Viewpoint

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The Evolution of Sports Bankruptcies

By Steve Krause

Team bankruptcies have never been more successful. Unsurprisingly, players and teams in the high-flying, swing-for-the-fences world of sports often follow great success with failure. Over the years, we have seen highly compensated players—including well-known names such as 1988 American League MVP Jose Canseco and 1986 NFL MVP Lawrence Taylor—file for bankruptcy after successful playing careers. Teams have failed with regularity as well; there have been 11 bankruptcies since 1970. Some team bankruptcies have been marked by poor team finances: the 1975 Pittsburgh Penguins faced an overwhelming IRS lien, and again in 1998 they were unable to meet payroll. Others, such as the 1970 Seattle Pilots, sought an end-run on league bylaws. Others were hampered by their owners' financial troubles; the 1993 Baltimore Orioles were sold after owner Eli Jacobs's financial troubles ended his "season."

However, while players are still filing for bankruptcy and even going to jail for financial fraud—Lenny Dykstra, most recently—teams seem to have found a more effective approach to financial difficulty. Generally, sales pursuant to Section 363 of the Bankruptcy Code, which allows the sale of assets free and clear of pre-existing liens, have become increasingly popular in many industries and markets. This has certainly been true in sports and in recent years, a number of struggling franchises have been sold in bankruptcy. The recent Los Angeles Dodgers sale bridged the old and the new, featuring an insolvent owner, a strong desire to skirt the league rules and a bankruptcy auction that ultimately resulted in the highest price ever paid for a professional sports team.

While bankruptcy often results from a would-be debtor's financial performance, several team bankruptcies have been caused by their owners' financial problems. For example, Eli Jacobs bought the Orioles in 1988 and quickly turned the team's fortunes. However, when his other investments faltered, Mr. Jacobs tried to sell the Orioles. Once Memorex filed for Chapter 11, Mr. Jacobs was forced to liquidate many of his other holdings, and both he and the team filed for bankruptcy, where the team was sold at auction.

Similarly, the Buffalo Sabres filed for bankruptcy in June 2003 after its owners were charged with corporate fraud and embezzlement in connection with their ownership of Adelphia Cable. The team was sold in bankruptcy in a 363 auction.

Bankruptcy often provides relief from burdensome contracts. For example, in 1969, the Seattle Pilots were a first-year expansion team with a big problem: their converted minor league ballpark was inadequate for their needs. Desperate to escape their lease but unable to leave because of MLB rules and injunctions by the state of Washington, the Pilots filed for bankruptcy in attempt to sell the team without further legal embroilment. The court eventually approved a sale to a group led by future Commissioner Bud Selig, who promptly moved the Pilots to Milwaukee and renamed them the Brewers.

Years later, the Phoenix Coyotes' bankruptcy sale failed when the court held that Section 363 could not be used to avoid the NHL's rule preventing relocation. The court held that the league's claim was not avoidable as a "bona fide dispute" to allow the "free and clear" transfer of the team, but rather that the claim was a bar to the transfer under applicable nonbankruptcy law. Ultimately, the NHL put in a bid, winning the team. The Coyotes are currently league-run and still looking for an owner to keep the team in Arizona.

In December 2008, the Tribune Co., owner of the Chicago Cubs, filed for bankruptcy. Tribune had tried to sell the Cubs prior to filing but the sale was delayed by the economic climate. During Tribune's bankruptcy, the team found a buyer and then initiated its own strategic Chapter 11 filing. The Cubs were sold within two days of filing. In approving the sale, Judge Kevin J. Carey held that Tribune had "a sound business reason" for the transaction. With the approval of other team owners, the sale closed 15 days after filing, without a bankruptcy auction.

Conversely, the Texas Rangers' sale was much harder to complete. Although the sale eventually generated greater value for creditors, it involved a fight that its owners had not anticipated. The Rangers had intended to use a quick 363 sale

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process to consummate a sale deal reached before the team filed for Chapter 11 to a group led by Nolan Ryan. However, the court found that the team's filing reopened bidding, and thereafter the Ryan group faced a vigorous challenge by a group led by Dallas Mavericks owner Mark Cuban. Ultimately, Mr. Ryan's group won with an increased bid, paying $593 million.

The bankruptcy of the Dodgers brought together each of these features and culminated in a quick and successful sale of the team. Owner Frank McCourt was mired in a contentious divorce, and reports indicate that he may have been $500 million in debt. In an attempt to revive the team's flagging finances and finalize his divorce, Mr. McCourt negotiated a TV deal with Fox Sports. However, Mr. Selig, now MLB commissioner, rejected the deal, which consequently forced the failure of Mr. McCourt's divorce settlement. In response, Mr. McCourt took the Dodgers to bankruptcy court in Delaware. There, Judge Kevin Gross refused to let Mr. McCourt ignore league rules. Without the TV deal or financing on his terms, Mr. McCourt had no path out of bankruptcy on his own. The team was auctioned under Section 363 and sold to a group led by Magic Johnson for a record-breaking $2 billion.

This sale could be a model for future team bankruptcies. Unlike many players who have filed for bankruptcy after successful careers, Mr. McCourt is walking away a very wealthy man. His golden parachute is said to be worth as much as $800 million. Of course, players sometimes have their own way out. If Mr. Dykstra could come back and play—as Michael Vick has—perhaps he could rewrite his final chapter, too.

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