BUSINESS LAW FORUM
SUCCESS AND FAILURE IN PROFESSIONAL SPORTS

VALUATION OF THE PROFESSIONAL SPORTS FRANCHISE IN BANKRUPTCY: IT'S A WHOLE DIFFERENT BALLGAME[1]

by
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An increasing number of professional sports teams have declared bankruptcy in recent years. Although no bankruptcy court has yet been required to value a bankrupt sports team as an enterprise, it is only a

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[1] The authors would collectively like to thank: Samir Parikh, William Snyder, and Russell Perry for all of their advice during the Article writing process.
The authors are particularly grateful to the following people who agreed to be interviewed for this Article:

> The Honorable Russell F. Nelms, United States Bankruptcy Judge, Northern District of Texas; Lou Strubeck, head of bankruptcy in the United States for Norton Rose Fulbright; Liz Boydston with Norton Rose Fulbright; and Clifton R. Jessup, Jr., Shareholder, Greenberg Traurig, LLP.

Each of the individuals listed above graciously provided the authors with the permission to record his or her respective interview for clarity and accuracy. Any references made to such interviews will be so indicated.

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matter of time before such a judicial valuation will be necessary. In this Article, Paul M. Lopez, K.M. Lewis, and Judge D.M. Lynn explain the challenges of valuing a professional sports franchise in bankruptcy, and offer judges and practitioners guidance in undertaking this difficult task.

> *In practice, no problem in bankruptcy is more vexing than the problem of valuation. Volumes have been written on it, literally thousands of cases each year involve disputes about it, and virtually every aspect of the bankruptcy system turns on it. Nonetheless, there is little conceptual guidance for valuing most assets, beyond some general sense of liquidation values and going-concern values. Both parties and courts try to scrape together a coherent picture of the business with a variety of numbers and an overriding sense of skepticism about the accuracy of any valuation estimates.*
>
> Elizabeth Warren[5]

INTRODUCTION

The professional sports industry has become so deeply rooted in American society that it transcends barriers of language, culture, or politics—a feat to which other industries only aspire. Professional sports provide inspiration to young adults,[6] a common ground for strangers, and, with the ever-present nature of sports due to advances in technology, multi-million-dollar opportunities for investors. Sports, needless to say, are big business. Professional sports franchises sell for hundreds of millions of dollars, and the price of acquiring a sports franchise appears to be ever-increasing.[7]

In most industries, these burgeoning price tags would imply "growing profit margins and cash flow," but that is "not necessarily true . . . in

[5] Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 13–14 (footnotes omitted).

[6] For better or for worse. *See, e.g.*, JEFF PEARLMAN, BOYS WILL BE BOYS: THE GLORY DAYS AND PARTY NIGHTS OF THE DALLAS COWBOYS DYNASTY 185 (2008); Richard H. McLaren, *Is Sport Losing its Integrity?*, 21 MARQ. SPORTS L. REV. 551, 552 (2011); Steve Silverberg, Note, *Safe at Home? Assessing U.S. Efforts to Protect Youths from the Effects of Performance-Enhancing Drugs in Sports*, 35 BROOK. J. INT'L L. 271, 282–83 (2010). As Simon and Garfunkel once put it, "Where have you gone, Joe DiMaggio? / A nation turns its lonely eyes to you." SIMON & GARFUNKEL, *Mrs. Robinson*, *on* BOOKENDS (Columbia Records 1968).

[7] *E.g.*, Stephen M. Carr & Timothy F. Cummins, *Professional Sports Franchises Still Present Unique Valuation Problems*, VALUATION STRATEGIES, Nov.–Dec. 2001, at 6, 8.

the world of professional sports. Quite the contrary: although media, venue, and corporate sponsorship revenues" for professional sports teams have "grown significantly" in recent years, "many franchises are operating at increasing losses," and "[i]n some leagues, the *majority* of franchises are losing money."[8]

As a result of this paradox, a number of professional sports teams have declared bankruptcy in recent years, and this trend shows no signs of slowing. In fact, of the twelve professional sports franchises in the United States to ever file bankruptcy, seven have done so in just the last ten years. These teams include the 1970 Seattle Pilots (later moved to Milwaukee and renamed the Brewers), 1975 and 1998 Pittsburgh Penguins,[9] 1978 Cleveland Barons,[10] 1993 Baltimore Orioles, 1994 Los Angeles Kings, 2003 Ottawa Senators,[11] 2003 Buffalo Sabres, 2009 Phoenix Coyotes, 2009 Chicago Cubs, 2010 Texas Rangers, 2011 Dallas Stars, and most recently, 2011 Los Angeles Dodgers.

Although sports teams are frequently valued outside the bankruptcy context,[12] to the best of the authors' knowledge no sports team has ever been valued on a stand-alone basis or as part of a larger enterprise in a bankruptcy court. So far, this is fortunate because, as we will describe below, while valuing any entity in bankruptcy is an arduous, risky, and costly process, the unique characteristics associated with owning a sports fran-

[8] *Id.*

[9] The Pittsburgh Penguins of the NHL are the only professional sports team to ever file for bankruptcy twice. Interestingly, Mario Lemieux, known as "Le Magnifique" in the hockey world and one of the greatest players in NHL history, retired as a Penguin in 1997. When the Penguins filed for bankruptcy in 1998, Mario Lemieux put together a group and purchased the Penguins out of bankruptcy. Le Magnifique "returned to the ice on Dec. 27, 2000—becoming the first player–owner of the modern era." Front Office–Executive Staff, Mario Lemieux, PITTSBURGH PENGUINS NHL, http://penguins.nhl.com/club/page.htm?id=56529. He played until January 2006 and is still a co-owner of the Penguins today. *Id.*

[10] Upon filing for bankruptcy, the Cleveland Barons of the NHL "were forced to merge with the financially hobbled Minnesota North Stars. The Stars moved to Dallas years later and won a Stanley Cup Championship in 1999." Joseph Checkler, *Sports Teams' Secret to Success After Bankruptcy: File Again!*, WALL ST. J. BLOGS: BANKRUPTCY BEAT (June 27, 2011, 5:15 PM), http://blogs.wsj.com/bankruptcy/2011/06/27/sports-teams-secret-to-success-after-bankruptcy-file-again/.

[11] It should be noted that the Ottawa Senators filed for bankruptcy protection under Canada's Companies' Creditors Arrangement Act (the "CCAA"). *No Surprise: Senators File for Bankruptcy Protection From Creditors*, SPORTS ILLUSTRATED (Jan. 9, 2003), http://sportsillustrated.cnn.com/hockey/news/2003/01/09/senators_bankruptcy_ap/. Although the Senators filed bankruptcy under the CCAA, the CCAA provides procedures for protection from creditors based in the United States. *See* Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, pt. IV (Can.).

[12] For instance, Forbes Magazine publishes an annual ranking of what it has calculated to be the world's most valuable sports teams. Kurt Badenhausen, *The World's 50 Most Valuable Sports Teams*, FORBES (July 12, 2011), http://www.forbes.com/sites/kurtbadenhausen/2011/07/12/the-worlds-50-most-valuable-sports-teams/.

chise make it particularly difficult to provide an accurate value of a professional team using traditional valuation methods in bankruptcy. Moreover, because bankruptcy confers advantages and disadvantages upon the debtor that declares it, one cannot simply import an enterprise valuation made outside the bankruptcy context and expect it to yield accurate results.

If trends continue, however, it is only a matter of time before a court will have to undertake the daunting task of valuing a professional sports franchise in bankruptcy. The purpose of this Article is to help courts and litigants successfully and reliably do just that. Part I describes how enterprise valuations are generally conducted in bankruptcy. Part II identifies the attributes of sports franchises that render traditional methods of enterprise valuation inaccurate or inappropriate in the sports bankruptcy context. The first subpart of Part III explains how the intricacies of a sports franchise render enterprise valuation of a bankrupt sports franchise a highly speculative task that should be avoided if an open market alternative is available. However, because there are instances where a full-fledged enterprise valuation is unavoidable under the Bankruptcy Code, the second subpart of Part III outlines a strategy for valuing the professional sports franchise in bankruptcy that will be of use to courts, practitioners, and valuation experts alike.

I. Valuation in Bankruptcy

A. *Occasions for Valuation in Bankruptcy*

A bankruptcy court may need to determine a Chapter 11 debtor's enterprise value "at multiple points in a bankruptcy proceeding."[13] Indeed, it is not uncommon for a bankruptcy court to determine a corporate debtor's enterprise value for purposes of ruling on a proposed plan

[13] Kerry O'Rourke, Survey, *Valuation Uncertainty in Chapter 11 Reorganizations*, 2005 Colum. Bus. L. Rev. 403, 406. Other situations where a valuation hearing may be necessary include "avoidance action[s]," which "depend[] upon whether [the] debtor was solvent at the time of the contested transaction." *Id.* at 406–07; *accord* Jonathan B. Cleveland, *Valuation in Bankruptcy and a Financial Restructuring Context*, J. Bus. Valuation, Oct. 2002, at 199, 202; *see also, e.g.*, 11 U.S.C. § 547 (2012) (authorizing the trustee to avoid transfers made while the debtor was insolvent); *id.* § 548 (authorizing the trustee to avoid fraudulent transfers and obligations made while the debtor was insolvent); Israel Shaked & Brad Orelowitz, *Case Studies in Corporate Bankruptcy Valuation*, 31 Am. Bankr. Inst. J., Aug. 2012, at 24, 24–25, 78–79 (describing how enterprise valuation is necessary in the context of fraudulent conveyances, preference claims, leveraged buyouts, and adversary proceedings where a plaintiff's theory of damages "is based on the decline in value of the debtor").

A debtor will also need to perform its own enterprise and equity valuation in the context of the disclosure statement required in Chapter 11. Cleveland, *supra*, at 199. Many other disputes may turn on value including entitlement to adequate protection, relief from the automatic stay, and sale pursuant to 11 U.S.C. § 363.

of reorganization. This is especially true in large corporate bankruptcies where a proposed plan of reorganization may not be supported by every impaired class of claims. In this instance, a bankruptcy court may confirm the plan over the rejection of an impaired class of claims pursuant to section 1129(b) of the Bankruptcy Code if at least one impaired class of claims votes to approve the plan.[14] This method of confirmation is commonly referred to as a "cramdown" confirmation.

In order to effectuate a cramdown confirmation, the Bankruptcy Code requires that the plan comply with the "absolute priority rule."[15] The absolute priority rule, in its simplest terms, requires that "all members of a given class are paid in full before members of a more junior class receive any recovery."[16] Thus, a bankruptcy court must assess the debtor's enterprise value to determine whether a plan satisfies the absolute priority rule.[17] In other words, "the size of the remaining pie must be established before it can be apportioned among competing claimants" and "the size of the pie relative to the claims outstanding is critical in determining whether a given class of claimants is entitled to any distribution at all."[18]

B. *Challenges of Valuing an Entity in Bankruptcy*

Although enterprises are regularly valued outside the bankruptcy context, such as for the purposes of acquisition, valuing an entity in bankruptcy differs from how one might value that entity outside of bank-

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[14] "A cramdown plan must meet all requirements of Section 1129(a) applicable to consensual plans except for Section 1129(a)(8), which requires the approval of all impaired classes." O'Rourke, *supra* note 13, at 409.

[15] *Id.* at 410 (citing Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 441–42 (1999)).

[16] *Id.* at 409 (citing 11 U.S.C. § 1129(b)(2)(B)(ii) (2000); 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][a] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2009)); *accord, e.g.*, Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 441 (1968); John A. Morris & Eric Haber, *A Primer on Litigating Business Valuation Cases*, 2004 ANN. SURV. BANKR. L. 381, 381–82. "[A] corollary of the absolute priority rule is that a senior class cannot receive more than full compensation for its claims." *In re* Exide Techs., 303 B.R. 48, 61 (Bankr. D. Del. 2003) (internal quotation marks omitted) (quoting *In re* Genesis Health Ventures, 266 B.R. 591, 612 (Bankr. D. Del. 2001)).

[17] O'Rourke, *supra* note 13, at 410. Note that "a judicial valuation determination is not required for plan confirmation unless a class of claimants has voted against the plan" or reorganization value does not clearly exceed liquidation value. *Id.* at 432 & n.114.

[18] *Id.* at 407–08; *accord, e.g.*, Peter V. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 BUS. LAW. 419, 419 (1996). This valuation is also important because if "the distributable value" of the company is "lower than the level of the debt, shareholders are unlikely to participate in the company post-emergence." Shaked & Orelowitz, *supra* note 13, at 24. By contrast, "if the distributable value is greater than the level of debt then upon emergence, shareholders are likely to retain a stake in the company." *Id.*

ruptcy.[19] Indeed, valuing an entity in bankruptcy is, to put it mildly, a complex and difficult affair.

> At best, the valuation of an enterprise . . . is an exercise in educated guesswork. At worst it is not much more than crystal ball gazing. There are too many variables, too many moving pieces . . . for the court to have great confidence that the result of the process will prove accurate in the future. Moreover, the court is constrained by the need to defer to experts and, in proper circumstances, to [d]ebtors' management. . . .
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> It may be that there are better ways to determine value than through courtroom dialectic. That said, the court must work within the system created by Congress—and, in valuing a company in chapter 11, that system contemplates an adversary contest among parties before a neutral judge.[20]

What follows is a description of the challenges facing courts, practitioners, and experts when engaged in the complicated task of valuing an entity as a whole in the context of bankruptcy and an outline of reasons why a bankruptcy court cannot simply import ordinary valuation methodologies into the bankruptcy context and expect accurate results. Judges, counsel, and witnesses must be aware of these difficulties, lest avoidable—and potentially calamitous—errors occur.[21]

1. Bankruptcy Confers Advantages and Disadvantages

Many courts and commentators agree that bankruptcy confers disadvantages insofar as "the 'taint' of bankruptcy will cause the market to undervalue the securities and future earning capacity of the [d]ebtor."[22] Bankruptcy can be very time consuming and may involve costly litigation. Bankruptcy also carries risks, such as the possibility that the proposed reorganization plan will not be confirmed.[23] "Another practical consideration is confidentiality. Although some information can be filed under

[19] *See, e.g.*, Shaked & Orelowitz, *supra* note 13, at 24. *See generally* Cleveland, *supra* note 13.

