can not exceed the greater of (1) one year's rent reserved under the lease, or (2) 15 % of the monies due under the lease, which cannot exceed three year's rent under the lease. *Id.* § 502(b)(6)(A).

258. *In re Elephant Bar Rest., Inc.*, 195 B.R. 353, 357 (Bankr. W.D. Pa. 1996); *Chatlos Sys., Inc. v. Kaplan*, 147 B.R. 96, 100 (Bankr. D. Del. 1992), *aff'd*, 998 F.2d 1005 (3d Cir. 1993); *In re Child World, Inc.*, 161 B.R. 349, 351 (Bankr. S.D.N.Y. 1993).

259. These are luxury suites, personal seat licenses and club seats. *See supra* § IX(A)-(C).

260. *In re Royster Co.*, 137 B.R. 530, 532 (Bankr. M.D. Fla. 1992); *United States Dep't. of Air Force v. Carolina Parachute Corp.*, 907 F.2d 1469, 1472 (4th Cir. 1990); *In re S.E. Nichols Inc.*, 120 B.R. 745, 747 (Bankr. S.D.N.Y. 1990); *In re Crippin*, 877 F.2d 594, 598 (7th Cir. 1989).

261. 11 U.S.C. § 365(b)(1).

262. *DWE Screw Prod's.*, 157 B.R. at 332 (an 18-month cure period is not a prompt cure); *In re Ontario Entm't Corp.*, 237 B.R. 460, 472 (Bankr. N.D. Ill. 1999).

263. 11 U.S.C. § 365(b)(2)(A)-(B).

contrary.²⁶⁴ Upon assignment, the franchise is relieved of liability for any post assignment breaches of the lease.²⁶⁵ However, the assignment does not relieve any guarantor of the original lease from liability arising from a post-assignment breach.²⁶⁶ Upon assignment, however, the lessor may require the assignee to make a deposit or provide security for the obligations under the lease.²⁶⁷

The typical sports facility lease will contain numerous provisions that will be significant in the bankruptcy case. The sports facility lease is generally long term.²⁶⁸ For leases entered into since 1996, the initial term ranges from twenty to thirty-five years, with the most common lease term being thirty years.²⁶⁹ In addition to a lengthy original term, there is also generally an option to extend the term.²⁷⁰

All four of the major league sports leagues have adopted restrictions on the ability of a sports franchise to relocate.²⁷¹ These restrictions appear in each league's Constitution and Bylaws.²⁷² However, due to the uncertain enforceability of these restrictions²⁷³ and the lack of resolve by the leagues to seek to enforce them, the sports franchises have been able to relocate at their discretion.²⁷⁴ As a result, owners of the sports venues have begun to insert clauses in the sports facility lease to restrict the ability of a sports franchise to relocate.²⁷⁵ These clauses take various

264. *Id.* at § 365(f)(1). There are three views adopted by the courts on the legal effect of clauses restricting the franchisee's ability to assign the franchise agreement. *See supra* § VI. The same analysis is applicable to clauses restricting the assignability of unexpired leases. 11 U.S.C. § 365(c)(1)(A)-(B).

265. 11 U.S.C. § 365(k).

266. *Wainer*, 984 F.2d at 684.

267. 11 U.S.C. § 365(1).

268. The average lease term is 25.6 years in the National Football League (NFL), 26 years in major league baseball, 28 years in the National Basketball Ass'n (NBA) and 24 years in the NHL. PAUL ANDERSON & BILL MILLER, MAJOR LEAGUE LEASES: AN OVERVIEW OF MAJOR LEAGUE FACILITY LEASES AND HOW THEY ARE NEGOTIATED 56-59 (2001).

269. GREENBERG, *supra* note 2, at 134-35.

270. *Id.* at 139.

271. *Id.* at 413-19.

272. *See, e.g.*, Response of the National Hockey League to Debtors' Emergency Motion For Order Authorizing Debtor-In-Possession Financing Pursuant to 11 U.S.C. §§ 105, 362, 364(C)(1), 364(C)(2), 364(C)(3), and 364(d) and Bankruptcy Rules 2002, 4001 and 9014 at Exhibit A, at 11, *Penguins' bankruptcy* (No. 98-28174); Record at 135 (NHL Const. § 4.2) ("No member shall transfer its club and franchise to a different city or borough.").

273. *See generally* L.A. Mem'l Coliseum Comm'n v. National Football League, 726 F.2d 1381 (9th Cir. 1984), *cert. denied*, 469 U.S. 990 (1984).

274. GREENBERG, *supra* note 2, at 414; ANDERSON & MILLER, *supra* note 268, at 357.

275. GREENBERG, *supra* note 2, at 414-15.

forms. The first is an absolute prohibition against any relocation.²⁷⁶ The second is to impose significant liquidated damages if a sports franchise attempts to relocate.²⁷⁷ And, the third is to require the sports franchise to offer a right of first refusal to sell the franchise to a local group in the event it wishes to relocate.²⁷⁸ Outside of bankruptcy, lessors have been successful in seeking injunctions to prevent professional sports franchises from breaching their lease agreement by playing games outside the confines of the leased stadium.²⁷⁹ In bankruptcy, however, none of these clauses will have its intended effect of restricting the franchise's ability to relocate if the sports franchise decides to reject the sports facility agreement. Rejection of the lease renders the lease terms unenforceable and provides the lessor with a pre-petition claim for damages for breach of contract.²⁸⁰

The sports facility lease also specifies various events that will terminate the lease. Typical terminating events would include an assignment for the benefit of creditors, bankruptcy proceedings, inability of one of the parties to perform as required by the lease, or any other violation of the lease which substantially interferes with the other parties use of the facility.²⁸¹ The sports franchise's insolvency or bankruptcy filing will not be recognized as a valid ground for termination of the sports facility lease.²⁸² The other grounds, however, will be recognized as a valid basis for termination of the sports facility lease under state law. It will be critical to determine whether the sports facility lease has been terminated prior to the filing of the bankruptcy petition. In order for a lease to be properly terminated under state law, all actions required under

276. "The no relocation-no move provision restricts a [sports] franchise's ability to move for a [number] of years specified [in the] lease." *Id.* at 413. By inserting such a term in the lease, the lessor is assured that if the sports franchise attempts to relocate at any time prior to the expiration of the lease term, the sports franchise is in material breach of the lease. A material breach subjects the sports franchise to injunctive relief, damages, and perhaps specific performance. *Id.*; ANDERSON & MILLER, *supra* note 268, at 357. The clause will not be effective if the franchise rejects the lease.

277. The liquidated damages approach attempts to restrict the sports franchise's ability to relocate by imposing a large amount of agreed damages for any relocation. GREENBERG, *supra* note 2, at 419-24; ANDERSON & MILLER, *supra* note 268, at 363. This approach attempts to impose upon the sports franchise a cost-benefit analysis if they undertake a move.

278. GREENBERG, *supra* note 2, at 425; *Headquarters Dodge*, 13 F.3d at 679; *In re Mr. Grocer, Inc.*, 77 B.R. 349, 353 (Bankr. D.N.H. 1987) (holding a right of first refusal was unenforceable).

279. *See, e.g.*, *New York v. N.Y. Jets Football Club, Inc.*, 394 N.Y.S.2d 799 (N.Y. Sup. Ct. 1977).

280. 11 U.S.C. § 365(g).

281. ANDERSON & MILLER, *supra* note 268, at ch. 7.

282. 11 U.S.C. § 365(e)(1).

state law for termination of the lease must be completed before the petition is filed.²⁸³ If the lease has been validly terminated under state law, the lease cannot be assumed or assigned in the Chapter 11 case.²⁸⁴ In addition, the debtor may not revive the terminated lease by alternative means.²⁸⁵ A terminated lease will have a very deleterious effect on the franchise's reorganization if the lease was a favorable one that the franchise wished to maintain either for itself or to assume and assign to a new entity.