[20] *In re* Mirant Corp., 334 B.R. 800, 848 (Bankr. N.D. Tex. 2005).

[21] For a description of the negative consequences of overvaluation and undervaluation, as well as the dangers posed by uncertainty in valuation generally, see O'Rourke, *supra* note 13, at 403–05, 432–39, 447–48.

[22] *In re* Exide Techs., 303 B.R. 48, 66 (Bankr. D. Del. 2003); *accord, e.g.*, Morris & Haber, *supra* note 16, at 388–91. *But see* O'Rourke, *supra* note 13, at 419 (suggesting that courts' concern "that markets tend systematically to undervalue distressed companies simply because they are distressed" is "called into question, at least in part, by the relatively high rate—twenty percent or so—at which reorganized companies re-file for bankruptcy protection" (citing John Yozzo & Randall S. Eisenberg, *Rethinking WACC in Estimating Reorganization Value*, 22 AM. BANKR. INST. J., July–Aug. 2003, at 38, 38)).

[23] *See* Cleveland, *supra* note 13, at 204.

seal . . ., bankruptcy makes publicly available terms of [a] deal that would have never otherwise been made publicly available."[24]

Contrariwise, bankruptcy also confers "advantages" that are arguably "not given sufficient recognition by the market," including "the requirement of a court determination of feasibility, the benefits of court supervision, disclosure requirements[,] limits on debt," "resolving expensive litigation on which [the d]ebtor's cash flow is contingent," "the claims process[,] . . . the savings through contract rejection and other special powers afforded by the [Bankruptcy] Code."[25] Of these, perhaps the largest advantage is that a bankrupt entity is able to clean up its balance sheet: that is, the entity may convert present and future lawsuits and judgments against it—known and unknown—to claims[26] that are then subject to discharge[27] and satisfied through a reorganization plan.[28] Bankruptcy thereby reduces uncertainty and risk. Bankruptcy can also spur management to improve the bottom line by liquidating wasteful or unnecessary perquisites, such as private jets and fancy art.[29] The Supreme Court has held that an enterprise valuation must recognize these advantages "if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants [if applicable] is to be fair and equitable."[30] This does not amount to "a rejection of the market; rather, [this] reflect[s] a notion that markets undervalue[] entities in bankruptcy and that the taint of the proceeding . . . adversely affect[s] what someone would pay."[31]

2. Bankruptcy May Distort Previously Assembled Data

Bankruptcy also may further exacerbate the problem of stale data; for instance, a chapter 11 reorganization may dramatically alter the entity's corporate and business structure, and thereby render data collected pre-petition obsolete.[32] Because reorganization will generally correct infirmities in an entity's capital structure, those who seek to value a bankrupt entity must take care not to undervalue the entity on the basis of its

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24 Kevin R. Schulz, *Bankruptcy of a Professional Sports Franchise and the Implications for the Franchise and Its Players*, 8 DEPAUL J. SPORTS L. & CONTEMP. PROBS. 143, 148 (2012).

25 *In re Mirant Corp.*, 334 B.R. at 822, 834–35 (footnotes omitted) (citing Till v. SCS Credit Corp., 541 U.S. 465, 475 n.12, 480 (2004)).

26 *E.g.*, 11 U.S.C. § 501 (2012) (allowing creditors to file proofs of claim or interest).

27 *E.g.*, *id.* § 727 (governing discharge in a liquidation case under Chapter 7 of the Bankruptcy Code).

28 *E.g.*, *id.* § 1129 (governing confirmation of a plan in a reorganization case under Chapter 11 of the Code).

29 Cleveland, *supra* note 13, at 207.

30 Consol. Rock Prods. Co. v. Du Bois, 312 U.S. 510, 526 (1941).

31 COLLIER, *supra* note 16, ¶ 1129.06[2][a] (footnotes omitted).

32 Shaked & Orelowitz, *supra* note 13, at 24.

currently overleveraged capital structure.[33] Moreover, "the earnings of a financially troubled company are more likely subject to non-recurring items[;]" one who seeks to value a bankrupt enterprise must be cognizant of this to "avoid[] perpetual recognition of one-time items."[34]

3. Lack of a Prescribed Valuation Method

"Congress expressly declined to include a statutory valuation formula in the Bankruptcy Code."[35] Per Congress, "[a] statutory valuation formula would have been helpful. The Committee has considered a number of suggested formulas but has been unable to come up with a satisfactory one. The valuation problem is, therefore, left to the . . . judges."[36] Nor has the Supreme Court prescribed a valuation method for courts to use or given much guidance regarding how bankruptcy courts should value a bankrupt entity,[37] although the Supreme Court has at least specified that an entity in a Chapter 11 bankruptcy should generally be valued as a going concern.[38] Bankruptcy courts have therefore been directed to "determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case."[39]

a. Common Valuation Methods

In response, courts have adopted multiple methods for valuing an entity in bankruptcy. These are not the only possible methods;[40] what follows is a description of those most commonly used.[41] No one size fits all; the most reliable method to be employed in any given valuation will depend on the attributes of the entity to be valued.[42] Indeed, the methods can produce wildly divergent results, and even different experts utilizing the same method but different inputs can reach markedly different enterprise values.[43] This is because "[a]t least as important as the methodology employed at arriving at market value is the 'quality and reasonable-

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[33] Cleveland, *supra* note 13, at 204.

[34] *Id.* at 203.

[35] O'Rourke, *supra* note 13, at 425.

[36] H.R. Rep. No. 95-595, at 216 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6176.

[37] *E.g.*, Pantaleo & Ridings, *supra* note 18, at 420–21 (citing Consol. Rock Prods. Co. v. Du Bois, 312 U.S. 510, 525 (1941)).

[38] Morris & Haber, *supra* note 16, at 383 (citing *Consol. Rock Prods. Co.*, 312 U.S. at 525); Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 442–53 (1968).

[39] H.R. Rep. No. 95-595, *supra* note 36, at 356; *accord, e.g.*, *Anderson*, 390 U.S. at 444; Morris & Haber, *supra* note 16, at 384.

[40] *E.g.*, *In re* Mirant Corp., 334 B.R. 800, 815 n.44, 815–16 (Bankr. N.D. Tex. 2005) (discussing the "Capacity Method" occasionally used to value energy providers).

[41] *See* Morris & Haber, *supra* note 16, at 384.

[42] *See* Shaked & Orelowitz, *supra* note 13 (describing situations where one method may be more reliable than another).

[43] *See, e.g.*, *In re* Exide Techs., 303 B.R. 48, 59 (Bankr. D. Del. 2003). For tabular data illustrating the range of divergence in various bankruptcy cases, see O'Rourke, *supra* note 13, at 422–23, 431.

ness of the assumptions'" and values that "are plugged into" the chosen methodology.[44] Moreover, "the reliable data needed" for accurately performing each method "is not always available."[45] As a result, the court may be advised to "use multiple methods to check value,"[46] and can weigh the results reached by each method equally or unequally.[47]

i. The Discounted Cash Flow ("DCF") Approach

"[T]he DCF approach aims to calculate enterprise value based on the present value of a debtor's projected cash flows."[48] DCF is therefore a "'forward-looking' method that 'measure[s] value by forecasting a firm's ability to generate cash.'"[49]

The first step of DCF is to estimate the debtor's cash flows for a term in the near future, such as the next five years.[50] This estimate should "exclude income from nonoperating assets;" "[e]xcess marketable securities, cash and working capital, and properties to be liquidated are generally valued separately to avoid having the cash flows associated with those assets distort operating cash flow."[51]

These cash flows are then discounted to present value using some discount rate.[52] It is necessary to perform this discounting because "a dollar to be received a year from now is not equivalent in value to a dollar received today . . . . Each payment must be weighted according to when it will be received."[53]

The most commonly utilized discount rate is the Weighted Average Cost of Capital ("WACC"), which "represents the return that a hypothetical investor would demand from an investment in the company, based in part on the company's relative debt to equity ratio."[54] WACC may need to

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[44] *In re* Vanderveer Estates Holding, LLC, 293 B.R. 560, 564 (Bankr. E.D.N.Y. 2003) (quoting *In re* Carmania Corp., 156 B.R. 119, 121 (Bankr. S.D.N.Y. 1993)).

[45] Shaked & Orelowitz, *supra* note 13, at 24.

[46] O'Rourke, *supra* note 13, at 424 (quoting COLLIER, *supra* note 16, ¶ 1129.06[2][a][iv]); *accord* Pantaleo & Ridings, *supra* note 18, at 426 (suggesting that the market comparison approach "should be supplemented whenever possible by" the comparable transaction approach to ensure accuracy).

[47] *See, e.g.*, *In re Exide Techs.*, 303 B.R. at 62–63 (citing Pantaleo & Ridings, *supra* note 18, at 437).

[48] O'Rourke, *supra* note 13, at 421; *see also* Morris & Haber, *supra* note 16, at 385.

[49] *In re Exide Techs.*, 303 B.R. at 63 (quoting Pantaleo & Ridings, *supra* note 18, at 427).

[50] O'Rourke, *supra* note 13, at 421.

[51] Pantaleo & Ridings, *supra* note 18, at 431 (citing *In re* Pullman Constr. Indus. Inc., 107 B.R. 909, 919–20 (Bankr. N.D. Ill. 1989)).

[52] O'Rourke, *supra* note 13, at 421.

[53] Pantaleo & Ridings, *supra* note 18, at 427 (internal quotation marks omitted) (quoting JOHN D. FINNERTY, CORPORATE FINANCIAL ANALYSIS 51 (1986)).

[54] O'Rourke, *supra* note 13, at 421 (citing COLLIER, *supra* note 16, 1129.06[2][a][ii][B]). "There are three basic steps to determine the WACC. First, the cost of debt must be calculated. Next, the cost of equity must be calculated. Finally,

be reduced by the real growth rate and the rate of inflation to yield accurate results.[55]

Typically, the next step is to calculate a terminal value, which "represent[s] the value of the debtor's cash flows beyond the projection period into perpetuity, . . . by applying an enterprise value multiple or perpetual growth rate to the final year of projected cash flows."[56] This terminal value is then discounted to present value using the discount rate (again, typically WACC) and then "added to the present value of the projected near-term cash flows to obtain the debtor's enterprise value."[57]

Simply put, "[t]he goal in a discounted cash flow valuation is to estimate the 'intrinsic value' of an asset" or enterprise "based on its fundamentals."[58] "Intrinsic value is the value that would be attached to the firm by an all-knowing analyst who not only estimates the expected cash flows correctly but also attaches the right discount rate to these cash flows and values them with absolute precision."[59]

One major advantage of the DCF method is that it is the method most consistent with the Supreme Court's admonition that bankruptcy courts are to value bankrupt entities on a going-concern basis.[60] Because the primary goal of the DCF method is to measure future earnings, it will produce very accurate results for stable companies with predictable cash flows.[61] Another advantage is that "it attempts to measure value directly" using "what is arguably the truest measure of value to any investor or creditor, namely, cash."[62]

However, not every entity has stable and predictable cash flow. "[P]recisely determining intrinsic value is impossible . . . with companies that have a substantial uncertainty about their future."[63] Moreover, even typically stable and established companies can experience shocks that

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appropriate weights must be assigned to each based upon the debt/equity ratio assumed for the target firm." Pantaleo & Ridings, *supra* note 18, at 432 (footnotes omitted). For instructions on how to calculate the cost of debt and the cost of equity, see *id.* at 432–33. The capital asset pricing model, or "CAPM," is a generally accepted method for calculating the cost of equity. *E.g.*, *In re Exide Techs.*, 303 B.R. at 64. However, CAPM can produce inaccurate results for companies that are not publicly traded. *Id.* For an in-depth discussion of how CAPM is calculated, see *id.* at 64 n.32.

55 Pantaleo & Ridings, *supra* note 18, at 429–30.

56 O'Rourke, *supra* note 13, at 421; *see also* Pantaleo & Ridings, *supra* note 18, at 428–29 (describing the difference between the EBITDA multiple and Perpetuity methods of calculating terminal value).

57 O'Rourke, *supra* note 13, at 421.

58 Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR. INST. L. REV. 1, 6 (2012).

59 *Id.*

60 *See* Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 442–53 (1968).

61 *See id.* at 453.

62 Pantaleo & Ridings, *supra* note 18, at 439.

63 Sontchi, *supra* note 58, at 6.

disrupt cash flow, such as the entry of a new competitor, a technological change that renders the entity's product or service obsolete, or international political upheaval. Therefore, the DCF method will not always produce accurate results.

Another problem with the DCF method is its difficulty. Because the DCF method requires judges to consider factors "that have nothing to do with law and much to do with financial theory," with which many judges are not particularly familiar, a number of courts have committed errors while attempting to utilize DCF.[64]

ii. The Market Comparison Approach

The market comparison approach, also known as the comparable companies analysis,[65] attempts to derive the debtor's enterprise value by comparing the debtor to its peers in the relevant industry.[66] "Under the comparable companies analysis, value is calculated by examining the trading ranges of comparable publicly-traded companies. Public companies are used because they are the only ones for which economic data (stock value, revenue, EBITDA,[67] EBIT,[68] etc.) is readily available."[69] The first step is to identify public companies similar to the entity being valued.[70] Although "perfectly comparable companies do not exist" because each entity is unique, one may identify companies that are sufficiently close by comparing the prospective comparator company's capital structure, earnings, book value, credit status, products or services, and other similar factors.[71] The next step is to calculate a ratio for each comparable firm, using some known indicator of value (such as stock price) as the numerator and some measure of the comparable company's operating results (such as earnings) as the denominator.[72] Several such ratios are

[64] Pantaleo & Ridings, *supra* note 18, at 440–41 (describing problems various courts have had utilizing the DCF method).

[65] *See id.* at 421.

[66] O'Rourke, *supra* note 13, at 420; *see also In re* Exide Techs., 303 B.R. 48, 61 (Bankr. D. Del. 2003); Morris & Haber, *supra* note 16, at 384–85.

[67] Earnings before interest, taxes, depreciation, and amortization or "EBITDA" is a metric that is used to analyze a company's profitability as well as its ability to service debt. EBITDA is a useful tool in calculating a company's profitability because it does not account for "non-recurring items (e.g., a litigation settlement) and non-operating revenues (e.g., income from investments)." *In re* Mirant Corp., 334 B.R. 800, 809–10 (Bankr. N.D. Tex. 2005).

[68] Earnings before interest and taxes or "EBIT" is a calculation that is used to gauge a company's operating profit. EBIT is often seen as the precursor to EBITDA.

[69] Sontchi, *supra* note 58, at 11.

[70] Pantaleo & Ridings, *supra* note 18, at 421.

[71] *Id.* at 422–23 (citing Estate of Clarke v. Comm'r, 35 T.C.M. (CCH) 1482 (1976); Tallichet v. Comm'r, 33 T.C.M. (CCH) 1133 (1974)).

[72] Pantaleo & Ridings, *supra* note 18, at 421.

generally accepted.[73] The ratios calculated for the comparable firms are then compared to the target company to calculate the target's enterprise value.[74]

The market comparison approach has shortcomings. "Potential problems with this approach include deciding which debtor performance metric should be chosen, which financial performance period the valuation should be based on given the debtor's current financial condition, and which companies, if any, are truly 'comparable' to the debtor."[75] Reasonable minds may differ regarding which comparable companies should be chosen, and, to reiterate, no comparator will be perfect because no two firms are exactly alike.[76] Naturally, "[t]he more similar the guideline or comparable companies are, the more supportable is the use of the [market comparison] method. Use of companies that are clearly not comparable will lead to unsupportable conclusions."[77]

Another shortcoming of the market comparison approach is that it is more backward-looking than the DCF method.[78] The market comparison approach uses multiples based on current market conditions, but "multiples change over time as inflation and macroeconomic conditions change, as indicated by factors such as GNP, industrial production, and unemployment. Therefore, today's multiples might differ significantly from those that would exist when the forecasted results are realized."[79]

Finally, using price/equity ratios to determine value in the market comparison approach, as is most commonly done in bankruptcy cases, "can yield misleading results" based on the target company's leverage structure.[80]

iii. The Comparable Transaction Approach

The comparable transaction approach is similar to the market comparison approach, but it "seeks to derive the debtor's enterprise valuation from the prices (enterprise valuations) paid by purchasers in recent acquisitions of comparable companies, rather than from market-assigned enterprise values."[81] Under this analysis, "the purchase price [of a comparable company] is viewed as a multiple of an appropriate earning meas-

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73 *See id.* at 421–22 (describing several ratios often used for this purpose, such as the price/earnings multiple (also called the P/E ratio) and Total Enterprise Value over EBITDA).

74 *See id.* at 422 (setting forth the equation for accomplishing this).

75 O'Rourke, *supra* note 13, at 420.

76 Pantaleo & Ridings, *supra* note 18, at 422.

77 Sontchi, *supra* note 58, at 11.

78 Pantaleo & Ridings, *supra* note 18, at 437.

79 *Id.* at 426 (footnote omitted).

80 *Id.* at 438.

81 O'Rourke, *supra* note 13, at 420 (footnote omitted); *see also In re* Exide Techs., 303 B.R. 48, 62 (Bankr. D. Del. 2003); Morris & Haber, *supra* note 16, at 385.

ure (revenue, EBITDA, or EBIT)."[82] Value is then "calculated by applying the resulting multiple to the same metric of the company being evaluated."[83] In real estate transactions, the comparable sales are evaluated vis-à-vis the subject property, and adjustments are made accordingly. Again, "the more similar the target company is to the firm being valued, the more confidence one can place in the valuation."[84]

However, like the market comparison approach, the comparable transaction approach suffers from the difficulty of determining which transactions are truly comparable.[85] Indeed, for certain industries, including the professional sports industry, market conditions may differ markedly from conditions in bankruptcy. Deriving the debtor's enterprise value by comparing it to acquisitions in the open market may therefore produce artificial results. Contrariwise, in other industries, such as the real estate industry, acquisitions of property outside of the bankruptcy context are typically very useful in determining the value of a substantially similar property in bankruptcy.

Another difficulty with the comparable transaction approach is "adjusting for any control premium which a purchaser may have paid" to acquire the benchmark company.[86] Because of this, the comparable transaction method may not produce accurate valuations when used on its own. As a result, some commentators suggest that the comparable transaction method "is 'best utilized to corroborate valuations obtained by other methods,' given the uniqueness of each transaction."[87]

4. *Expert Testimony*

Valuation hearings, at which the bankruptcy court may hear testimony from dozens of expert witnesses and accept into evidence hundreds of exhibits, may last for weeks or months.[88] The larger the entity to be valued, the more complicated—and important—valuation becomes.[89] Bankruptcy courts, though capable of identifying methodological errors

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[82] Sontchi, *supra* note 58, at 12 (citing Stan Bernstein et al., *Squaring Bankruptcy Valuation Practice with* Daubert *Demands*, 16 AM. BANKR. INST. L. REV. 161, 195 (2008)).

[83] *Id.* at 12.

[84] *Id.*

[85] O'Rourke, *supra* note 13, at 420–21.

[86] *Id.* (footnote omitted); *accord In re* Am. HomePatient, Inc., 298 B.R. 152, 174 n.19 (Bankr. M.D. Tenn. 2003), *aff'd*, 420 F.3d 559 (6th Cir. 2005) ("The Control Premium is a measure of the difference in value between a controlling interest in a company and a minority interest and can be found in successful public tender offers where the investor acquired a control position."); Pantaleo & Ridings, *supra* note 18, at 426–27.

[87] O'Rourke, *supra* note 13, at 421 (quoting David F. Heroy & Adam R. Schaeffer, *Valuation in Bankruptcy*, 862 PLI/COMM. 153, 184 (2004)).

[88] *See, e.g.*, *In re* Mirant Corp., 334 B.R. at 809–10 (describing the valuation hearing which continued "for 27 days over . . . 11 weeks," during which the court heard testimony from numerous witnesses and received into evidence "a total of 454 exhibits" plus deposition transcripts and additional expert reports).

[89] *See, e.g.*, *id.* at 820.

in enterprise valuation and evaluating the credibility of witnesses,[90] lack the resources or the experience to calculate enterprise value on their own; they must rely on expert witnesses to accomplish the task.[91] The court, applying the *Daubert*[92] standard, must carefully scrutinize the qualifications of expert witnesses before they may provide valuation testimony.[93] Even where an expert qualifies under the *Daubert* standard, the court may be required to disqualify that expert's report if it contains material errors.[94] Furthermore, even after an expert has been admitted to testify as to the enterprise's value, the court must judge whether the expert has given objective testimony (or at least testimony as objective as the valuation context permits) or biased advocacy, and weigh the evidence accordingly.[95]

"[I]n performing valuations, financial professionals often make 'adjustments' to the selected methodology," and "judges are inherently suspicious of [such] adjustments."[96] "The concern is that the adjustment is being made to manipulate the valuation to reach a predetermined result."[97] "Thus, a financial professional making such an adjustment should be prepared to provide a clear reason for [doing] it" and "be prepared to defend [it] on cross examination."[98]

5. Subjectivity, Uncertainty, and Invention

Valuation essentially requires the court to undertake the impossible task of predicting the future, which is more of an art than a science. Although valuation experts are undoubtedly highly skilled, courts and practitioners must remember that valuation experts

> are not oracles. The opinion evidence they present . . . should be taken as a set of assumptions that are factored into a model and critical analysis then employed to test those assumptions. The evi-

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[90] *E.g.*, *In re* Miami Beach Hotel Investors LLC, 304 B.R. 532, 535 (Bankr. S.D. Fla. 2004); O'Rourke, *supra* note 13, at 427–28.

[91] *See* O'Rourke, *supra* note 13, at 427.

[92] Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993).

[93] *See, e.g.*, *In re Mirant Corp.*, 334 B.R. at 811–13 (citing FED. R. EVID. 702; Kumho Tire Co., Ltd. v. Carmichael, 526 U.S. 137, 150–52 (1999); *Daubert*, 509 U.S. at 593–94). Note that the fact "[t]hat experts may be anxious to serve the interests of the parties retaining them is [not] . . . enough reason to disregard their testimony." *In re Mirant Corp.*, 334 B.R. at 814; *see id.* at 815 (citing *In re* Coram Healthcare Corp., 315 B.R. 321, 339 (Bankr. D. Del. 2004); *In re* Exide Techs., 303 B.R. 48, 61 (Bankr. D. Del. 2003); *In re* Beker Indus. Corp., 58 B.R. 725, 739 (Bankr. S.D.N.Y. 1986)).

[94] *See, e.g.*, *id.* at 813–14.

[95] Cleveland, *supra* note 13, at 201. *See generally* Morris & Haber, *supra* note 16.

[96] Sontchi, *supra* note 58, at 16; *see, e.g.*, *In re Exide Techs.*, 303 B.R. at 60–66 (holding that debtor's expert should not have adjusted his results downward).

[97] Sontchi, *supra* note 58, at 16.

[98] *Id.*

> dence in this exercise is hardly clear, is highly judgmental and consists largely of inferences.[99]

Data grows stale quickly. Technological change and world events may beneficially—or cataclysmically—affect an entity's bottom line. As a result, "[t]wo basic types of valuation uncertainty confront the stakeholders in bankruptcy: uncertainty regarding the true value of an enterprise ('actual uncertainty') and uncertainty regarding the value that a judge would assign to the enterprise ('judicial valuation uncertainty')."[100]

Enterprise valuation often necessarily requires the expert and the court to engage in invention and fantasy because there is typically "no ready, 'efficient' market in which" commercial entities similar to the debtor at issue "are bought and sold."[101] "[M]arkets—especially those for distressed businesses—are often imperfect, whether due to illiquidity, incomplete or asymmetric information among investors, strategic behavior, or other factors."[102]

II. Traditional Methods of Valuation Fall Short When Valuing a Professional Sports Franchise in Bankruptcy

The problem with valuing the professional sports franchise is that it possesses key attributes that set it apart from more traditional businesses. Additionally, professional sports leagues set forth strict policies and restrictions in their constitutions, bylaws, and other governing documents in order to maintain control over the ownership of its member teams which may or may not bind courts.[103] As a result, valuation techniques typically used in corporate bankruptcies are unlikely to produce accurate results if applied reflexively.

To illustrate how the unique characteristics of a professional sports team coupled with league restrictions can directly affect the value of a team in bankruptcy, the authors begin with a brief synopsis of the Texas Rangers' bankruptcy case below. A list of ways that sports franchises differ from traditional corporations and an explanation as to why these differences make difficult the task of valuing a professional sports franchise in bankruptcy using the traditional methods will follow.

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[99] *In re* Beker Indus. Corp., 58 B.R. 725, 739 (Bankr. S.D.N.Y. 1986).

[100] O'Rourke, *supra* note 13, at 414–15 (citing Douglas G. Baird & Donald S. Bernstein, *Enterprise Valuation and the Puzzling Persistence of Relative Priority Outcomes in Corporate Reorganization*, Univ. of Cal. Berkeley: Berkeley Program in Law and Economics (2004), *available at* http://escholarship.org/uc/item/0z7906ct). For proposals for reducing such uncertainty, see *id.* at 438–50.

[101] *In re* Mirant Corp., 334 B.R. 800, 832 n.113 (Bankr. N.D. Tex. 2005).

[102] O'Rourke, *supra* note 13, at 416.

[103] Lawrence J. Kotler & Matthew E. Hoffman, *Rangers', Coyotes' Asset-Purchase Agreements: Trumping Bankruptcy's Fundamental Goals?*, 29 Am. Bankr. Inst. J., Sept. 2010, at 26, 26, 70.

A. *The Texas Rangers' Bankruptcy Case*[104]

In late 2009, Texas Rangers Baseball Partners ("TRBP") held an auction to facilitate the sale of the Texas Rangers (the "2009 Auction").[105] In December 2009, TRBP, in conjunction and with the approval of MLB, selected a group led by Nolan Ryan[106] and Chuck Greenberg (the "Greenberg–Ryan Group") as the winning bidder.[107] On January 23, 2010, TRBP entered into an asset purchase agreement for the sale of the Texas Rangers to the Greenberg–Ryan Group.[108] The January 23rd contract required the consent of the Texas Rangers' first lien lenders (the "First-Lien Lenders") to finalize the sale.[109] Because the First-Lien Lenders did not consent to the sale, it was never finalized.[110]

On May 24, 2010, TRBP filed for Chapter 11 bankruptcy.[111] In doing so, TRBP sought approval of a "pre-packaged" bankruptcy plan to consummate the sale of the Texas Rangers to the Greenberg–Ryan Group for approximately $495 million (the "Original Purchase Price").[112] MLB argued that the Original Purchase Price was adequate, affirmed its approval of the transfer of the Texas Rangers to the Greenberg–Ryan Group, and urged the bankruptcy court to, in turn, approve the prepackaged bankruptcy plan.[113] The First-Lien Lenders maintained that the Original Purchase Price was inadequate and that TRBP could only receive fair value for the Texas Rangers through an open auction in bankruptcy.[114]

Shortly thereafter, the equity owners of TRBP (the "Equity Owners") retained a chief restructuring officer (the "Equity CRO") to advise the

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[104] Due to Judge Lynn's involvement with the Texas Rangers' bankruptcy case, he chose not to participate in the drafting of the following section titled *The Texas Rangers' Bankruptcy Case*. Therefore, any information included in the section titled *The Texas Rangers' Bankruptcy Case* was gathered from pleadings and transcripts that are available to the general public and interviews conducted by Paul M. Lopez and K.M. Lewis. Additionally, any opinions expressed in the following discussion titled *The Texas Rangers' Bankruptcy Case* regarding the proceedings of the Texas Rangers' bankruptcy case are exclusively those of Paul M. Lopez and K.M. Lewis or the particular interviewees as indicated.