The sports facility lease often requires the sports franchise to pay a security deposit to guarantee performance under the lease.²⁸⁶ The security deposit will be treated as cash collateral.²⁸⁷ It is subject to setoff for any pre-petition breaches by the sports franchise.²⁸⁸ In the Penguins' reorganization, the lessor did move the court to setoff against the security deposit for delinquent pre-petition rent.²⁸⁹ Any post-petition breaches of the sports facility lease result in an administrative claim.²⁹⁰

There are several issues that relate to the nature of the lease agreement itself. The first issue is whether the lease agreement is a lease or a license. Different rules will be applicable depending on the answer to that question.²⁹¹ If it's a lease, the unexpired lease rules will apply.²⁹² If it's a license, the executory contract rules will apply.²⁹³ The unexpired lease rules require the sports franchise to accept/reject within sixty days of the petition date.²⁹⁴ Executory contracts have no such requirement. During the sixty-day period, the sports franchise is required to perform

283. *Id.* § 365(c)(3).

284. *In re Crabb*, 48 B.R. 165, 167 (Bankr. D. Mass. 1985); *In re Triangle Labs., Inc.*, 663 F.2d 463, 468 (3d Cir. 1981); *In re GSVK Rest. Corp.*, 3 B.R. 491, 494 (Bankr. S.D.N.Y. 1980).

285. The use of § 105 has been rejected as a basis to revive a terminated lease. *See, e.g., In re Emory Prop's., Ltd.*, 106 B.R. 318, 321 (Bankr. N.D. Ga. 1989); *In re West Pine Const. Co.*, 80 B.R. 315, 323 (Bankr. E.D. Pa. 1987). Also, although there is some authority to the contrary, a validly terminated lease under state law is not subject to avoidance as a fraudulent transfer. The theory is that § 365(3)(c) should govern over § 548. *Haines*, 178 B.R. at 477.

286. ANDERSON & MILLER, *supra* note 268, at 27.

287. *See supra* § IV(A).

288. 11 U.S.C. § 553(a).

289. Motion for Relief from Stay to Permit Setoff Pursuant to § 553 of the Bankruptcy Code at 1-7, *Penguins' bankruptcy* (No. 98-28174); Record at 231.

290. *Elliott v. Four Seasons Props. (In re Frontier Prop's., Inc.)*, 979 F.2d 1358, 1367 (9th Cir. 1992); *In re Multech Corp.*, 47 B.R. 747, 750 (Bankr. N.D. Iowa 1985).

291. Although some of the treatment is the same, § 365 has separate subsections applicable only to leases, licenses, or executory contracts. 11 U.S.C. § 365.

292. *In re Huff*, 81 B.R. 531, 534 (Bankr. D. Minn. 1988).

293. *Id.*

294. 11 U.S.C. § 365(d)(4).

all obligations under the lease agreement.²⁹⁵ There is no such requirement for executory contracts. If the sports franchise is in default under the lease, the lessor is not required to provide services under the lease agreement.²⁹⁶ Executory contracts have no such protection. The unexpired lease is generally assignable.²⁹⁷ Licenses are generally not assignable.²⁹⁸ Upon assignment of the lease, the lessor is authorized to require a security deposit from the assignee.²⁹⁹ There is no such authorization for parties to an executory contract. The lessor has a maximum limit on its claim if the sports franchise rejects the lease.³⁰⁰ There is no statutory cap for executory contracts with the one exception of employment contracts.³⁰¹

Some authors comment that the sports franchise agreement is better understood as a license agreement rather than a lease agreement.³⁰² The actual language used in many of the sport facility agreements is language of license rather than lease.³⁰³ Traditionally, a lease conveys an interest in the land, and a license is a personal contract between the parties that grants a privilege to occupy an area.³⁰⁴ A comparison of the lease and license definitions is not helpful in distinguishing the two.³⁰⁵ A review of the case law identifies a number of factors that are examined by the courts when distinguishing a lease from a license. Some of the factors include: (1) ascertaining the intent of the parties; (2) does the contract use language of license or lease; (3) the more particularly the demised area is defined favors a lease construction; and (4) the more exclusive the grant of possession to the demised area favors a lease construction. Leases were found in cases of self-storage agreements,³⁰⁶ a public access

295. *Id.* § 365(d)(3).

296. *Id.* § 365(b)(4).

297. *Id.* § 365(a).

298. *Watson Pac. Ventures v. Valley Fed. Sav. & Loan (In re Safeguard Self-Storage Trust)*, 2 F.3d 967, 97 (9th Cir. 1993); *In re Yachthaven Rest., Inc.*, 103 B.R. 68, 72 (Bankr. E.D.N.Y. 1989).

299. 11 U.S.C. § 365(l).

300. *Id.* § 502(b)(6).

301. *Id.* § 502(b)(7).

302. ANDERSON & MILLER, *supra* note 268, at 32.

303. *Id.*

304. *United States v. Incline Vill.*, 976 F.Supp. 1327, 1357 (D. Nev. 1997).

305. A license is defined as a revocable permission to commit some act that would otherwise be unlawful. A lease is defined as a contract by which a rightful possessor of real property conveys the right to use and occupy that property in exchange for consideration. The lease term can be for life, for a fixed period, or for a period terminable at will. BLACK'S LAW DICTIONARY 898, 931 (7th ed. 1999).

306. *Incline Vill.*, 976 F. Supp. 1327; *Safeguard Self-Storage Trust*, 2 F.3d 967; *Tips v. United States*, 70 F.2d 525 (5th Cir. 1934).

agreement,³⁰⁷ a hotel operation,³⁰⁸ and an irrevocable right for fifty years to set aside certain designated spaces in a parking lot for tenants in an apartment building.³⁰⁹ License agreements were found in cases of operating a dry-cleaning business,³¹⁰ a marina/restaurant,³¹¹ department store,³¹² billboard rental,³¹³ convention exhibitor,³¹⁴ lounge,³¹⁵ timber purchasing agreement,³¹⁶ right to display messages on an electronic scoreboard,³¹⁷ and catering agreement.³¹⁸ The franchise's sports facility lease will need to be analyzed to determine whether it's a lease or license agreement. If it is determined to be a license agreement, it will qualify as an executory contract under either of the two interpretations.³¹⁹ In such a case, the principles applicable to the membership agreement will govern its treatment in the reorganization.³²⁰ If it's determined to be a lease agreement, the unexpired lease rules will control.

A second issue is whether the lease/license agreement is a financing arrangement. If the agreement is construed to be a financing arrangement, it will not be subject to assumption or rejection.³²¹ A secured debt is not considered to be an executory contract.³²² Rather, it will be treated as a debt instrument and subject to modification in the reorganization process.³²³ The factors that are important in determining whether the lease/license agreement is a disguised financing arrangement are: whether the rental payments are really payments of principal and interest, whether the lessee has the option to purchase the leased premises for no or nominal consideration, and whether the lessee assumes and

307. *Ontario Entm't Corp.*, 237 B.R. 460.

308. *In re Dunes Hotel Assocs.*, 212 B.R. 110 (Bankr. D.S.C. 1997).

309. *In re Historical Locust St. Dev. Assocs.*, 246 B.R. 218 (Bankr. E.D. Pa. 2000).

310. *In re Greenfield Dry Cleaning & Laundry, Inc.*, 249 B.R. 634 (Bankr. E.D. Pa. 2000).

311. *Yachthaven Rest., Inc.*, 103 B.R. 68.

312. *In re Daben Corp.*, 469 F. Supp. 135 (D.P.R. 1979).

313. *Lumbermens Mut. Cas. Co. v. Nolan*, 331 F.2d 711 (5th Cir. 1964).

314. *Bentley v. Palmer House Co.*, 332 F.2d 107 (7th Cir. 1964).

315. *In re Harbour House Operating Corp.*, 26 B.R. 324 (Bankr. D. Mass. 1982).

316. *Steward v. St. Regis Paper Co.*, 484 F. Supp. 992 (S.D. Ala. 1979).

317. *Anheuser-Busch, Inc. v. Miller*, 99 B.R. 137 (D. Mass. 1989).

318. *Moore v. Chesapeake & Ohio Ry. Co.*, 493 F. Supp. 1252 (S.D. W.Va. 1980), *aff'd*, 649 F.2d 1004 (4th Cir. 1981).

319. *See supra* § VI.