[105] Transcript of Proceedings at 18, *In re* Texas Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010) (No. 10-43400), ECF No. 98.

[106] At the time, Nolan Ryan was President of the Texas Rangers.

[107] Transcript of Proceedings, *supra* note 105, at 18.

[108] *Id.*

[109] *Id.*

[110] *Id.*

[111] *See* Chapter 11 Voluntary Petition, *In re* Texas Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010) (No. 10-43400), ECF No. 1.

[112] Interview with Judge Russell F. Nelms, Bankr. N.D. Tex. (Mar. 11, 2013) (audio recording on file with authors).

[113] Transcript of Proceedings, *supra* note 105, at 29–30.

[114] Interview with Judge Russell F. Nelms, *supra* note 112; *see also* Transcript of Proceedings at 77–78, *In re Texas Rangers Baseball Partners*, 434 B.R. 393, ECF No. 99.

Equity Owners, as well as the court, of his views regarding any proposed plan in TRBP's bankruptcy.[115] The Equity CRO was also granted control over the Equity Owners' vote with respect to any proposed plan in TRBP's bankruptcy. While the Equity CRO familiarized himself on the case, the Greenberg–Ryan Group indicated to the Equity CRO that "if this deal [for the purchase of the Texas Rangers] doesn't close, we're going away and if we come back, we're going to pay a lot less money than [the Original Purchase Price] . . . and by the way, no one else is going to get approved [by MLB] to [purchase the Texas Rangers]."[116]

Given the pace at which the bankruptcy case was moving, the Equity CRO initially supported the Original Purchase Price and endorsed the transaction between TRBP and the Greenberg–Ryan Group.[117] The Equity CRO did so in part because he felt that it was the best offer available and in part because MLB suggested that it would not support any other group to purchase the Texas Rangers.[118]

As the case continued, parties, including the Equity CRO, began to feel as though the bankruptcy process could "loosen the grip" that MLB historically enjoyed over the sale of its member teams outside of bankruptcy.[119] Thereafter, the Equity CRO felt that "the key . . . to getting more people interested in bidding was two-fold:" "de-linking the inclusion of certain parking lots from the purchase price of the Texas Rangers" and "getting past the perception that existed that it was a forgone conclusion that Nolan Ryan was going to buy the [Texas] Rangers and MLB wouldn't let anybody else bid."[120]

During this time, "it became clear to [TRBP] following discussions with the [Equity] CRO that the [Equity] CRO would be more likely to support and vote to approve the [p]repackaged [p]lan [including the Original Purchase Price] following an auction process."[121] Therefore,

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115 *See* Emergency Application Pursuant to 11 U.S.C. §§ 105(a) and 363(b) for Authorization to (a) Employ CRG Partners Group LLC to Provide a Chief Restructuring Officer and Additional Personnel and (b) Designate William Snyder as the Chief Restructuring Officer for Initial Limited Purpose at 1–2, 8 *In re* Rangers Equity Holdings, L.P., No. 10-43624 (Bankr. N.D. Tex. June 27, 2010), ECF No. 30; Order Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code Authorizing Debtor to Employ and Retain CRG Partners Group LLC to Provide the Debtors a Chief Restructuring Officer and Additional Personnel and (b) to Designate William Snyder as the Chief Restructuring Officer for Initial Limited Purpose at 1–2, 8, *In re* Texas Rangers Equity Holdings, L.P., No. 10-43624 (Bankr. N.D. Tex. June 27, 2010), ECF No. 30.

116 Interview with Lou Strubeck, Head of Bankruptcy, United States, Norton Rose Fulbright & Liz Boydston, Associate, Norton Rose Fulbright (Mar. 29, 2013) (audio recording on file with authors).

117 *Id.*

118 *Id.*

119 *Id.*

120 *Id.*

121 *See* Debtors' Motion Pursuant to Sections 105(a) and 363 of the Bankruptcy Code for (i) Approval of Procedures for the Sale of the Texas Rangers Baseball

TRBP submitted proposed bid procedures to govern an auction for the sale of the Texas Rangers for the bankruptcy court's approval.[122] Ten days later, the bankruptcy court, *sua sponte*, entered its own bid procedures (the "Bid Procedures") that would govern the auction.[123] "Once the [Bid Procedures] were entered, it was clear that" the bankruptcy court would provide "an opportunity for . . . anyone to bid on the [Texas Rangers]."[124]

Enter Mark Cuban.

When asked about his involvement with the TRBP bankruptcy case, counsel for Mark Cuban's group stated, "it's actually fairly simple. The springboard of my involvement in the case occurred when Judge Lynn promulgated his [Bid Procedures]."[125] Up until that point, the perception was that "[TRBP] . . . only wanted to sell to [the Greenberg–Ryan Group] and there wasn't going to be a public auction."[126]

> When [Judge Lynn] issued his own procedures for sale, it was revolutionary . . . and I think that is what drove the fight to keep the auction from happening and to keep [other bidders] from owning the team. It was the prospect of anybody being able to own a team that [MLB] had not anointed.[127]

Counsel for the Mark Cuban group went on to explain that "all my client [the Mark Cuban group] wanted was a fair opportunity to bid on the [Texas] Rangers," and "had it not been for the Bid Procedures and the bankruptcy auction, he may have never had that opportunity."[128]

"On the very eve of the auction, the [First-Lien] Lenders got the deal from [TRBP] and the Greenberg–Ryan Group that they wanted."[129] The same evening, the First-Lien Lenders contacted the bankruptcy court and requested that the auction be called off, "but having argued so successfully in favor of an auction [at the beginning of the case], [Judge Lynn] refused to call it off."[130] Ultimately, the bankruptcy court determined, over the objection of MLB, TRBP, the Greenberg–Ryan Group, and the First-

Partners' Assets to Rangers Baseball Express LLC or Other Successful Bidder, (ii) Authorization to Use the Asset Purchase Agreement as a Stalking Horse Agreement with Rangers Baseball Express LLC in Connection Therewith, (iii) Approval of the Payment of Break-Up Fee and (iv) the Setting of Related Auction and Hearing Dates at 5, *In re* Texas Rangers Baseball Partners, 431 B.R. 706 (Bankr. N.D. Tex. 2010) (No. 10-43400), ECF No. 310.

[122] *See id.*

[123] *See* Order Adopting Bidding Procedures at 2, *In re Texas Rangers Baseball Partners*, 431 B.R. 706, ECF No. 363.

[124] Telephone interview with Clifton R. Jessup, Jr., Shareholder, Greenberg Traurig, LLP, (Sept. 19, 2013) (audio recording on file with authors).

[125] *Id.*

[126] *Id.*

[127] *Id.*

[128] *Id.*

[129] Interview with Judge Russell F. Nelms, *supra* note 112.

[130] *Id.*

Lien Lenders, that an auction was necessary to eliminate any existing biases and provide TRBP's estate with fair value for the Texas Rangers.

On August 4, 2010 at 9:00 a.m. (Central Time), Judge Russell F. Nelms commenced the auction for the sale of the Texas Rangers, in accordance with the Bid Procedures, to the individual or group that brought forth the highest and best bid. At 1:30 a.m. on August 5, 2010, after sixteen and a half hours, the Greenberg–Ryan Group submitted an offer worth approximately $593 million. In response, counsel for the Mark Cuban group approached the podium and stated, "Your Honor, we'd like to congratulate Mr. Ryan and his group for owning the Rangers."[131]

To recap, in April 2010 *Forbes Magazine* valued the Texas Rangers at $451 million.[132] In May 2010, if not for the First-Lien Lenders' objection, the Texas Rangers would have been sold on the "open market" for approximately $495 million.[133] Three months later, the Texas Rangers were sold, at a bankruptcy auction, for approximately $593 million. According to individuals who were intimately involved with the TRBP bankruptcy case, the nearly $100 million increase in value of the Texas Rangers was directly attributable to the authority granted to the bankruptcy court to govern such an open-auction process.[134]

B. Valuations Performed Outside of the Bankruptcy Context Do Not Provide Suitable Guidance to Bankruptcy Courts

Every year commentators publish numerous reports concerning the projected value of professional sports franchises, but none are more well-known or frequently cited than *Forbes Magazine*'s *The World's 50 Most Valuable Sports Teams*.[135] While this publication provides fodder for sports fans and writers alike and allows them to attach tangible values to their favorite teams, as we saw in the Texas Rangers' case, the values *Forbes* places on professional teams seem to fall short in terms of accuracy.[136]

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[131] Interview with Clifton R. Jessup, Jr., *supra* note 124.

[132] *The Business of Baseball: #12 Texas Rangers*, FORBES (Apr. 7, 2010), http://www.forbes.com/lists/2010/33/baseball-valuations-10_Texas-Rangers_337656.html.

[133] Interview with Clifton R. Jessup, Jr., *supra* note 124.

[134] *Id.*; Interview with Judge Russell F. Nelms, *supra* note 112; Interview with Lou Strubeck & Liz Boydston, *supra* note 116.

[135] Kurt Badenhausen, *The World's 50 Most Valuable Sports Teams*, FORBES (July 12, 2011), http://www.forbes.com/sites/kurtbadenhausen/2011/07/12/the-worlds-50-most-valuable-sports-teams; *See generally* Kurt Badenhausen, *Real Madrid Tops the World's Most Valuable Sports Teams*, FORBES (July 15, 2013), http://www.forbes.com/sites/kurtbadenhausen/2013/07/15/real-madrid-tops-the-worlds-most-valuable-sports-teams.

[136] Maury Brown, *Bizball: Why the* Forbes *MLB Valuations Are Far from Perfect*, BASEBALL PROSPECTUS (Mar. 26, 2012), http://www.baseballprospectus.com/article.php?articleid=16297.

At least one commentator has suggested that, while *Forbes*'s valuations of professional sports teams are a great "trending" measurement, the actual valuation of a professional team should also include value derived from media rights and capital improvements to a team's stadium.[137] The fact that recent purchase prices of professional sports teams (both inside and outside of the bankruptcy context) have far exceeded *Forbes*'s initial valuations indicates that although widely available valuations may be good "trending measurements," a judge or practitioner would be wise not to view one particular valuation of a sports team in a vacuum.

That being said, certain statistics or financial information of a particular team derived from a valuation done outside of the bankruptcy context can still provide a good foundation from which to start the valuation process of the team in bankruptcy. For instance, revenue and operating income from the prior season as well as the team's stadium debt can be useful in calculating forward-looking projections.[138]

C. *Unique Relationship Between Professional Sports Leagues and Their Teams*

It is axiomatic that "[n]o single owner could engage in professional [sports] for profit without at least one other competing team."[139] Indeed, "[s]eparate owners for each team are desirable in order to convince the public of the honesty of the competition."[140] However, "there is a great deal of economic interdependence among the clubs comprising a league. They jointly produce a product which no one of them is capable of producing alone. In addition, the success of the overall venture depends upon the financial stability of each club."[141]

1. *The Impact of League Constitutions, Bylaws, and Collective Bargaining Agreements on Value*

Collective bargaining agreements ("CBAs") are mechanisms that govern the employer–employee relationships between the owners of professional sports teams and players' associations.[142] The National Football League ("NFL"), National Basketball Association ("NBA"), National Hockey League ("NHL"), and Major League Baseball ("MLB") (collectively the "Leagues" or the "Big Four") each have separate league consti-

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[137] *Id.*

[138] However, given the ever-changing landscape of professional sports, a bankruptcy professional should be mindful that such information may become stale. *See infra* sections B.1. and 2.

[139] N. Am. Soccer League v. Nat'l Football League, 670 F.2d 1249, 1251 (2d Cir. 1982).

[140] *Id.*

[141] *Id.* (internal quotation marks omitted) (quoting JOHN C. WEISTART & CYM H. LOWELL, THE LAW OF SPORTS § 5.11, at 757 (1979)).

[142] Ryan T. Dryer, Comment, *Beyond the Box Score: A Look at Collective Bargaining Agreements in Professional Sports and Their Effect on Competition*, 2008 J. DISP. RESOL. 267, 267.

tutions and CBAs which govern, among myriad other things, players' compensation, revenue sharing, sale, and purchase procedures, including approval of new owners and relocation of franchises.[143]

a. Approval of Potential Buyers

Therefore, when a professional sports team files for relief under the Bankruptcy Code, its league (and possibly the public) has a tremendous interest in the case as well as who might emerge as the team's new owner in the event that the team is sold.[144]

Each of the Big Four has implemented strict policies that govern the transfer of an interest or sale of a member team to a new owner. Under normal circumstances, a potential owner would need to be accepted into the league by a majority of its current owners and ultimately approved by the commissioner. While it is unclear as to what the specific requirements are in each respective league to obtain approval to purchase a team, some have suggested to the authors that the ability to offer the highest purchase price is certainly not one of them.[145]

In fact, a candidate for ownership of a league franchise is often said to be a member of the "anointed ones."[146] The "anointed ones" are a select few that, for whatever reason, have been preordained by owners and league officials to be "owners-in-waiting." Some argue that this bias in selecting new ownership restricts the potential value of a professional team.[147] Additionally, outside of the bankruptcy context, leagues are not required to disclose information with respect to interested buyers or the price offered for a particular franchise; therefore, the approved buyer, which is not necessarily the entity willing to pay the highest price, sets the "market rate."

Indeed, outside of bankruptcy, a league may facilitate the purchase of one of its member teams by an "anointed one" without having to seek authorization or ever disclose to the public whether more lucrative offers were available. Without having to operate on a field where all spectators are welcome to observe, it is understandable that league officials may not find anything improper with such a transaction.

However, under the Bankruptcy Code, a debtor is required to obtain bankruptcy court approval of any sale of its assets outside the debtor's

[143] Because a professional sports franchise has never been valued in a bankruptcy court, the enforceability of league constitutions or CBAs within the bankruptcy context has not yet been addressed.

[144] *See In re* Texas Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010).

[145] Interview with Judge Russell F. Nelms, *supra* note 112; Interview with Lou Strubeck & Liz Boydston, *supra* note 116; Interview with Clifton R. Jessup, Jr., *supra* note 124.

[146] Interview with Clifton R. Jessup, Jr., *supra* note 124.

[147] Interview with Judge Russell F. Nelms, *supra* note 112; Interview with Lou Strubeck & Liz Boydston, *supra* note 116; Interview with Clifton R. Jessup, Jr., *supra* note 124.

ordinary course of business.[148] Additionally, upon filing a petition for relief under Chapter 11 of the Bankruptcy Code, a debtor-in-possession has a fiduciary duty to maximize the value of the bankruptcy estate.[149] This necessarily requires the disclosure of any asset purchase agreement and the proposed treatment of all parties involved under such agreement for court approval. The inherent conflict with the requirements under the Bankruptcy Code and customary league behavior has, not surprisingly, led to very contentious litigation.[150]

b. Relocation of Teams

In virtually every industry, a proposal to relocate a business that supports an entire community will invariably create tension. Professional sports teams are billion-dollar businesses. Professional sports teams are no longer just about competition; they have evolved into a modern entertainment commodity housed in billion-dollar coliseums complete with shopping centers and restaurants. Therefore, multiple interests are involved when there is a proposal to relocate a professional team.

However, "moving a sports franchise is not like moving a factory. Such a move generates significantly increased emotional responses from all concerned parties, seemingly including the bankruptcy judge."[151] "Thus, the normal bankruptcy policy of maximizing the value of assets to the estate seems to have been inverted" in some cases "in favor of policy seeking, at all costs, to retain the franchise [in its current location]."[152]

In addition to the policy consideration, a bankruptcy judge may be faced with determining whether a league's consitution requires league-level approval of the relocation.

c. Revenue Sharing

Another unusual attribute of professional sports franchises is revenue sharing. "Professional sports leagues are governed by each league's respective collective bargaining agreement, which establishes a player

[148] *See* 11 U.S.C. § 363(b)(1) (2012); *see also* Institutional Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. (*In re* Cont'l Air Lines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986); Stephens Indus., Inc. v. McClung, 789 F.2d 386, 388 (6th Cir. 1986); Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).

[149] Official Comm. of Unsecured Creditors of Cybergenics Corp. *ex rel.* Cybergenics Corp. v. Chinery, 330 F.3d 548, 568 (3d Cir. 2003). *But see In re Texas Rangers Baseball Partners*, 434 B.R. at 401–02 (holding that a debtor has no duty to maximize the value obtained for its estate when a plan provides for full payment of all creditors and 100% of equity interests have accepted the plan).

[150] *See, e.g.*, *In re Texas Rangers Baseball Partners*, 434 B.R. at 399–400.

[151] Richard L. Wynne et al., *Sports Franchises and Bankruptcy Law*, ABI BANKRUPTCY BATTLEGROUND WEST 8 (Mar. 19, 1999), *available at* http://www.kirkland.com/siteFiles/kirkexp/publications/2572/Document1/Sports%20Franchises.pdf.

[152] *Id.*

compensation system and a revenue sharing model."[153] At its core, a revenue sharing model requires teams to contribute a percentage of their total annual revenue to a general fund, which the league then distributes to certain teams based on metrics outlined in their respective CBA. Each of the Big Four has implemented its own variation of a revenue sharing model which "rel[ies] on the collaborative efforts of [the respective] league members to maximize revenue from specific activities" in order to promote parity between large and small market teams.[154]

It is important to understand each league's respective CBA and its corresponding revenue sharing model to arrive at an accurate valuation of a team. To put the point more starkly, "[a]ny appraisal by a financial appraiser with the right sets of initials behind his or her name is essentially worthless, unless the appraiser is intimately familiar with the league's CBA."[155] Although practitioners, judges, and expert witnesses should study the relevant league's CBA more thoroughly than is possible in this Article before attempting to value a sports team, the authors will provide a brief introduction into each league's revenue sharing model and the potential impact it has on its member-teams' values. Keep in mind that each league's CBA is subject to change over time.

i. NFL

While "[t]he NFL's revenue sharing model is the least complex of the existing models,"[156] it is "highly regarded as the most successful revenue sharing model" in all professional sports.[157] Indeed, at least one commentator has suggested that "[t]he most important reason that the NFL maintains parity is due to revenue sharing."[158] In order to ensure this parity, each NFL team receives an equal amount of league revenue ("NFL Revenue") to operate during the season.

NFL Revenue consists of, among other things, league media or broadcasting revenue (television, satellite, radio, and internet), NFL Ventures/postseason (all revenues arising from operation of postseason NFL games and from NFL-affiliated entities for purposes such as licensing and productions),[159] and local revenues (such as sale of preseason television

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[153] Justin R. Hunt, Note, *To Share or Not to Share: Revenue Sharing Structures in Professional Sports*, 13 TEX. REV. ENT. & SPORTS L. 139, 139 (2012).

[154] *Id.*

[155] Paul L. B. McKenney & Eric M. Nemeth, *The Purchase and Sale of a Sports Team*, 80 MICH. B.J., June 2001, at 54, 56.

[156] Hunt, *supra* note 153, at 141.

[157] *Id.* at 140.

[158] Michael Schottey, *How the NFL Became the Most Competitive League in All of Sports*, BLEACHER REPORT (Mar. 20, 2013), http://bleacherreport.com/articles/1574285-how-the-nfl-became-the-most-competitive-league-in-all-of-sports.

[159] NFL-affiliated entities include: NFL Ventures, NFL Network, NFL Properties, NFL Enterprises, NFL Productions, and NFL Digital.

broadcasts).[160] The NFL Revenue is compiled and then divided into 32 equal amounts and distributed to each team annually. Each team's NFL Revenue is then divided into an amount the owners may keep to operate their respective teams and an amount that must be used to pay players. The major provisions regarding the revenue split between players and owners under the current CBA are as follows:

- League Media–55% for players vs. 45% for owners;
- NFL Ventures–45% for players vs. 55% for owners; and
- Local Club Revenues–40% for players vs. 60% for owners.[161]

The lion's share of the NFL Revenue earned by NFL teams comes from the broadcasting deals negotiated by the NFL.[162] Given that the NFL's broadcasting contracts generate approximately $5.2 billion a year,[163] these revenue splits would certainly seem attractive to a prospective owner. Additionally, revenue from luxury suites and personal seat licenses and any revenue generated from non-NFL related performances at an arena are excluded from NFL Revenue. Therefore, in addition to the generous league revenue sharing agreement, one should also take into account a team's stadium and the possibility for additional non-NFL Revenue when assessing the value of an NFL team.

ii. MLB

The MLB's revenue-sharing model operates according to a base plan (the "Base Plan") and a supplemental plan (the "Supplemental Plan").[164] This complex system of revenue sharing begins with the calculation of each team's gross revenue and the MLB-generated central revenue.

An MLB team's gross revenue consists of "all revenue generated by [a] team's baseball operations (ticket sales, concessions, local television contracts, etc.)."[165] In addition to its gross revenue, each MLB team receives an equal share of MLB-generated revenue. MLB-generated revenue consists of, among other things, "national television contracts, MLB.tv, licensing and merchandise, [and] the All-Star Game."[166] Each

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160 Chris Deubert et al., *All Four Quarters: A Retrospective and Analysis of the 2011 Collective Bargaining Process and Agreement in the National Football League*, 19 UCLA ENT. L. REV. 1, 45–46 (2012).

161 WR HAMBRECHT & CO., THE U.S. PROFESSIONAL SPORTS MARKET & FRANCHISE VALUE REPORT 9 (2012), *available at* http://www.wrhambrecht.com/wp-content/uploads/2013/09/SportsMarketReport_2012.pdf.

162 *Id.* at 10–11.

163 *Id.* at 11.

164 *See* MLB Collective Bargaining Agreement art. XXVI, § A(9)–(10) (Dec. 12, 2011) [hereinafter MLB CBA 2012–16], http://mlb.mlb.com/pa/pdf/cba_english.pdf.

165 Wendy Thurm, *The Marlins and the MLB Revenue Sharing System*, FANGRAPHS (Nov. 14, 2012), http://www.fangraphs.com/blogs/marlins-mlb-revenue-sharing-syste/; *see also* MLB CBA 2012–16, *supra* note 164, art. XXIV, § A(3).

166 Thurm, *supra* note 165.

team then subtracts the 1/30th share of MLB-generated revenue and certain stadium related expenses from its gross revenue to arrive at its net local revenue (the "Net Local Revenue").[167]

Each team contributes 34% of its Net Local Revenue to the Base Plan.[168] The Base Plan is then divided into 1/30th shares and distributed equally to the 30 MLB teams.[169] "Some teams . . . contribute significantly more to the base plan . . . than they receive[;]" these teams "are known as Revenue Sharing Payor Clubs."[170] "Others . . . receive more than they contribute" to the Base Plan; these teams "are known as Revenue Sharing Payee Clubs."[171]

In addition to the Base Plan, certain teams are required to contribute an additional amount of their Net Local Revenue to the Supplemental Plan. The goal of the Supplemental Plan is to raise an additional 14% of total net local revenue from Payor Clubs.[172] However, unlike the Base Plan where teams are required to contribute an equal amount, the Supplemental Plan requires each Payor Club to contribute an amount based on its "performance factor."[173] A "performance factor" is a figure that the MLB assigns to each team in order to determine the amount it will pay or be paid according to the terms of the Supplemental Plan.[174] In other words, "[teams] with a positive Performance Factor shall be 'Contributors' under the Supplemental Plan and [teams] with a negative Performance Factor shall be 'Recipients' under the Supplemental Plan."[175]

iii. NBA

"The NBA's new revenue-sharing plan was years in development and today represents a staggering shift in league policy as the NBA redistributes wealth among its teams."[176] "[T]he new [revenue-sharing] plan is rooted in a philosophy of including locally generated dollars from the big-market, high-revenue teams to be spread among the low-revenue teams.[177] The NBA "did not follow any other league['s] [revenue-sharing]

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[167] *See id.*; MLB CBA 2012–16, *supra* note 164, art. XXIV, § A(5)–(7).

[168] MLB CBA 2012–16, *supra* note 164, art. XXIV, § A(10).

[169] *Id.*

[170] Thurm, *supra* note 165.

[171] *Id.*

[172] *Id.*; *see also* MLB CBA 2012–16, *supra* note 164, art. XXIV, § A(12)–(13).

[173] Thurm, *supra* note 165.

[174] *See* MLB CBA 2012–16, *supra* note 164, Attachment 26: Revenue Sharing Performance Factor, at 222 (listing the performance factors assigned to each MLB team).

[175] *Id.* art. XXIV, § A(13)(b).

[176] John Lombardo, *Inside NBA's Revenue Sharing*, SPORTS BUS. J. (Jan. 23, 2012), http://www.sportsbusinessdaily.com/Journal/Issues/2012/01/23/Leagues-and-Governing-Bodies/NBA-revenue.aspx.

[177] *Id.*

model, but instead tailored a new plan specifically to address NBA team needs."[178]

The NBA's revenue-sharing plan requires each member team to contribute a fixed annual percentage (the "Annual Contribution") of approximately 50% of its total basketball related income ("BRI")[179] less certain expenses such as stadium renovations and operating costs, to a shared-revenue fund.[180] The NBA then takes the average of all teams' player payrolls from the previous year (the "Average Payroll") and allocates that amount back to each team.[181]

If an NBA team's Annual Contribution is less than the Average Payroll, that team will receive a distribution equal to the difference between the two amounts from the shared-revenue fund.[182] Conversely, if an NBA team's Annual Contribution exceeds the Average Payroll, that team must contribute the difference of the two amounts into the shared-revenue fund.[183]

iv. NHL

The last CBA of the Big Four includes another complex revenue-sharing program that attempts to create parity among the NHL's member teams. In that regard, the NHL multiplies league-wide hockey-related revenue by .06055 to arrive at a "Redistribution Commitment."[184] This projection is funded by three sources:

1) The NHL's ten highest grossing teams must contribute any amount over and above what the eleventh ranked team grossed. The contribution amount is capped at 50% of the total Redistribution Commitment.
2) Playoff teams, regardless of rank, must contribute 35% of all gate receipts from playoff games.
3) If the "Redistribution Commitment" has still not been met, then the NHL will use centrally generated revenue to cover the shortfall.[185]

Revenue sharing provisions can provide helpful information when valuing a bankrupt professional sports team and may shed light on po-

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178 *Id.*

179 BRI consists of, among other things, gate receipts, broadcasting rights (whether local or otherwise), sales or leases of luxury suites, and sponsorships. For a full description of BRI, see NBA Collective Bargaining Agreement art. VII (Dec. 2011), http://www.nbpa.com/cba/2011.

180 Larry Coon, *Breaking Down Changes in New CBA*, ESPN (Nov. 28, 2011), http://espn.go.com/nba/story/_/page/CBA-111128/how-new-nba-deal-compares-last-one.

181 Lombardo, *supra* note 176.

182 *Id.*

183 *Id.*

184 NHL Collective Bargaining Agreement art. 49.1(y) (Feb. 15, 2013), http://cdn.agilitycms.com/nhlpacom/PDF/NHL_NHLPA_2013_CBA.pdf.

185 *Id.* art. 49 pmbl.

tential moving pieces. For example, whereas a potential TV deal can increase a bankrupt MLB team's value exponentially, it may have little effect on an NFL team's value.

D. Private Ownership

The overwhelming majority of professional sports franchises are privately held entities. To the best of the authors' knowledge, the only remaining professional team that is "publicly held" is the Green Bay Packers, which has been a nonprofit corporation since August 18, 1923.[186] However, while "stock certificates are issued [by Green Bay Packers, Inc.], the stock is largely ceremonial."[187] This type of "public ownership" has been aptly described by at least one commentator as "community ownership."[188] The NFL has since enacted several rules banning public ownership of teams.[189] However, a "grandfather clause" was included in the NFL Constitution, which allows the Green Bay Packers to continue its current ownership structure.[190]

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[186] *Shareholders*, PACKERS (2013), http://www.packers.com/community/shareholders.html. Ironically, the first three stock sales by Green Bay Packers, Inc. were consummated to avoid bankruptcy. *Packers Stock Sale Underway: $250 Shares to Support Lambeau Field Expansion*, PACKERS (Dec. 6, 2011), http://www.packers.com/news-and-events/article-1/Packers-stock-sale-underway-250-shares-to-support-Lambeau-Field-expansion/17178be6-6fdc-49a2-bffe-d650bda38ef5.