320. *Id.*

321. *In re Cox*, 179 B.R. 495, 498-500 (Bankr. N.D. Tex. 1995); *Hotel Syracuse, Inc. v. City of Syracuse Indus. Dev. Agency (In re Hotel Syracuse, Inc.)*, 155 B.R. 824, 837 (Bankr. N.D.N.Y. 1993); *Dicapp Indus., Inc. v. Starr (In re Starr)*, 113 B.R. 481, 482 (Bankr. S.D. Ill. 1990).

322. *Patton v. Scholl*, 1998 WL 779238 (E.D. Pa. 1998).

323. 11 U.S.C. § 1129(a)(11); *In re SCCC Assocs. II Ltd. P'ship*, 158 B.R. 1004, 1012 (Bankr. N.D. Cal. 1993).

discharges substantially all the risks and obligations of ownership.³²⁴ In *In re Pittsburgh Sports Associates Holding Company*,³²⁵ the Penguins moved to reject their lease, or in the alternative, sought a determination that the lease was not a true lease, but rather a financing arrangement.³²⁶ The court noted that the determination whether an agreement is a true lease or a financing device is made under state law.³²⁷ A review of the lease indicated that both the Penguins and the lessor had the right to relocate the team to a different venue.³²⁸ Upon relocation, however, the Penguins were required to continue to make the lease payments.³²⁹ In addition, the lease did not have a prescribed ending period.³³⁰ Based on those factors, the court held that the lease agreement was not a true lease, but rather a financing device.³³¹ In any reorganization, the franchise's lease will need to be examined to determine its true nature.

VIII. CONTRACTS WITH PLAYERS

Players' salaries are one of the primary expenses for any sports franchise.³³² Each player negotiates his own contract, albeit each league has a player's union. Players' salaries are the one expense that seems to be spiraling out of control.³³³ The average annual salary increase from 1996 through 1999 was 16% in Major League Baseball, 23% in the National Basketball Association, 11.75% in the National Football League and 12.2% in the National Hockey League.³³⁴ Understandably, an area of potential cost savings for the franchise will be the player's salary. Upon filing the bankruptcy petition, each player's contract becomes property of the bankruptcy estate.³³⁵ Each player's contract will be treated as an executory contract since performance is due to a material extent on both sides. It will be important for the franchise to review each individual player's contract. As part of the reorganization, the

324. 207 Montgomery St. v. Union Bank & Trust Co. (*In re* 207 Montgomery St., Inc.), 160 B.R. 181, 184 (Bankr. M.D. Ala. 1992); *In re* Lansing Clarion Ltd. P'ship, 132 B.R. 845, 850-51 (Bankr. W.D. Mich. 1991).

325. 239 B.R. 75 (Bankr. W.D. Pa. 1999), *vacated*, 1999 Bankr. LEXIS 1872 (Bankr. W.D. Pa. 1999).

326. *Id.* at 75.

327. *Id.* at 83.

328. *Id.* at 84.

329. *Id.*

330. *Pittsburgh Sports Assocs.*, 239 B.R. at 85.

331. *Id.*

332. GREENBERG, *supra* note 2, at 42.

333. *Id.* at 43.

334. *Id.* at 42.

335. 11 U.S.C. § 541(a).

franchise will need to decide whether to reject or assume each one of the player contracts.³³⁶ The decision can be made in the proposed plan of reorganization, unless the player requests the court to set an earlier time for the decision.³³⁷ The decision will be based on the business-judgment rule.³³⁸

If it's in the franchise's best interest, the franchise can selectively reject certain players' contracts. Upon rejection, the franchise is no longer required to comply with the contract terms. The rejection is deemed a breach of contract, and the player is relegated to a pre-petition claim for the breach.³³⁹ If the player's contract has a remaining term for greater than a year beyond the filing date, the player's claim is capped at one year's salary, plus any delinquent compensation due under the contract.³⁴⁰ A small amount of delinquent compensation and delinquent contributions to benefit plans will be treated as a priority expense in the reorganization.³⁴¹

For those players' contracts the franchise wishes to maintain, the franchise will need to assume those contracts. The contracts must meet the business-judgment test, and any defaults must be cured before the court will approve the assumption.³⁴² The prohibition against the assumption of personal service contracts has no application to the assumption of the players' contracts by the franchise. It would only have application where the player is the bankrupt, and a substituted performance was tendered in the player's stead. Finally, the franchise is permitted to assign the assumed contracts to a new entity as part of a reorganization plan.³⁴³ In the event the player's contract contained an anti-assignment clause or a player's consent clause, the enforceability of such a clause will be determined by which of the three views the particular jurisdiction has adopted on the enforceability of clauses restricting assignment.³⁴⁴

336. *Id.* § 365(a).

337. *Id.* § 365(d)(2).

338. *Orion Pictures Corp.*, 4 F.3d at 1099; *Prime Motor Inns*, 124 B.R. at 381; *Richmond Leasing Co.*, 762 F.2d at 1308-09.

339. 11 U.S.C. § 365(g)(1).

340. *Id.* § 502(b)(7)(A)-(B).

341. *Id.* § 507(a)(3)-(4).

342. *Id.* § 365(b)(1)(A).

343. *Id.* § 365(c).

344. *See supra* § VI (discussing the three views).

IX. CONTRACTS WITH PATRONS, ADVERTISERS, AND VENDORS

As a preface to this section, a distinction needs to be drawn between pure legal analysis and legal analysis tempered by prudent, business judgment. The foregoing sections dealt with the contractual relationships between the franchise and its league, its landlord, and its players. For the most part, the franchise's fan-base will not be significantly impaired by the franchise's decision on any of those contracts. The next series of contracts, however, particularly the luxury suite agreements, personal seat licenses, club seats, and current ticket sales, directly affect the franchise's patrons. The subsequent analysis is purely legal in that the legal issues are being explored without being tempered by business judgment. In other words, even though a franchise may be legally able to reject certain contracts, the franchise will need to evaluate the impact on its patrons. In the Penguins' bankruptcy, the franchise filed a motion with the court asking for the authority to place the monies from advance ticket sales in an escrow account so that in the event the reorganization was not successful, the fans' monies could be fully refunded.³⁴⁵ The court granted the franchise's motion.³⁴⁶ The franchise's motion indicated a concern for its patrons in addition to being a sound business decision to encourage patrons to advance monies for tickets without the risk of losing their money. Unfortunately, some of the decisions in the subsequent subsections will not have a favorable impact on both the franchise and its patrons.

A. *Luxury Suites*

A luxury suite is a "private box with a number of seats facing the playing area with an enclosed lounge area behind the open-air seats."³⁴⁷ Luxury suites generally have some of the following amenities: "sound system control[s], restrooms, wet bar, [range and refrigerator,] color televisions, air conditioning and heating, buffet area, sitting area, telephones and membership to the stadium club."³⁴⁸ In addition, "the agreement will also delineate suite services[,] . . . which may include . . . catering service[s], . . . housekeeping service[s], . . . the right to a pri-

345. Voluntary Motion of Pittsburgh Hockey Associates., d/b/a Pittsburgh Penguins to Provide Protection for Purchasers of 1999-2000 Season Tickets by Creating and Maintaining Escrow Accounts for all Credits, Deposits and Payments Toward 1999-2000 Season Tickets, *Penguins' bankruptcy* (No. 98-28174); Record at 520.

346. Order of Court at 2-6, *Penguins' bankruptcy* (No. 98-28174); Record at 569.

347. GREENBERG, *supra* note 2, at 289.

348. *Id.*

vate entrance[, and] normally some form of parking privilege.³⁴⁹ The term of the luxury suite ranges from one to ten years with renewal options.³⁵⁰ “In many [cases,] the rental fee will be subject to [the Consumer Price Index] or [some] other [type] of escalation during the term of the agreement.”³⁵¹ Most of the luxury suite agreements “contain security deposit provisions [to guarantee] . . . payment and performance by the tenant of all of its obligations” under the agreement.³⁵² The agreement also generally reserves the right of the sports franchise to collateralize the luxury suite and/or income stream.³⁵³ The revenue from luxury suites is the second most important revenue stream for professional sports franchises behind television revenues.³⁵⁴

The luxury suite agreements are either in a license or lease format. As with the sports facility agreement, it will again be very important to determine whether the luxury suite agreement is a lease or a license. The factors delineating a license from a lease are discussed in Section VII of this article. If the luxury suite agreements are deemed to be a sublease agreement, the rules relating to an unexpired lease will apply.³⁵⁵ It is important to note that for the luxury suite agreements, the sports franchise is now the lessor, as contrasted with its position as lessee in the sports facility agreement. The tenant is the lessee under the luxury suite agreement. In the event the luxury suite agreement is rejected, either by the franchise’s volitional rejection³⁵⁶ or automatically by its rejection of the primary lease,³⁵⁷ the tenant has two options available. First, the tenant can accept the rejection and assert a claim in the bankruptcy for the damages associated with the termination of the sublease.³⁵⁸ Second, the tenant can choose to remain in possession and retain all rights under the sublease agreement, plus any renewal periods.³⁵⁹ If the tenant chooses to retain its rights under the sublease agreement, the lessee is permitted to setoff against the rent due under the

349. *Id.* at 290.

350. *Id.* at 289.

351. *Id.*

352. *Id.*

353. *Id.* at 290.

354. *Id.* at 279.

355. *See supra* § VII.

356. 11 U.S.C. § 365(a).

357. *Elephant Bar Rest.*, 195 B.R. at 357 (citing and quoting *Gordon v. Schneikor*, 699 P.2d 3, 4 (Colo. Ct. App. (1994)); *Chatlos Sys.*, 147 B.R. at 98; *Child World, Inc.*, 161 B.R. at 350-51.

358. 11 U.S.C. § 365(h)(1)(A)(i).

359. *Id.* § 365(h)(1)(A)(ii).

sublease any damages for breach of the sublease caused by the franchise's nonperformance.³⁶⁰ Set-off is the tenant's sole remedy.³⁶¹

An unanswered question is whether the patron under a luxury suite agreement who does not qualify for lessee protection could establish that his interest is a time-share interest. An owner of a time-share interest is entitled to the same protections in bankruptcy as a lessee under an unexpired lease.³⁶² A purchaser of a time-share interest is one who has purchased an interest under a time-share plan.³⁶³ A time-share plan is an arrangement, including a license, "whereby a purchaser . . . receives [the] right to use [a] . . . recreational site . . . for a specific period of time less than a full year during any given year, . . . which extends for a period of more than three years."³⁶⁴ The patron has a compelling argument for protection under the plain-meaning rule.³⁶⁵ On the other hand, the time-share interest protection was incorporated into the Bankruptcy Code in response to the *Sombrero Reef* case.³⁶⁶ In *In re Sombrero Reef Club, Inc.*,³⁶⁷ the debtor was able to reject time-share contracts in a resort complex, dispossess the time-share owners, and resell the time-share units.³⁶⁸ Congress was dismayed by the result, and amended the Code to correct the result.³⁶⁹ Only time will tell if courts will draw an analogy between a time-share interest in a vacation resort and a patron's interest in attending a professional sporting event. One court, in dictum, did not agree with the analogy.³⁷⁰

If the luxury suite agreements are deemed to be a sublicense agreement, the protections afforded a lessee/time-share owner are not available. Only one case has addressed the issue whether a luxury suite agreement is a license or a lease.³⁷¹ That case held that luxury suite

360. *Id.* § 365(h)(1)(B).

361. *Id.*

362. *Id.* § 365(i).

363. *Id.*

364. *Id.* § 101(53D).

365. The plain-meaning rule provides that if a writing appears to be unambiguous on its face, its meaning must be determined from the writing itself without resort to any extrinsic evidence. BLACK'S LAW DICTIONARY 1170 (7th ed. 1999).

366. *In re Lee Road Partners, Ltd.*, 155 B.R. 55, 61 (Bankr. E.D.N.Y. 1993), *aff'd*, 169 B.R. 507 (E.D.N.Y. 1994).

367. *Sombrero Reef Club, Inc. v. Allman (In re Sombrero Reef Club, Inc.)*, 18 B.R. 612 (Bankr. S.D. Fla. 1982).

368. *Id.*

369. *Lee Road Partners, Ltd.*, 155 B.R. at 61.

370. *Anheuser-Busch, Inc.* 99 B.R. at 139.

371. *Id.*

agreements are licenses.³⁷² The only licensees protected under the Bankruptcy Code are licensees of intellectual property.³⁷³ Therefore, the licensees under the luxury suite agreements are not protected licensees and will be governed by the executory contract rules. The sublicense agreement will likely qualify as an executory contract under either the material breach or functional analysis test.³⁷⁴ In the event the luxury suite agreement is rejected, either by the franchise's volitional rejection³⁷⁵ or by its rejection of the primary license,³⁷⁶ the licensee does not have the option to remain in possession. The licensee's only choice is to file a claim in the reorganization for the damages associated with the rejection. Upon rejection, the franchise would be able to enter into new sublicense agreements to increase the revenue for the reorganized entity.

Another unanswered question is whether the franchise is able to reject the luxury suite agreements in light of the fact that the revenue stream flowing from the contracts has been committed to a secured party as collateral. There is no consensus of opinion on the answer to this question. One approach indicates that even if the financing arrangement is an executory contract, the secured creditor's status cannot be affected by the rejection.³⁷⁷ A second approach holds that the franchise can reject the underlying contract that is the collateral, but the secured creditor is entitled to adequate protection for the loss of its collateral.³⁷⁸ A third approach concludes that the franchise can reject the underlying contract that is the collateral, but the secured creditor can pursue a claim against the replacement contract as substituted collateral.³⁷⁹ Finally, the fourth approach holds that the franchise can reject the underlying contract that is the collateral, and the secured creditor simply loses its lien and claim to any collateral.³⁸⁰

All four approaches agree that the franchise can reject the underlying contract that is the secured party's collateral. They differ, however, on the legal effect of the rejection. The tenant's payments arising from the

372. *Id.*

373. 11 U.S.C. § 365(n).

374. *See supra* § VI.

375. 11 USC § 365(a).

376. *See generally Yachthaven Rest., Inc.*, 103 B.R. 68.

377. *See, e.g., Leasing Serv. Corp. v. First Tenn. Bank Nat'l. Ass'n*, 826 F.2d 434, 436-37 (6th Cir. 1987).

378. *Sombrero Reef Club*, 18 B.R. at 617.

379. *J. Catton Farms, Inc. v. First Nat'l. Bank of Chicago*, 779 F.2d 1242, 1247-48 (7th Cir. 1985); *see also* 11 U.S.C. § 552(b).

380. *In re Eagle-Picher Indus., Inc.*, 139 B.R. 873, 874 (Bankr. S.D. Ohio 1992); *J. Catton Farms, Inc.*, 779 F.2d at 1245-47.

luxury suite agreements are the secured creditor's collateral. In bankruptcy, a secured claim is "allowed" to the extent of the value of the collateral.³⁸¹ Upon rejection of the luxury suite agreement, the revenue stream will be severely impacted. If the luxury suite agreement is deemed to be a sublease or time-share interest, the tenant has the option to remain in possession and remit payments for the agreed amount, less any setoffs for breach of the luxury suite agreement by the franchise.³⁸² Clearly, the revenue stream will be adversely affected. If the tenant opts to accept the rejection, or the contractual arrangement is deemed to be a license, there will be no further payments forthcoming from the licensee/tenant. The secured creditor's collateral has now become worthless. Under either scenario, the secured creditor's collateral is obviously affected by the rejection. Therefore, the first approach is not sustainable. In *Sombrero Reef Club*, the debtor used the revenue stream flowing from the sale of time-share contracts as collateral.³⁸³ The debtor moved the court to reject the time-share contracts to permit the debtor-club to resell the time-share interests.³⁸⁴ The secured creditor objected to the debtor-club's motion to reject.³⁸⁵ The court held that the time-share contracts were executory contracts, and could be rejected by the debtor-club.³⁸⁶ The court set a date for a later hearing to determine whether the secured creditors were entitled to any adequate protection as a result of the loss of their collateral.³⁸⁷ There is no express authority in the Code for a court to provide adequate protection to a secured party who suffers a loss under § 365. The Code provides for adequate protection only under §§ 362, 363 and 364.³⁸⁸ The second approach lacks any tangible support under the Code.