[187] Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. 1257, 1297 (2011). To illustrate, shareholders of Green Bay Packers, Inc. do not receive a dividend on their stock. *Id.* Therefore, "shareholders have no possibility of making a profit on their 'investment' and receive no tax deduction for their money." *Id.* "Stock may not be sold but may be given as gifts . . . ." *Id.* at 1299. "[S]hareholders do not receive coveted tickets to Packers games at Lambeau Field . . . ." *Id.* "Indeed, one could fairly say that being a shareholder of the Green Bay Packers entitles one only to be a shareholder of the Green Bay Packers." *Id.* at 1297–98.

[188] Ryan Schaffer, Note, *A Piece of the Rock (or the Rockets): The Viability of Widespread Public Offerings of Professional Sports Franchises*, 5 VA. SPORTS & ENT. L.J. 201, 206 (2006) (determining a professional sports team to be community owned when "non-marketable securities are sold and the public owns a majority of the [team's] stock").

[189] Most notably, Article III, section 3.2(A) of the Constitution and Bylaws of the NFL, which provides that "[n]o corporation, association, partnership, or other entity not operated for profit nor any charitable organization or entity not presently a member of the League shall be eligible for membership." Constitution and Bylaws of the National Football League (Feb. 1, 1970) (as amended in 2006), http://static.nfl.com/static/content/public/static/html/careers/pdf/co_.pdf; *see also id.* art. III, §§ 3.3(A)(1) (requiring names and addresses of all persons who may have an interest or stock in a team), 3.3(A)(2) (requiring written financial statements from all persons who will have ownership interests in a team, including stockholders), 3.3(C) (requiring any "proposed owner or holder of any interest . . . including stockholders" to be individually approved by the league), 3.5 (placing strict restrictions on the transfer of any interest in a team, including approval by the league Commissioner).

[190] *See id.* art. III, § 3.2(A) (excepting entities that are presently a member of the League); Genevieve F.E. Birren, *NFL vs. Sherman Act: How the NFL's Ban on Public Ownership Violates Federal Antitrust Laws*, 11 SPORTS LAW. J. 121, 122 (2004).

Apart from this exception, all other professional sports teams that were publicly traded in the past are now privately held. The last independently owned, publicly traded professional sports franchise was the Boston Celtics.[191] "Between 1986 and 2002, the Celtics were owned by a limited partnership, Boston Celtics LP, which was traded on the New York Stock Exchange . . . . In 2002, the Celtics were sold to a group of private investors, leaving the current United States landscape void of any true [publicly traded] teams."[192]

That being said, a few privately held franchises are "owned either directly or indirectly by public companies," and "almost *all* franchises owned by public companies are part of much larger conglomerates."[193] However, it is important to recognize the distinction between a professional sports franchise owned by a publicly traded company and a professional sports franchise that *is* a publicly traded company. The fact that some professional teams are owned by publicly traded companies does not necessarily create a market of comparable teams sufficient to calculate an accurate valuation. Indeed, "[w]hile the decision to buy a share of [Boston Celtics'] stock may come from your love of the team, 'buying Disney when one is thinking about the [Anaheim] Angels is a bit of a stretch.'"[194]

As discussed above,[195] the market comparison approach requires, as one of its key inputs, the price of publicly traded shares in both the entity being valued and its comparable competitors. Based on these facts alone, the market comparison approach does not appear to be an effective valuation method in the sports bankruptcy context.

Moreover, private ownership renders any method that relies on comparing the entity to its competitors in the industry incredibly difficult because unlike publicly traded companies that must comply with SEC disclosure regulations, privately owned entities need not disclose their financial data.[196] Indeed, sports franchises are notoriously "secretive about their profitability and sources of revenue."[197] As a result, a "pure" application of the comparable transaction approach to valuing a sports franchise may be problematic; "[a]lthough purchase prices [a]re readily available (the dependent variable), the figures corresponding to the in-

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[191] Schaffer, *supra* note 188, at 204.

[192] *Id.*

[193] Carr & Cummins, *supra* note 7, at 15 (emphasis added).

[194] Schaffer, *supra* note 188, at 205–06 (third alteration in original) (quoting Brian R. Cheffins, *Playing the Stock Market: "Going Public" and Professional Team Sports*, 24 J. CORP. L. 641, 648 (1999)). Disney sold the Anaheim Angels in 2003.

[195] *See supra* section I.B.3.a.ii.

[196] David Vine, Student Paper, *The Value of Sports Franchises*, WHARTON RES. SCHOLARS J. (Apr. 1, 2004), *available at* http://repository.upenn.edu/cgi/viewcontent.cgi?article=1020&context=wharton_research_scholars.

[197] *Id.*

dependent variables such as revenues and debt/value ratios" are generally hard to obtain, rendering extrapolation and comparison difficult.[198]

The comparable transaction approach becomes increasingly difficult to apply in the bankruptcy context because it "seeks to derive the debtor's enterprise valuation from the prices (enterprise valuations) paid by purchasers in recent acquisitions of comparable companies."[199] This valuation method compares multiple transactions that have occurred in the past involving similarly situated companies while taking into account a multitude of market factors to determine a probable sale price of the target company.

Although the recent trend shows an increase in professional sports teams filing bankruptcy, only seven teams have been sold after filing bankruptcy in a span of ten years.[200] Seven teams hardly make up a sufficient sample size to establish an accurate value of a target team. Further, of the seven teams sold, four were NHL teams and three were MLB teams. Aside from the potential problems that may arise when attempting to compare sale transactions within the same sport,[201] a practitioner would be put in quite the pickle if he or she decided to compare the sales of past NHL teams to establish the present value of a hypothetically bankrupt NFL team.

E. The Ego Factor

The value of a sports franchise is boosted by what has been dubbed the "ego factor": a would-be buyer of a sports team will often be willing to pay a greater sum of money for the franchise than a strictly economic valuation of the team's assets would suggest because owning a sports team is prestigious and "sexy" in a way that, say, owning a diaper manufacturing company or a paper plant is not.[202] The effect of the ego factor is magnified by the relative "scarcity . . . of sports franchises available for purchase."[203] Although anecdotal and empirical evidence suggests that

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[198] *Id. But see* Fishman v. Wirtz, 807 F.2d 520, 554–55 (7th Cir. 1986) (holding that the district court did not err in applying a modified version of the comparable transaction approach to determine an appropriate "sales price" of the Chicago Bulls in a non-bankruptcy case).

[199] O'Rourke, *supra* note 13, at 420.

[200] Checkler, *supra* note 10.

[201] As one commentator put it, "[w]hile the Texas Rangers' bankruptcy was contentious, it did not compare to the 'tangled web' surrounding the Los Angeles Dodgers' Chapter 11 bankruptcy." John Dillon, *Major League Baseball Team Bankruptcies: Who Wins? Who Loses?*, 32 LOY. L.A. ENT. L. REV. 297, 307 (2012) (citing Mark Harriman, Dodgers Bankruptcy: A Tangled Web Woven, BOS. SPORTS DESK (July 10, 2011)), http://bostonsportsdesk.wordpress.com/2011/07/10/dodgers-bankruptcy-a-tangled-web-woven.

[202] *See* Carr & Cummins, *supra* note 7, at 18; Vine, *supra* note 196.

[203] Carr & Cummins, *supra* note 7, at 17.

prospective buyers of sports teams still care about the bottom line,[204] there is little doubt that franchise ownership confers psychological benefits beyond just the revenues produced by the assets.

Relatedly, some authors suggest that there exists a subset of prospective and current franchise owners who "might be more interested in intangible benefits of owning a franchise than in the typical profit-maximization goals pursued by owners of most other businesses."[205] This is because "buyers are usually wealthy individuals with extensive business interests outside the franchise itself," and thus are not necessarily purchasing the franchise to make profit.[206] To illustrate, Stephen Carr and Timothy Cummins quote a statement made by Mark Cuban as reported in *Sports Illustrated*: "Let's say I'm worth $1.1 billion—it's more—and through a series of incredibly moronic moves I lose $100 million. Oh gee! What does that leave me?"[207] In short, the ego factor further complicates the task of accurately valuing a professional sports team.

F. The Predominance of Intangible Assets

Although every sports team owns a "small number of tangible assets such as uniforms and equipment,"[208]

> [o]ne of the most distinguishing features of a sports franchise is the supreme importance of intangible assets. For the standard corporation, tangible assets such as machinery, property, and equipment are primary drivers in the valuation of a company. However, these are not of preeminent relevance in considering the value of a sports entity. Rather, it is the intangible assets, things such as player contracts, televisions rights, stadium leases, [advertising] agreements, concession agreements, luxury suite agreements, season ticket-holder relationships, coach and management employment contracts, draft rights, and goodwill that affect the market price.[209]

The IRS has estimated that "nearly 90% of the value of a sports franchise is attributable to its intangible assets."[210] Of these intangible assets, the most valuable to the sports franchise are typically player contracts and media contracts.[211]

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204 *See* Vine, *supra* note 196.

205 Carr & Cummins, *supra* note 7, at 18.

206 Robert Holo & Jonathan Talansky, *Taxing the Business of Sports,* 9 FLA. TAX. REV. 162, 184 (2008).

207 Carr & Cummins, *supra* note 7, at 18.

208 Holo & Talansky, *supra* note 206, at 184.

209 Vine, *supra* note 196.

210 Holo & Talansky, *supra* note 206, at 184 (citing Thomas W. Wilson, Jr., *Examination of Sports Franchise Acquisitions,* IRS (Oct. 24, 2003), http://www.irs.gov/Businesses/Examination-of-Sports-Franchise-Acquisitions).

211 Carr & Cummins, *supra* note 7, at 48.

While it is of course possible to value intangible assets, it is at least more difficult.[212] As a result, a valuation method that attempts to value a sports franchise based on the sum of the value of the team's assets may undervalue the franchise.[213]

1. *Goodwill and Strength of Customer Loyalty*

Sports franchises differ from more traditional firms with respect to the strength of customer loyalty. Sports fans rabidly support their favorite franchises in a way that customers of other products do not; one may strongly prefer Coke to Pepsi, but one is unlikely to celebrate that preference by wearing head-to-toe Coke merchandise and rooting uproariously whenever they consume their beverage of choice. Whereas a formerly devout PC user may eventually switch to a Mac in frustration if the product quality of the former declines while that of the latter increases, sports fans are likely to remain loyal to their favorite team regardless of the team's player composition or the team's win–loss record.[214] Indeed, "[i]n the short term, sports fans are not easily dissuaded from attending their favorites' games, no matter how inept the exhibition. . . . The singular ineptness of the New York Mets in 1993," for example, "did not result in no revenue at all. In fact, well over 1.5 million fans still attended the team's home games."[215]

For balance sheet purposes, this entails "that an established sports franchise has considerable goodwill."[216] This renders valuation even more difficult because "attempting to calculate the value of goodwill . . . is at best[] a highly speculative enterprise."[217]

2. *The Difficulty of Valuing Player Contracts*

"Many fans generalize that [professional] athletes, as a group, are overpaid young adults often with bad attitudes."[218] "While everyone is en-

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[212] *Id.* at 11; Vine, *supra* note 196.

[213] Carr & Cummins, *supra* note 7, at 11.

[214] *See, e.g.*, Stephen A. Zorn, *"Couldna Done It Without the Players:" Depreciation of Professional Sports Player Contracts Under the Internal Revenue Code*, 4 SETON HALL J. SPORT L. 337, 358 (1994); Robert Taylor Bowling, Comment, *Sports Aggravated: The Fan's Guide to the Franchise Relocation Problem in Professional Sports*, 28 STETSON L. REV. 645, 645 (1999); Danette R. Davis, Comment, *The Myth & Mystery of Personal Seat Licenses and Season Tickets: Licenses or More?*, 51 ST. LOUIS U. L.J. 241, 256 (2006).

[215] Zorn, *supra* note 214, at 358–59 (footnote omitted). Anecdotally, several of these authors hail from Chicago, and can attest to the rabidity of Chicago Cubs fans despite the team's perpetually abysmal record.

[216] *Id.* at 358. "Goodwill may be defined either negatively, as the excess of the purchase price of the business over the fair market value of identifiable assets, or positively, as 'the probability that old customers will resort to the old place' or 'the expectation of continued patronage for whatever reason.'" *Id.* at 356 (footnotes omitted) (quoting Computing & Software, Inc. v. Comissioner, 64 T.C. 223, 232 (1975); Winn-Dixie Montgomery, Inc. v. United States, 44 F.2d 677, 681 (5th Cir. 1971)).

[217] *Id.* at 357.

[218] McKenney & Nemeth, *supra* note 155, at 57.

titled to [one's] own opinion, in economic terms, [the players] are entertainers."[219] "[T]he value of a particular player—as contrasted to the rights to continue assembling, on an ongoing basis, a group of players to compete in the league—is significantly more difficult to quantify and may be a much smaller proportion of the total purchase price."[220] "[C]ertain star players may have an appreciable effect on team revenue," but such stars are relatively few.[221]

Although a very charismatic player can bring additional revenue to a team from increased jersey sales or attendance over a short period of time, such revenue streams are inconsistent and do not have the same lasting impact on value as media contracts or sponsorships. Additionally, sophisticated buyers are keenly aware of the health risks associated with playing a professional sport and are unlikely to place a significant amount of value on a team based on the appeal of one player. Unfortunately, unlike many tangible assets, "player contracts[] have no value whatsoever apart from the franchise."[222]

G. *Many Sports Teams Have Negative Cash Flows*

The Discounted Cash Flow method described above is also likely to be inaccurate when valuing a bankrupt sports franchise. "Because many franchises are losing money, or are only slightly profitable, a DCF model can easily produce a result substantially below what the franchise might actually sell for" on the open market.[223] A team in bankruptcy is particularly likely to exhibit financial distress that would cause the DCF method to produce artificially low results.