It is reasonable to assume that the franchise will enter into replacement contracts once it rejects the current luxury suite agreements. The interesting question is whether the secured creditor will have a claim to the replacement contracts as substituted collateral. The Code permits a pre-petition security interest to extend to "proceeds, products, offspring, or profits" of the pre-petition property that is acquired after the commencement of the case.³⁸⁹ The secured creditor is generally required to

381. 11 U.S.C. § 506(a).

382. *Id.* § 365(h)(1)(A)(ii), (h)(1)(B).

383. *Sombrero Reef Club*, 18 B.R. at 615.

384. *Id.* at 614.

385. *Id.* at 615.

386. *Id.*

387. *Id.* at 620.

388. 11 U.S.C. § 361.

389. *Id.* § 552(b).

trace the trail of cash from the sale of the pre-petition collateral to the purchase of the post-petition collateral.³⁹⁰ Upon the rejection of the luxury suite agreement, there is obviously no stream of cash traceable to a substitute asset. There is, however, a clearly traceable path to the replacement contract. In addition, the interpretation of the language "proceeds, product, offspring, rents or profits" is given a broad interpretation in other parts of the Code.³⁹¹ As indicated, a legal argument can be constructed to support the secured creditor's claim to the replacement contracts as substituted collateral. On the other hand, there is no explicit authority in the Code to support the secured creditor's claim to the replacement contracts. The limited circumstance of permitting a pre-petition security interest to extend to post-petition "proceeds, products, offspring or profits" under the Bankruptcy Code was intended to maintain consistency with the Uniform Commercial Code.³⁹² Under the Uniform Commercial Code, if collateral becomes worthless, or the secured creditor's claim to the collateral is cut off, there is no corresponding claim to substitute collateral. Therefore, to maintain consistency, there should be no corresponding claim to substitute collateral under the Bankruptcy Code. Understandably, the sparse case law on this issue is divided, but the fourth approach appears to be the most sound.³⁹³

B. Personal Seat Licenses

A personal seat license is a contractual arrangement between a sports franchise acting as the licensor and the purchaser acting as the licensee.³⁹⁴ The licensee pays the team a fee in exchange for the team guaranteeing the licensee the right to purchase season tickets at a particular seat location for a designated period of time. The license holder has a guarantee to purchase specific seats over a period of time, but is not obligated to make the purchase from year to year.³⁹⁵ The personal seat license terminates if the licensee does not purchase his/her season tickets

390. *In re Vill. Mobile Homes, Inc.*, 947 F.2d 1282, 1283 (5th Cir. 1991); *Unsecured Creditors Comm. v. Marepcon Fin. Corp. (In re Bumper Sales, Inc.)*, 907 F.2d 1430, 1438 (4th Cir. 1990).

391. 11 U.S.C. § 541(a)(6); *see also* *Sticka v. Mellon Bank (D.E.) Nat'l Ass'n (In re Martin)*, 167 B.R. 609, 617 (Bankr. D. Or. 1994); *Bookout Holsteins v. Superblend, Inc. (In re Bookout Holsteins, Inc.)*, 100 B.R. 427, 431 (Bankr. N.D. Ind. 1989).

392. 11 U.S.C.A. § 365 (West 2001).

393. *Compare J. Catton Farms, Inc.*, 779 F.2d 1242 *with Eagle-Picher Industries, Inc.*, 139 B.R. 873.

394. GREENBERG, *supra* note 2, at 293.

395. *Id.* at 177.

by a particular deadline date.³⁹⁶ The term on a personal seat license normally ranges from five years and up.³⁹⁷ Personal seat licenses are generally transferable, which gives the holder a valuable property right that can be sold, exchanged, or passed down to future generations. In addition to the guaranteed right to purchase season tickets and the right of transferability, additional benefits from a personal seat license include access to limited or preferred parking, more comfortable seats, access to membership club areas, and priority to buy the same seats for other events in the stadium.³⁹⁸ A personal seat license can be a valuable property right for a patron.

Personal seat licenses are generally used as a stadium-financing vehicle rather than a revenue stream during the sports franchise's operation.³⁹⁹ An up-front fee is normally based on the seat location and the length of the right. The fee is most often paid in full, but it can be financed. The personal seat license is clearly a license agreement, so the unexpired lease rules will not apply. The patron, however, can assert that the personal seat license is a time-share interest. If successful, the patron will receive protection under the Code. This issue, however, is still open.⁴⁰⁰

The next question is whether the personal seat license is an executory contract able to be rejected or assumed in the reorganization. If the personal seat license qualifies as an executory contract, the franchise may reject the agreement. A rejection of the personal seat license relegates the licensee to an unsecured claim in the reorganization.⁴⁰¹ Coincidentally, the franchise can seek to enter into new personal seat license agreements to enrich the reorganized franchise. Again, the issue of substituted collateral will arise.⁴⁰² On the other hand, if the personal seat licenses do not qualify as an executory contract, the personal seat licenses remain as a contract claim against the reorganized entity. Unlike luxury suite agreements, the personal seat license does not require the licensee to purchase the tickets. The licensee has the option to purchase the tickets. Clearly, under the functional analysis test, the personal seat license is an executory contract if it is in the best interest of the estate to

396. *Id.* at 294.

397. *Id.* at 293.

398. *Id.* at 294.

399. *Id.* at 181.

400. *See supra* § IX(A) (discussing time-share issues).

401. 11 U.S.C. § 365(g).

402. *See supra* § IX(A) (discussing substituted collateral).

declare it as such.⁴⁰³ Conversely, under the material breach test, the personal seat license will not qualify as an executory contract. The fact that the licensee has no obligation to purchase the tickets does not satisfy the material breach test.⁴⁰⁴ Understandably, the courts are currently divided on whether an option contract is an executory contract.⁴⁰⁵ The legal characterization of the personal seat license will depend on which executory contract approach the court adopts.

C. Club Seats

Club seats came into being in the mid-1980s.⁴⁰⁶ They have "become one of the largest revenue producers for [a] stadium."⁴⁰⁷ Club seat amenities vary from team to team but normally include items such as free parking, premium seat location, wider and more comfortable seats, clubroom admittance, pre game meals, invitations to special events, and access to other restricted areas.⁴⁰⁸ Club seat contracts normally range from one to ten years.⁴⁰⁹

A club seat license is similar to a personal seat license. They are both license agreements, and there is no obligation on behalf of the patron to purchase season tickets.⁴¹⁰ For reorganization purposes, the club seat analysis is the same as the personal seat license. Whether it is an executory contract or not will be determined by which executory contract test is adopted by the court.⁴¹¹ The club seat contract will not qualify as an executory contract under the material breach test because the patron has

403. See, e.g., *Fox*, 83 B.R. at 302; *In re Booth*, 19 B.R. 53, 55 (Bankr. D. Utah 1982); *Jolly*, 574 F.2d 349.

404. *In re I.D. Craig Serv. Corp.*, 138 B.R. 490, 501 (Bankr. W.D. Pa. 1992).

405. Compare Unsecured Creditors' Comm. Of Robert L. Helms Constr. & Dev. Co. v. Southmark Corp. (*In re Robert L. Helms Constr. & Dev. Co., Inc.*), 139 F.3d 702 (9th Cir. 1998); *Bronner v. Chenoweth-Massie P'ship.* (*In re National Fin. Realty Trust*), 226 B.R. 586 (Bankr. W.D. Ky. 1998); *In re America. W. Airlines, Inc.*, 179 B.R. 893 (Bankr. D. Ariz. 1995); and *In re Texstone Venture, Ltd.*, 54 B.R. 54 (Bankr. S.D. Tex. 1985) (finding option contracts are not executory contracts); with *In re Riodizio, Inc.*, 204 B.R. 417 (Bankr. S.D.N.Y. 1997); *Health Sci. Prod's. v. Taylor* (*In re Health Sci. Prod's., Inc.*), 183 B.R. 903 (Bankr. N.D. Ala. 1995); *In re West Chestnut Realty of Haverford, Inc.*, 177 B.R. 501 (Bankr. E.D. Pa. 1995); *In re A.J. Lane & Co., Inc.*, 107 B.R. 435 (Bankr. D. Mass. 1989); *In re Hardie*, 100 B.R. 284 (Bankr. E.D.N.C. 1989); and *In re G-N Partners*, 48 B.R. 462 (Bankr. D. Minn. 1985) (finding options contracts are executory contracts).

406. GREENBERG, *supra* note 2, at 271.

407. *Id.*

408. *Id.* at 272.

409. *Id.* at 275.

410. *Id.* at 177.

411. See *supra* § VI.

no obligation to exercise the option.⁴¹² On the other hand, it will qualify as an executory contract under the functional analysis test. If the club seat agreement is an executory contract, it can be rejected by the franchise.⁴¹³ Upon rejection, the patron has a claim in the reorganization, and the franchise is able to resell the club seats.⁴¹⁴ If the club seat agreement is not an executory contract, the contract cannot be rejected and remains an obligation of the franchise.⁴¹⁵

"Club seats differ from [personal] seat licenses in that the patron [with a club seat generally] has no vested property right[s] in [his/her] seat."⁴¹⁶ As a result, club seats are generally not transferable and may not be sold to a third party.⁴¹⁷ There are, however, circumstances where the club seat agreement may have property rights similar to a personal seat license. The contract between the parties and their course of dealing will determine whether the patron with a club seat agreement has a property right or a revocable license.⁴¹⁸ A property right is not created simply by the repeated sales of season tickets.⁴¹⁹ The expectation that the tickets will be renewed and the fact they have been renewed, does not ripen into a property interest.⁴²⁰ However, where there is a policy to permit automatic renewal and the transferability of season tickets, a property interest will be created.⁴²¹ Once a property interest is established, the patron will have a basis to assert he owns a time-share interest with the appendant protections.⁴²²

D. Current Season Ticket Sales

Tickets for a game event are considered to be revocable licenses.⁴²³ The legal effect of a revocable license is that game admission can be denied. Circumstances resulting in denial are where the ticket is reported as lost or stolen, if the person seeking admittance has behaved in

412. *I.D. Craig Service Corp.*, 138 B.R. at 502.

413. *Id.* at 501.

414. *Id.* at 502.

415. *Id.*

416. GREENBERG, *supra* note 2, at 275.

417. *Id.*

418. *In re Liebman*, 208 B.R. 38, 40 (Bankr. N.D. Ill. 1997).

419. *Soderholm v. Chicago Nat'l League Ball Club, Inc.*, 587 N.E.2d 517, 520-21 (Ill. Ct. App. 1992).

420. *Abele v. Phoenix Suns Ltd. P'ship (In re Harrell)*, 73 F.3d 218, 219 (9th Cir. 1996); *Soderholm*, 587 N.E.2d 517, 519 (Ill. Ct. App. 1992).

421. *I.D. Craig Serv. Corp.*, 138 B.R. at 502 (Bankr. W.D. Pa. 1992).

422. *See supra* § IX(A) (discussing time-share).

423. *Id.*

a disruptive or improper manner, or if the person seeking admittance has otherwise violated the law in obtaining the ticket, such as buying from a scalper.⁴²⁴ Depending upon the timing of the filing of the bankruptcy petition, there may be two categories of ticket holders for the current season. These categories are distinct from the ticket holders for future seasons that are discussed in the preceding three sections. One category includes patrons who have paid for their tickets and have either received them or are awaiting delivery. The second category includes patrons who have exercised their option to purchase tickets for the season but have not paid for them. For those patrons who have paid for their tickets, under the material breach test, the contracts are not executory. Therefore, the franchise cannot reject the sales and must perform. For those patrons who have exercised their option to purchase the tickets, but have not paid for them, those contracts are executory and can be rejected by the franchise. Under the functional analysis test, both categories of ticket holders could be executory contracts, and thereby able to be rejected.⁴²⁵

E. Naming Rights

The most lucrative of revenue streams generated by new stadiums is the selling of naming rights.⁴²⁶ A naming rights agreement involves a corporation paying a sum of money in order to receive certain naming rights. Ninety-five percent of the sports facilities constructed since 1990 have a naming rights deal.⁴²⁷ The monies obtained from naming rights agreements are primarily used for stadium construction, rather than as operating income for the franchise.⁴²⁸ However, in about one-third of the agreements, the monies are available as operating income for the stadium owner.⁴²⁹ Since thirty-three percent of the franchises own their own facility,⁴³⁰ naming rights agreements will be involved in reorganization proceedings.

In 1999, the average naming rights agreement brought in \$129.1 million, or an average of \$5.58 million per year for the life of the naming agreement.⁴³¹ The naming rights agreement contains what is commonly

424. *Id.*

425. 11 U.S.C. § 365(a).

426. GREENBERG, *supra* note 2, at 299

427. *Id.* at 300

428. *Id.* at 299.

429. *Id.*

430. *Id.* at 105.

431. *Id.* at 307.

referred to as a standard amenity clause.⁴³² The amenities include: principal identification of the building; advertising signs on the building, at the entrances and on the playing surfaces; on the program advertising; marquee and image boards; scoreboard spots; ads on game tickets; media advertising; logos on directional signage; insignias on uniforms; logo on letterheads and other printed materials, including pocket schedules and cups.⁴³³ The naming rights agreement will normally have a term from five to thirty years⁴³⁴ with most agreements falling in the fifteen to twenty year range. The payment of the price under the naming rights agreement is generally payable over the term of the agreement. The naming rights agreement is an ongoing relationship between the naming rights sponsor and the sports franchise/facility. The naming rights agreement likely qualifies as an executory contract under both the material breach and functional analysis tests.⁴³⁵ Therefore, the naming rights agreement will be subject to the rejection/assumption analysis. The revenue stream flowing from the naming rights agreement is often utilized as collateral by the franchise.⁴³⁶ There is significant disagreement among the courts on the legal effect of rejecting an agreement that is used as collateral, and whether the secured creditor has a claim to the replacement naming rights agreement, if any.⁴³⁷

F. Advertising within the Sports Facility/Concessions

Advertising revenue is exempt from the league's revenue sharing programs.⁴³⁸ Therefore, all advertising money will go directly to the franchise. "The demand for advertising has turned every square inch of a sports facility into a potential source of advertising income."⁴³⁹ Depending on the scope of the naming rights agreement, there may be space available in the sports facility for additional advertising. The normal types of advertising in a sports facility are signage, sponsorships and virtual advertising.⁴⁴⁰ Signage appears inside the sports facility and is often part of an elaborate scoreboard display. The best spots in a stadium for signage are where the television cameras hit. Sponsorships dif-

432. *Id.* at 321.

433. *Id.*

434. *Id.* at 320.

435. *See supra* § VI.

436. GREENBERG, *supra* note 2, at 299.

437. *See supra* § IX(A).

438. GREENBERG, *supra* note 2, at 334.

439. *Id.* at 181-82.

440. *Id.* at 334-45

fer from advertising in that a sponsorship permits a company to pay for the right to be associated with a particular event or events.⁴⁴¹ "Sponsorship agreements include a wide variety of advertising opportunities."⁴⁴² For example, a sponsorship agreement may grant the sponsor "the right to display its name or logo on team uniforms or other clothing, . . . or offer promotions like a fan contest held as part of a sporting event."⁴⁴³ Pouring rights are a type of sponsorship agreement. Pouring rights allow "a beverage company to sign a sponsorship agreement[] [granting] the beverage maker [the] exclusive right[] to sell its beverage[] in the . . . home stadium or arena."⁴⁴⁴ The company pays an upfront or annual fee to be the exclusive beverage supplier. Pouring rights are negotiated locally and each team receives the revenue from such a contract right. Sponsorship agreements generally last ten years or longer.⁴⁴⁵ Virtual advertising involves "computer-generated ads [that are] electronically placed on . . . blank walls, fences, [or] playing surfaces."⁴⁴⁶ These ads are directed at only the TV audience. The virtual ad looks like real stadium signage on the television screen.