H. *Taxation Concerns*

As mentioned above,[224] a professional sports team's most valuable assets are intangibles. "The tax treatment of these intangible assets, which include franchise value, player contracts, and media rights, has substantially affected the market's valuation of franchises."[225] The IRS has historically struggled in its attempts to stay in front of investors who began to purchase professional sport franchises for the "tax shelter aspects of the business rather than . . . the prospect of operating profits."[226]

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[219] *Id.*
[220] Zorn, *supra* note 214, at 361.
[221] *Id.* at 361–62.
[222] *Id.* at 367.
[223] Carr & Cummins, *supra* note 7, at 15.
[224] *See supra* section II.2.D.
[225] Holo & Talansky, *supra* note 206, at 184.
[226] Zorn, *supra* note 214, at 351.

Sports franchises may be subject to special tax treatment that could affect the franchise's valuation.[227] Recently, many sports-specific provisions have been removed from the Internal Revenue Code.[228] However, up until 1976, a buyer of a professional franchise could attribute almost the entire amount of the purchase price to the cost of player contracts.[229] Under the applicable provisions of the tax code, that buyer could then amortize the cost associated with acquiring player contracts over a period of five years.[230]

In March of 1970, the Seattle Pilots of the American League filed for bankruptcy protection after experiencing significant financial difficulties.[231] On April 1, 1970, the bankruptcy court approved the sale of the Seattle Pilots to Allan "Bud" Selig[232] for $10.8 million.[233] Of this purchase price, Selig attributed $100,000 to equipment and supplies, $500,000 to the value of the franchise including league membership, and $10.2 million to the player contracts.[234] In doing so, under the applicable Internal Revenue Code provision, the group led by Selig was "able to write off nearly [its] entire investment over five years, the approximate 'useful life' of a baseball player at the time."[235]

In response to cases such as *Selig*, courts as well as the IRS have attempted to close these lucrative tax loopholes. Most recently, Congress has dealt with this issue by enacting the American Jobs Creation Act of 2004 ("Jobs Act").[236] Under the Jobs Act, player contracts can no longer

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227 *See generally* Holo & Talansky, *supra* note 206, at 162–63; Zorn, *supra* note 214.

228 *Compare* 26 U.S.C. § 197(e)(6) (2000) (repealed 2004) (excluding from the general treatment of intangible assets "[a] franchise to engage in professional football, basketball, baseball, or other professional sport, and any item acquired in connection with such a franchise"), *with* 26 U.S.C. § 197(e)(6) (2006) (removing the provision), *and* 26 U.S.C. § 1056 (2000) (repealed 2004) (relating to basis limitation for player contracts transferred in connection with the sale of a franchise), *with* 26 U.S.C. § 1056 (2006) (repealing the section).

229 *See, e.g.*, Selig v. United States, 740 F.2d 572, 575 (7th Cir. 1984) (buyer of a professional baseball team attributed nearly 95% of the purchase price to professional contracts).

230 The IRS categorized player contracts as intangible assets that were capable of being amortized over a period of time determined by the approximate "useful life" of a professional athlete. *See generally* Holo & Talansky, *supra* note 206. At the time, five years was determined to be the approximate "useful life" of a professional athlete. *Id.* at 190.

231 *Selig*, 740 F.2d at 574–75.

232 Today, Bud Selig is the commissioner of MLB.

233 *Selig*, 740 F.2d at 575.

234 *Id.*

235 Holo & Talansky, *supra* note 206, at 190. In a recent non-bankruptcy example, "[t]he syndicate of investors who purchased the Boston Red Sox in 2002 for $700 million allocated $350 million to player salaries. Thus, the first $70 million of Red Sox operating profits for each of the next five years were essentially tax free." *Id.* at 191 (footnote omitted).

236 American Jobs Creation (Jobs Act) Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

be amortized based on a "useful life" standard, but are now treated as an intangible asset within the meaning of section 197 subject to a 15-year recovery period.[237]

While the intent of the Jobs Act was to prevent a buyer of a professional sports franchise from stealing home, "[s]everal commentators have asserted that the legislation will ultimately prove to be a boon to sports owners."[238] This is because in abolishing special treatment for player contracts, the Jobs Act also abolished any distinction between non-amortizable and amortizable intangible assets that existed under previous law.[239] Thus, in addition to player contracts being subject to a 15 year recovery period, previously non-amortizable intangible assets such as sponsorship agreements, luxury suite contracts, the franchise value, and media contracts now enjoy the same amortization treatment.[240]

Therefore, "[f]ranchises with the most lucrative national and local broadcasting contracts stand to gain the most from the Jobs Act amendments [and applicable tax provisions], since the primary effect of the new law is to permit depreciation on these heretofore unamortizable intangibles."[241]

I. The Sports Franchise's Relationship with the City in Which it Is Located

Sports franchises have a unique relationship with their host communities. While it is not unusual for large companies to receive public benefits, sports teams receive massive public support, particularly through public funding of costly, palatial stadiums.[242] Positively, this means that sports franchises may have a ready source of outside funding that a more traditional bankrupt firm may not, which could increase value. Negatively, this may restrict the franchise's ability to relocate to a more profitable metropolitan area, which would decrease value.[243]

A sports franchise has a symbiotic relationship with the city in which it is located.[244] While this is true of all large firms—think Flint, Michigan and General Motors—sports franchises are unique in the "non-tangible, non-economic benefits" that they confer, such as "growth and vitality," "a common interest for the local community," and "cultural identity across lines of race, ethnic background and class."[245] These intangible benefits—

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[237] 26 U.S.C. § 197 (2006); Jobs Act § 886; Holo & Talansky, *supra* note 206, at 200.

[238] Holo & Talansky, *supra* note 206, at 203; *see also* Duff Wilson, *Bill Changing Tax Provision Would Raise Franchise Value of Sports Teams*, N.Y. TIMES, Aug. 2, 2004, at A1.

[239] Holo & Talansky, *supra* note 206, at 200; Wilson, *supra* note 238, at A1.

[240] Holo & Talansky, *supra* note 206, at 200; *see also* 26 U.S.C. § 197; Jobs Act § 886.

[241] Holo & Talansky, *supra* note 206, at 204; *see also* 26 U.S.C. § 197; Jobs Act § 886.

[242] Holo & Talansky, *supra* note 206, at 162; Bowling, *supra* note 214, at 651.

[243] *See generally* Will Hendrick, Comment, *Pay or Play?: On Specific Performance and Sports Franchise Leases*, 87 N.C. L. REV. 504 (2009); *see also supra* section II.2.B.1.b.

[244] Bowling, *supra* note 214, at 648–49; *see* Hendrick, *supra* note 243, at 520–28.

[245] Bowling, *supra* note 214, at 649; *accord* Hendrick, *supra* note 243, at 525–26.

and the cost of losing them if bankruptcy requires the franchise to be relocated—are extremely difficult to quantify.[246]

However, the added value associated with teams that are entrenched in the culture of their jurisdiction cannot be ignored. For example, while the San Antonio Spurs are considered a "small market" NBA team, they are listed as the 10th most valuable franchise in the NBA (eight spots ahead of the Los Angeles Clippers).[247] Additionally, in a recent survey conducted by ESPN, the Spurs were named the second-best sports franchise in America.[248]

II. Valuing the Professional Sports Franchise in Bankruptcy

A. *In a Sale Context: A Fair Market Will Determine the Fair Value*

The difficulties of valuing a professional sports franchise in bankruptcy creates a great deal of uncertainty, but one thing is clear: bankruptcy courts should avoid attempting to value bankrupt teams whenever possible. Specifically, whenever a sports team comes before a bankruptcy judge, that judge should be especially receptive to a strategy that includes an auction (or some other market test) that would obviate the need for the court to value the team itself.

Given that the primary aim of this Article is to provide guidance for courts tasked with valuing a bankrupt sports team, the conclusion that a bankruptcy judge should attempt to avoid valuing a sports team may seem unhelpful, or even perverse. In actuality, it is none of these things. To paraphrase a wise scholar writing about a similar problem facing the judiciary, "[t]he empirical questions relevant to" valuing a sports franchise "frequently strain the limits of judicial information and predictive capacities."[249] The variables that determine value are not only difficult to estimate, they are indeterminate when considered in tandem. It is difficult enough (perhaps impossible) for a highly trained and well-prepared expert witness to accurately predict and calculate a team's value; it is much more so for bankruptcy judges (and their clerks and staff), who, although bright, capable, and conscientious people, often lack the time,

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[246] Bowling, *supra* note 214, at 652 (citing Glenn M. Wong, *Of Franchise Relocation, Expansion and Competition in Professional Team Sports: The Ultimate Political Football?*, 9 Seton Hall Legis. J. 7, 28 (1985)); Hendrick, *supra* note 243, at 525.

[247] *NBA Team Valuations: San Antonio Spurs*, Forbes.com (Jan. 2013), http://www.forbes.com/teams/san-antonio-spurs/; *NBA Team Valuations: Los Angeles Clippers*, Forbes.com (Jan. 2013), http://www.forbes.com/teams/los-angeles-clippers/.

[248] Survey based on the ranking of all 122 professional sports teams in the Big Four. San Antonio is the only professional sports franchise out of the Big Four to rank in the top ten every year since ESPN introduced its annual survey in 2003. *San Antonio Spurs Named Second-Best Sports Franchise in ESPN the Magazine's Ultimate Standings Survey for 2013*, NBA.com (Sept. 23, 2013), http://www.nba.com/spurs/news/130923_espn.

[249] Adrian Vermeule, *Interpretive Choice*, 75 N.Y.U. L. Rev. 74, 77 (2000).

resources, information, and quantitative training necessary to value the enterprise.[250] Moreover, the court can never be certain, at least in the short term, whether or not the value it reaches is accurate. Although the Supreme Court has stated that "'mathematical certitude' is neither expected nor required" when valuing a bankrupt entity,[251] substantial errors in valuation can have seriously adverse consequences.[252] Thus, a multi-week valuation hearing, for which high-priced lawyers and economists must be compensated, introduces massive decision costs without guaranteeing a commensurate decrease in error costs.[253] As a pair of scholars aptly note, "[n]ot only do judges lack the business expertise of individual capital investors, but also a judicial valuation cannot benefit from the collective wisdom of market investors in the aggregate. As a result, even unbiased judges make mistakes that a market process would not permit."[254]

Obviously, a bankruptcy judge cannot avoid the expense simply by taking shortcuts; the Supreme Court has held that "[t]he need for expedition" of the valuation process "is not a justification for abandoning proper standards."[255] Should the court commit reversible error in a valuation proceeding, the court will have to perform the valuation again, thereby further exacerbating the expense.[256]

What should the court do, faced with this gargantuan and uncertain task? The most desirable choice is to "eliminate imponderables from both sides of the scales and focus instead on the variables that can be grasped."[257] The variables that determine the value of a sports team are murky and indeterminate, but the costs of a valuation hearing are certain and high. In the face of massive costs and daunting uncertainty, bankruptcy courts' "foremost concern should be to minimize the costs of" the valuation enterprise.[258]

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[250] *See* Pantaleo & Ridings, *supra* note 18, at 440–41 (describing instances in which judges have misunderstood valuation methodologies, in part because many aspects of valuation "have nothing to do with law and much to do with financial theory" with which many judges lack familiarity).

[251] Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 452 (1968).

[252] *See* O'Rourke, *supra* note 13, at 403–06, 432–39, 447–48.

[253] *Cf.* Vermeule, *supra* note 249, at 88 (describing the trade-off between error costs and decision costs in judicial decisionmaking). Furthermore, when a bankruptcy court is embroiled in a protracted valuation hearing, it takes time away from other litigants before the court. In other words, judicial valuation clogs up the courts and prevent bankruptcy judges from doing what they are most qualified to do: administer and facilitate the day-to-day operation of the bankruptcy system.

[254] Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 YALE L.J. 83, 90 (2001).

[255] *Anderson*, 390 U.S. at 450.

[256] *See, e.g.*, *id.* at 454.

[257] Vermeule, *supra* note 249, at 125.

[258] *Id.* at 79.

In the authors' judgment, the most cost-effective method of arriving at an enterprise value is to auction the franchise, as permitted by 11 U.S.C. §§ 363 and 1129(b)(2), and let the market operate, as was done in the Texas Rangers' bankruptcy.[259] If prospective buyers' access to information is equalized, then the winning bid should approximate the value of the enterprise. Future developments, incorrect calculations, or irrational exuberance or pessimism may ultimately render that value erroneous, but the same may be said of a judicial valuation. The point is that an auction is generally cheaper and more compressed than holding a valuation hearing, taking the matter under judicial advisement, and then substantiating conclusions in the form of a judicial opinion subject to subsequent appellate review.

Moreover, in the authors' view, an auction increases value and thereby maximizes return to creditors. Scholars generally agree that market-based bankruptcy processes often produce better results than judicial valuations, because "[m]arkets evaluate assets more accurately than do judges and may do so at lower transaction costs."[260] A fair, open, and competitive bidding process lessens the likelihood of sweetheart deals where the team is sold to a preselected buyer at a deep discount.[261]

To be sure, an auction is not cost-free. In particular, an auction requires establishing a data room to which prospective buyers have access, which in turn requires assembly and organization of the franchise's financial data in the first place. However, as technology improves, much of this information can be assembled and accessed online at reduced cost.

Likewise, the auction concededly does not eliminate the need for parties to expend resources producing their own valuation; it merely shifts some costs from the debtor's estate to the prospective bidders. However, some of these costs would be incurred anyway in a judicial valuation, as each side would need to prepare its own valuation to persuade the court of the enterprise's true value. More importantly, an auction shifts the costs of valuation from an entity relatively ill-equipped to handle them—namely, an overworked, understaffed judiciary—to the prospective buyers, who are better able to absorb them.

The bankruptcy judge has many tools to encourage exposing a debtor's business to an auction. The first is blunt but effective—the intimidation factor. Of course, a bankruptcy judge should and will decide issues based only on the merits and not on the basis of displeasure with a particular litigant. Nevertheless, bankruptcy judges are afforded a great deal

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[259] Interview with Judge Russell F. Nelms, *supra* note 112; Interview with Lou Strubeck & Liz Boydston, *supra* note 116; Interview with Clifton R. Jessup, Jr., *supra* note 124. There may very well be ways to sell the franchise on the open market other than an auction; the point is that an auction is a common and tried-and-true method for maximizing value in a cost-efficient manner.