Concessions broadly refer to food, beverage and novelty sales in a stadium. These operations are generally performed by outside contractors. The concessionaire agreement grants the concessionaire the rights to the concession operations⁴⁴⁷ for a specified period of time. The amount of money paid depends on the specific terms of the agreement.⁴⁴⁸ Concessions are an important revenue source for the sports franchises. Sport franchises have undertaken litigation to protect their concession income.⁴⁴⁹

441. ANDERSON & MILLER, *supra* note 268, at 193.

442. GREENBERG, *supra* note 2, at 338.

443. *Id.*

444. *Id.* at 342.

445. *Id.* at 339.

446. *Id.* at 344.

447. Concession rights are [those] rights transferred to a concessionaire for the sale and dispensing of food, snacks, refreshments, alcoholic and non-alcoholic beverage[s.] merchandise, souvenirs, clothing, novelties, publications, and other articles . . . pursuant to [the] concession agreement. The concession agreement [will] set aside sales spaces which will include[] concession stands, condiment areas, vending machines, hawkers station[s], press room, [club seating], cafeterias, executive clubs, executive suites, food courts, [outside] cafés and waitress service for club seats.

Id. at 349.

448. *See generally id.* at 351.

449. *See generally* Nat'l Football League Props., Inc. v. Helinger (*In re Helinger*), 22 B.R. 139 (Bankr. M.D. Fla. 1982).

Initially, it must be determined whether the advertising and concession contracts are executory contracts. Both types of concession agreements⁴⁵⁰ qualify as an executory contract. For advertising contracts, it has been determined that the refusal to display future advertising is sufficient to qualify as an executory contract under the material breach test.⁴⁵¹ Under the functional analysis test, the advertising contract will be deemed executory if it will benefit the reorganization to be able to reject/assume the advertising contract. Both the concession and advertising contracts appear to qualify as executory contracts. Therefore, the franchise will need to conduct an economic analysis to determine whether it will be in the best interest of the franchise to assume/assign these contracts or reject them and enter into replacement contracts.

X. SECTION 363 SALES

In most Chapter 11 cases where the debtor's assets are to be liquidated, the liquidation will take place as part of a confirmed plan of reorganization. However, in certain circumstances, the franchise may attempt to use the Code's more expedited procedure to effectuate a sale of all or substantially all of the franchise's assets. It is called a § 363 sale.⁴⁵² Court approval is required. The usual justification for a § 363 sale is that there is some need to complete the sale more quickly than can be accomplished through the plan confirmation process. The § 363 sale, however, does have the practical effect of depriving parties of their various rights inherent in the plan confirmation process. Courts, therefore, closely scrutinize the request for a § 363 sale.⁴⁵³

A § 363 sale will be allowed as part of the reorganization process provided certain criteria are met. The court must determine that: (1) there is a sound business reason for conducting the sale prior to the plan's confirmation, (2) adequate and reasonable notice of the proposed sale has been given, (3) the sale has been proposed in good faith, and (4) the proposed sales price is fair and reasonable.⁴⁵⁴ The courts will not approve a § 363 sale that does not satisfy these criteria. In that event,

450. There are two types of concession agreements – the commission contract and management fee contract. Under the commission contract, the facility or sports franchise is paid “a percentage based on the gross sales of the facility.” GREENBERG, *supra* note 2, at 351. Under the management fee contract, “the concessionaire will be reimbursed for operating expenses and then paid [an agreed] management fee.” *Id.*

451. *Anheuser-Busch, Inc.* 99 B.R. at 139.

452. 11 U.S.C. § 363(b)(1).

453. *See In re Savage Indus., Inc.*, 43 F.3d 714 (1st Cir. 1994).

454. *See, e.g., In re Lady H Coal Co., Inc.*, 193 B.R. 233, 243-44 (Bankr. S.D.W. Va. 1996).

the franchise will be required to present a plan of reorganization to the court for confirmation.

XI. REORGANIZATION PLANS

The plans of reorganization for a sports franchise will either be one that seeks to reorganize through an ongoing plan that allows current ownership to retain its equity⁴⁵⁵ or one that intends to reorganize the sports franchise by having new ownership through a liquidating plan.⁴⁵⁶ Liquidating plans are expressly authorized by the Code.⁴⁵⁷ Since a liquidating plan anticipates transferring the franchise's assets, it will be imperative to be able to assume and assign to the new owner the league membership agreement.⁴⁵⁸ Also, the sports facility agreement will need to be assumed and assigned to the new owner or rejected, depending on the attractiveness of its financial terms.⁴⁵⁹ Finally, the favorable players' contracts will need to be assumed and assigned to the new owner and the unfavorable ones rejected.⁴⁶⁰ A liquidating plan has the potential to raise a significant sum for the creditors. Since 1966, the average cost of a sports franchise is \$510 million for the NFL, \$310 million for the NBA, \$180 million for the NHL and \$300 million for Major League Baseball.⁴⁶¹ Sometimes, the prospect for a successful reorganization is so remote, the court cannot let the case proceed.⁴⁶² In that event, a complete liquidation is the only available choice. The NHL plan in the Penguins' reorganization was a complete liquidation plan.⁴⁶³

The Bankruptcy Code, however, has a built-in bias favoring reorganization over complete liquidation.⁴⁶⁴ The Supreme Court has stated, "[t]he fundamental purpose of reorganization is to prevent the debtor from going into liquidation, with [the] attendant loss of jobs and possible misuse of economic resources."⁴⁶⁵ Universally, the owner's first choice

455. *Lehigh Valley Prof'l Sports Clubs, Inc.*, 2000 WL 290187, at *15 (Bankr. E.D. Pa. 2000).

456. *Id.* at *20.

457. 11 U.S.C. § 1123 (a)(5)(D), (b)(4).

458. *See supra* § VI.

459. *See supra* § VII.

460. *See supra* § VIII.

461. GREENBERG, *supra* note 2, at 45.

462. *In re Great Am. Pyramid Joint Venture*, 144 B.R. 780, 790 (Bankr. W.D. Tenn. 1992).

463. The details of the NHL plan are discussed at the end of this Section. *See infra*.

464. 11 U.S.C. § 1123(b)(4).

465. *Bildisco & Bildisco*, 465 U.S. at 528.

is to seek to reorganize by preserving its equity in the sports franchise.⁴⁶⁶ This, however, is a difficult task and fraught with legal uncertainties. A basic principle in reorganization is that all creditors must be paid 100% of their claim before the current owners can receive any interest in the reorganized entity.⁴⁶⁷ This is called the absolute priority rule. Since it is exceedingly rare that creditors will receive payment on one hundred percent of their claims in bankruptcy, the current owners cannot retain an equity position in the reorganized debtor without contributing "new value." This is called the new value exception to the absolute priority rule. In essence, the current owners are repurchasing their interest in the reorganized entity and not retaining an equity position on account of their prior ownership. In *Lehigh Valley*, the court held that the prior owner of a minor league baseball franchise was not able to retain his equity in the reorganized sports franchise without extending the opportunity to third persons either to compete for that equity or to propose a competing reorganization plan.⁴⁶⁸ The court indicated that the plan would run a foul of the absolute priority rule if it did not provide such an opportunity. Although there is controversy regarding whether the new value exception exists,⁴⁶⁹ the weight of authority is clearly in favor of recognizing "new value" as the way to obtain ownership of the reorganized entity.⁴⁷⁰

Another issue surrounding the new value exception is how to measure the "new value." There are four requirements to the new value exception. The value must be (1) new, (2) necessary, (3) substantial, and (4) equal to or in excess of the value of the interest purchased.⁴⁷¹ The current owners must satisfy all four requirements in order to be the new owners of the reorganized entity. A very significant risk is that an outside bidder may submit a competing plan that contains new value and thereby become the new owner of the reorganized franchise.⁴⁷² When there are competing plans, the creditors will ultimately select the final

466. *Lehigh Valley Prof'l Sports Clubs, Inc.*, 2000 WL 290187, at *13 (Bankr. E.D. Pa. 2000).

467. 11 U.S.C. § 1129(a)(12).

468. See generally 2000 WL 290187.

469. NORTON, supra note 191, § 93.13.

470. See, e.g., *Bank of Am. Nat'l Trust & Sav. Ass'n. v. 203 N. LaSalle St. P'ship*, 526 U.S. 434 (U.S. 1999).

471. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-08 (U.S. 1988).

472. The debtor is given the exclusive right for 120 days after the filing of the bankruptcy petition to file a plan of reorganization. 11 U.S.C. § 1121(b). The 120-day period can be extended for cause, but will be shortened only in rare circumstances. *Lehigh Valley Prof'l Sports Clubs, Inc.*, 2000 WL 290187.

plan confirmed by the court. The Chapter 11 process, however, has exposed the franchise to a takeover situation.

In the Penguins' reorganization, there were three plans presented to the creditors. Two of the plans anticipated the reorganized entity remaining in Pittsburgh and the third did not. The first plan presented was a plan by Mario Lemieux.⁴⁷³ Some of the noteworthy features of the Lemieux plan were:

- (1) the franchise would remain in Pittsburgh;
- (2) a claims resolution trust would be created, and the unsecured creditors would be paid a pro rata share of the monies procured by the trust;
- (3) the reorganized entity would be a limited partnership with Mario Lemieux as the general partner (1% ownership interest) and the remaining limited partners would be required to pay \$50 million in new value to purchase their interest (83.34% ownership interest);
- (4) Mario Lemieux's allowed claim of \$32 million against the franchise would be resolved by the payment of \$6 million paid in cash upon the effective date of the plan; \$10 million to be evidenced by a promissory note from the new entity, which he agreed to subordinate to the new equity owners, whereby he became a limited partner (15.66% ownership interest) as well as the general partner; \$11 million to be evidenced by a promissory note to be paid over 8 years, and the balance of \$5 million to be forgiven; and
- (5) Several conditions precedent to the plan's implementation were that: (1) Lemieux was able to renegotiate a new sports facility agreement and a new local TV contract, (2) NHL approval of the plan of reorganization, and (3) the limited partners contribute the \$50 million in new value.⁴⁷⁴

The court confirmed the Lemieux plan on June 30, 1999.⁴⁷⁵ The second plan presented had two sponsors – the landlord on the sports facility

473. Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates Proposed by Mario Lemieux at 1, *Penguins' bankruptcy* (No. 98-28174); Record at 489 (disclosing the essential terms of the plan).

474. *Id.*

475. Order of Court at 1-4, *Penguins' bankruptcy* (No. 98-28174); Record at 686.

lease and the local TV network.⁴⁷⁶ The second plan provided two alternative means to reorganize the franchise. The first choice would distribute less than fifty percent ownership of the reorganized entity to the secured creditors, if they voted in favor of the plan, and the balance of the ownership (the majority) would be distributed to limited partners who were required to contribute \$27 million in new value. The second choice provided that in the event the secured creditors did not vote to accept the plan, the franchise would be sold through a public auction by the court. The buyers were obligated to maintain the franchise in Pittsburgh. The third and final plan submitted was by the NHL.⁴⁷⁷ The NHL made it clear that its plan was offered only in the event one of the other plans that intended to keep the franchise in Pittsburgh was not confirmed by the court. The NHL plan also provided two choices. The first choice was to offer the franchise for sale as a new franchise for \$85 million. The sale anticipated moving the new franchise to a location other than Pittsburgh. In the event the franchise could not be sold for \$85 million, the second choice required the NHL to pay \$65 million into the bankruptcy court and conduct a dispersal draft. The dispersal draft would absorb the players into the existing teams, and the franchise would be dissolved. It is interesting to note that the NHL did receive an \$85 million deposit from an undisclosed source to purchase the new franchise.⁴⁷⁸

XII. CONCLUSION

Sports franchises, like any other business, are not immune from fiscal problems. At least four major league franchises have been through a public reorganization. As players' salaries continue to escalate, additional franchises may find their expenses exceeding their revenues and a financial reorganization becomes a reality.

For many reasons, a private reorganization is preferable to a public reorganization. A private reorganization is an agreement between the franchise and its creditor(s) to restructure the franchise's obligations. It

476. Second Amended Disclosure Statement to Accompany Plan of Reorganization for Pittsburgh Hockey Associates. Proposed by SMG Pittsburgh, L.P. and Liberty/FOX KBL, L.P. d/b/a FOX Sports Net Pittsburgh at *Penguins' bankruptcy* (No. 98-28174); Record at 592.

477. Amended Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for the Amended Plan of Reorganization for Pittsburgh Hockey Associates. Proposed by the NHL at 1, *Penguins' bankruptcy* (No. 98-28174); Record at 577.

478. Designation of Assets to be Transferred to the New Member Under the Amended Plan of Reorganization for Pittsburgh Hockey Associates. Proposed by the NHL at 2, *Penguins' bankruptcy* (No. 98-28174); Record at 653.

is difficult, however, to accomplish a private reorganization. In addition, the particular circumstances of the franchise may not lend themselves to a private reorganization. In such event, the franchise should attempt a prepackaged Chapter 11 reorganization. A prepackaged Chapter 11 is where the franchise procures the requisite consents for its plan of reorganization *prior to* filing for bankruptcy relief. Upon filing its bankruptcy petition, the franchise also files its plan of reorganization and requests a final hearing for confirmation of its plan.

Failing a private reorganization or a prepackaged Chapter 11, the only remaining relief available for the insolvent franchise is a traditional Chapter 11 reorganization. At the inception of the reorganization, the franchise will encounter two major obstacles. First, the reorganization will need to be financed. A business needs cash to operate. Several methods of financing are available for the franchise. Second, the franchise will likely need to resist the actions of secured creditors who will seek to foreclose on the franchise's assets. The franchise will be required to provide adequate protection in one of its various forms to stave off the secured creditors.

If the franchise is successful in procuring financing for the reorganization and providing adequate protection to its secured creditors, the franchise must then focus on how to successfully reorganize. Invariably, any successful reorganization involves a reduction in a business's expenses. For a professional sports franchise, however, there are three requirements to a successful reorganization. First, it will be essential for the franchise to maintain its membership in its professional sports league. The franchise or membership agreement generally provides that the franchise's membership terminates upon the franchise's filing for bankruptcy relief. In addition, each league's Constitution generally prohibits any sale or assignment of the franchise without the league's consent. Both restrictions can be overcome in Chapter 11. Second, the franchise must have a facility to play its home games. This is normally accomplished through a lease or sports facility agreement. In Chapter 11, the franchise has the ability to assume the current lease, or reject it, and negotiate a new lease with the landlord. Third, the franchise must find a way to reduce expenses and/or increase revenues. A number of means are available to reduce expenses. The franchise can reject its current lease and renegotiate a more favorable one. Also, the franchise can review all the players' contracts and reject those contracts that are not beneficial to the franchise. Each of these options is a primary source to reduce operating expenses.

Finally, there are means available to increase revenues. The franchise has contracts with its patrons, advertisers, and vendors. These contracts may be rejected in Chapter 11. Obviously, a business decision needs to be made whether to touch these contracts. A public backlash against the franchise will not bode well for the reorganization. At a minimum, rejecting some of these contracts creates a severe public relations problem. The contracts with its patrons are luxury suite agreements, personal seat licenses, club seats, and current season ticket sales. Although each category has its own unique legal rights, if rejected, these contracts could be renegotiated and/or resold. The contracts with its advertisers are the naming rights contract and the contracts for advertising within the sports facility. These contracts could also be rejected in Chapter 11 and renegotiated for a higher fee. Finally, the franchise's concession contracts could be rejected and renegotiated for a higher return for the franchise.

The final form of the franchise's plan of reorganization will largely depend on how the franchise decides to satisfy the three requirements. Necessarily, each plan will be different. One area of considerable difference will be who will own the reorganized franchise after Chapter 11. Chapter 11 requires the old owners to contribute "new value" in order to continue with an ownership position. New value is an evolving concept and subject to much interpretation. However, in the absence of contributing "new value," there will be new owners of the reorganized franchise.