[260] Adler & Ayres, *supra* note 254, at 90–96 (citations omitted).

[261] *See, e.g.*, Selig v. United States, 740 F.2d 572, 575 (7th Cir. 1984).

of discretion to manage their cases as they see fit. Litigants before a court, if they are wise, fear invoking the ire of the bankruptcy judge, lest that discretion later be exercised against them. Sometimes, simply by announcing to the parties a preference for valuation by auction, the judge may convince the parties to take the hint.

The judge may also, when faced with a prepackaged deal, resist approving the deal until the parties satisfy some sort of market test.

The court has other, less direct ways of pushing a debtor toward an auction. For instance, 11 U.S.C. § 1104(a) permits the court, "[a]t any time after the commencement of the case but before confirmation of a plan," after notice and a hearing, to appoint a trustee to administer the debtor in a case "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate."[262] Because an auction will generally maximize value and minimize costs, the appointment of a trustee that will cause the debtor to sell itself at auction may be in the best interests of creditors. This method would be particularly useful where creditors want to force a sale but the debtor-in-possession wants to retain control of the team. However, this method is not without problems. For one, appointment of a trustee is a blunt instrument; because the court does not control the trustee directly, the trustee may decide after his or her own investigation that an auction would not be warranted, which would defeat the purpose. Moreover, the trustee may lack experience managing sports teams, and in any event will have less experience administering the debtor than current management. The trustee will need time to familiarize himself or herself with the debtor's operations. Thus, while appointing a trustee may maximize value in some respects, it may hurt the team's bottom line in others.

B. *Judicial Valuation*

1. *Situations Where a Judicial Valuation Is Necessary*

Thus, although the bankruptcy court has tools to encourage an auction, these tools have limits. The Bankruptcy Code does not authorize the court to force an auction or other section 363 sale where the owner wishes to retain control of the franchise. Likewise, when the debtor's favored buyer doesn't want to be the stalking horse, but rather wants to be the only horse, there is not much the court can do to encourage an auction and avoid valuing the entity. Additionally, if a team is publicly held and

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[262] Although the text of section 1104(a) might suggest that the court may appoint a trustee only "on request of a party in interest or the United States trustee," 11 U.S.C. § 105(a) (2012) provides that "[n]o provision [of the Bankruptcy Code] providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." The court may therefore appoint a trustee *sua sponte* if all other statutory prerequisites are met.

the debtor wishes to satisfy unsecured creditors with stock, the court will need to value the stock, and therefore will need to value the team.

There are also instances where, even when a sale of the franchise is contemplated, a judicial valuation may be necessary. An enterprise valuation may also be necessary where equity holders believe that the price obtained through a sale or auction is too low, or where the league wants to see the team sold to an entity other than the highest bidder.

The upshot is that even though the valuation problem is nearly intractable, there are scenarios in which the court will have to do it anyway.

2. *Strategy to Determine the Value of a Professional Sports Franchise in Bankruptcy*

What, then, should the court do if it cannot avoid the need to value a bankrupt sports franchise? Although, for the reasons described above, pure application of the traditional methods of valuation may not provide the most accurate reflection of the value of a professional sports franchise in bankruptcy, the authors are not ready to throw in the towel just yet. With certain adjustments or modifications, they may provide a useful framework to begin the valuation of a professional sports franchise in bankruptcy.

It should be noted that even with modification, certain of the traditional methods of valuation described above would not translate into accurate valuations of professional sports teams. Specifically, the DCF method and the market comparison approach will in all likelihood not provide an accurate valuation of a professional sports team. This is because the DCF method and the market comparison approach are much more sensitive to the unpredictable variation in cash flow characteristics of a professional sports franchise.[263]

A weakness with the DCF method in particular is that sports franchises are made up predominantly of intangible assets for which future cash flows are difficult to estimate. For example, it is difficult to estimate the gate and merchandise revenue that any given player contract will earn for the team because attendance is based on many factors, and player performance is variable and unpredictable. Yet another shortcoming of the DCF method is that the traditional methods for calculating the cost of equity, which is a necessary step in the DCF analysis, produce inaccurate results when the subject company is not publicly traded, as is true of most sports franchises.[264]

Also, the market comparison and DCF methods will not account for the substantial goodwill and ego factor premiums that a buyer would place on the team if it were sold on the open market, so values obtained

[263] Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 453 (1968) (noting the difficulties when a court is "asked to value [a] company's future prospects by hypothesizing unforeseeable changes").

[264] *See supra* text accompanying note 54.

under those methods are likely to be deflated.[265] Therefore, the authors submit that a modified comparable transactions approach is likely to produce the most accurate enterprise value of a professional sports franchise in bankruptcy.[266]

While there has been an increase in the number of professional sports teams that have filed for bankruptcy in the past 10 years,[267] the number of professional sports teams that have been sold outside of bankruptcy far outpaces that statistic. Additionally, because a large number of sports teams have been sold in market transactions, there is more robust data from which a court may extrapolate than would be true if, say, the court used the market comparison method, which depends heavily on the availability of financial data that is generally not publicly available. Furthermore, because the comparable transactions method involves data obtained through (relatively) open-market transactions, the value is most likely to approximate the price a winning bidder would pay if the team were instead auctioned off, as this Article recommends.

To be sure, although teams are more often sold outside the bankruptcy process, for the reasons described previously, bankruptcy may affect the value of an entity in indeterminate ways.[268] Thus, without additional considerations, using the sale of a non-bankrupt team to estimate the value of a bankrupt team may not produce wholly accurate results. However, as we have also explained above, because sports teams differ from other entities in bankruptcy there is little chance that the team will be liquidated. Thus, the distortion caused by using non-bankruptcy data to perform the comparable transaction approach is probably less than the distortion that would occur if the court instead used the DCF or market comparison method.

Additionally, as mentioned above, a court may compare the results obtained through multiple valuation methods to compensate for each method's weaknesses. Thus, in addition to estimating enterprise value by comparing the bankrupt team to franchises sold on the open market as a whole, the court should also take into consideration the subject team's sport, metropolitan media market (including the status of the team's media contract), jurisdictional intricacies, the team's venue (including suites and capital improvements), and the degree to which all of the above is affected by its league's revenue-sharing model. Things that may, at first glance, seem to provide significant value, but have proved to be of negligible importance and therefore should not be given serious consideration when valuing a professional franchise in bankruptcy, are the subject team's winning percentage, impending draft position, and the presence of a "super-star" player on the roster (even if that player, perhaps

[265] Carr & Cummins, *supra* note 7, at 17–18.
[266] *Accord id.* at 17, 48.
[267] *See supra* Introduction.
[268] *See supra* section I.B.

due to connections with another nation, is expected to appeal to a global market).[269] There also appears to be little if any negative impact on a team's value based on the stigma that is often said to be associated with an entity in bankruptcy.[270]

a. Type of Sport

One variable that the court must take into account is the sport the team plays. Outside the bankruptcy context, football teams tend to sell for a sum much higher than the *Forbes* valuations suggest, while hockey teams tend to sell for a slight discount.[271]

The type of sport also has a major influence on gate receipts. For example, while the average MLB franchise plays approximately 81 home games in a given season,[272] the average NFL team will play only 8.[273] Further, it seems more likely that the average sports fan would attend an NFL game, which is typically held on a Sunday in the fall, as opposed to an MLB game, which is played in an open-air stadium in the summer. Additionally, far fewer MLB teams qualify for postseason play than their counterparts in other leagues; accordingly, "if a baseball team is out of contention early, attendance will suffer."[274]

Another difference is that whereas "Major League Baseball teams support an elaborate infrastructure of minor league players, designed to maintain a regular supply of players," the NBA and the NFL "do not have to pay comparable player development costs" because they "rely[] instead on colleges and universities to develop their future players."[275]

League-wide revenue sharing also results in what may be (somewhat ham-handedly) described as a portfolio diversification effect. In leagues where revenue sharing is absent or minimal, a team's financial performance will be highly dependent on its performance on the field or court. Where, by contrast, revenue sharing is prevalent, financial and team performance become more of a zero-sum game: some team has to be in first, some team has to be last, and the resulting variation will cancel out. League sharing thereby reduces enterprise risk, which may positively impact value. League sharing likewise improves the accuracy of judicial valuation by making the team's future financial performance more predictable.

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[269] *See* Zorn, *supra* note 214, at 361–62, 367.

[270] In fact, based on the interviews conducted in preparation for this Article and in the wake of the Texas Rangers auction, the value of a professional team in bankruptcy may actually be higher than that of a team outside of bankruptcy.

[271] Vine, *supra* note 196.

[272] *2013 MLB Attendance Report*, ESPN, http://espn.go.com/mlb/attendance.

[273] *2012 NFL Attendance*, ESPN, http://espn.go.com/nfl/attendance/_/year/2012; *see also* Carr & Cummins, *supra* note 7, at 8.

[274] Carr & Cummins, *supra* note 7, at 8.

[275] Zorn, *supra* note 214, at 388.

b. Revenue

Sports franchises obtain revenue through multiple sources, including "ticket sales, parking, concessions, sponsorship deals, broadcasting contracts, licensing, and merchandise."[276] The sponsorship and broadcasting contracts are undoubtedly the largest source of revenue,[277] but ticket sales are also significant.[278]

Recently franchises have also experimented with new ways of earning revenue, such as personal private seat licenses,[279] internet streaming,[280] "Beverage Availability Rights,"[281] signage at stadiums,[282] and ad space on jerseys.[283] Stadium naming rights have become an increasingly important source of revenue in recent years.[284] Some teams have also begun "creat[ing] venues where season ticket holders may resell their [unused] tickets. Through this secondary market, the team collects profits, over their normal per-ticket profit, by facilitating the ticket transfer between fans and charging the buyer and/or seller."[285]

Some empirical studies of sports teams outside the bankruptcy context have found that "revenue," more so than operating income, is the "key driver behind the valuation of sports franchises," but that "franchises typically demand a 27% premium" over what revenue figures alone would suggest.[286]

c. Metropolitan Media Market

The metropolitan area in which a team plays must also be taken into account when valuing the franchise. For instance, whereas small-market NFL franchises "have a high degree of parity with large-market franchises" because "all NFL regular and post-season television revenue is shared equally," "NHL and NBA franchises in large media markets have an even bigger economic advantage over franchises in small media markets" because "local broadcast revenues are not shared" in these leagues.[287] As discussed above, MLB franchises located in large media markets also have a significant economic advantage over franchises in

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[276] Davis, *supra* note 214, at 241; Carr & Cummins, *supra* note 7, at 8–10.

[277] Holo & Talansky, *supra* note 206, at 163; Zorn, *supra* note 214, at 395.

[278] Holo & Talansky, *supra* note 206, at 177.

[279] Davis, *supra* note 214, at 243.

[280] Carr & Cummins, *supra* note 7, at 10.

[281] Holo & Talansky, *supra* note 206, at 173.

[282] *Id.* at 173–74.

[283] Rich Thomaselli, *If English Soccer Can Take in $155M From Sponsored Jerseys, What About NBA, NFL?*, ADVERTISING AGE (Oct. 4, 2010), http://adage.com/article/news/nba-nfl-follow-english-soccer-sponsor-jerseys/146264/.

[284] Carr & Cummins, *supra* note 7, at 9.

[285] Davis, *supra* note 214, at 262 (footnote omitted).

[286] Vine, *supra* note 196.

[287] Carr & Cummins, *supra* note 7, at 9.

smaller markets due to the MLB's revenue sharing model.[288] In addition to the revenue generated from broadcasting rights, teams located in large metropolitan areas enjoy significantly larger revenue attributable to merchandise sales.

d. *Player Salaries*

"On the expense side of the ledger, the single largest expense that differentiates one franchise from the next in terms of profitability is player costs, which are affected significantly by the respective league's collective bargaining agreements."[289] Moreover, player salaries have increased over time, despite leagues' attempts to control salary expense via collective bargaining agreements.[290] Player salaries are not only large; they are also "the single most variable expense from franchise to franchise."[291]

e. *Assets*

The "most valuable assets" of sports franchises "are generally the league franchise (and the concomitant right to geographical exclusivity), rights to league-wide revenue streams (especially media and licensing contracts), and player contracts."[292]

CONCLUSION

The most accurate way to determine the value of an entity is to find out what a willing buyer will pay to a willing seller, and the same is true of a professional sports franchise. Although outside of the bankruptcy context, a league may reduce the value of a team by placing certain restrictions on the market, inside of bankruptcy, a judge may be able to provide an open auction to help realize the true value of a team.

If an auction is not possible, a modified version of the comparable transaction approach will provide the most accurate enterprise value of a professional sports team in bankruptcy. Because teams are sold much more frequently outside of bankruptcy, such transactions may provide a useful comparison to help determine the value of a team in bankruptcy. However, courts, practitioners, and experts must be wary of the misperception that the value of a bankrupt team is properly set by the market price that it would obtain outside of bankruptcy without further inquiry.[293]

Indeed, while the sale of a team outside the bankruptcy context may be used to establish a benchmark value, the leagues' power to restrict the

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[288] *See supra* section II.B.1.c.

[289] Carr & Cummins, *supra* note 7, at 8.

[290] *Id.* at 10.

[291] *Id.* at 11.

[292] Holo & Talansky, *supra* note 206, at 184–85 (citing Zorn, *supra* note 214).

[293] *In re* Mirant Corp., 334 B.R. 800, 832–36 (Bankr. N.D. Tex. 2005); *accord* Shaked & Orelowitz, *supra* note 13, at 24.

transferability of teams outside of bankruptcy will limit its usefulness. Finally, as we mentioned above, a team's particular metropolitan media market, media contract, venue (including suites and capital improvements), and league's revenue sharing model are all unique factors that have proven to significantly impact the value of a professional sports franchise in bankruptcy and that must be accounted for in comparing a subject to similar transactions.