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Sports Franchises and Bankruptcy Law

Exhibits

a. League Constitution excerpts

b. Limited comments of the NHL filed in LAK acquisition corp. Chapter 11 case

c. Stipulation between NHL and Pittsburgh penguins re: franchise termination

d. Relocation Negotiation Injunction used in *Penguins* bankruptcy case.

SPORTS FRANCHISES AND BANKRUPTCY LAW: A STRAINED MARRIAGE

I. INTRODUCTION

A. SPORTS: THE AMERICAN DREAM

Few areas of American culture evoke as strong an emotional response as sports, particularly a popular hometown team. However, the economics of the sports business, and it is a business, have fundamentally changed in the recent past, with the explosion of television revenues, player salaries, and, inevitably, ticket prices. Sports "stars" often have as great, if not greater, an economic stake in the team they play for, as the owners of the team, and the major labor-management issue in sports is how much of the revenues generated will go to the players, and how much to the owners. And, those mega-million dollar salary deals heralded in the press often include substantial deferred compensation, payable over many years. The fundamental shift in the sports business includes the "new" stadium economics, which, to be competitive in the current financial/marketing/entertaining milieu, requires that teams play in new stadiums replete with luxury skyboxes for corporate entertainment. Ownership of sports teams is also shifting inexorably from wealthy individuals to entertainment conglomerates, such as the Walt Disney Company. Yet, with all this change, the major sports leagues continue to portray themselves, largely successfully, as private, members only clubs, with ownership reserved for the approved individual or entity, and power concentrated in the hands of a commissioner or owners committee.

Fortunately for the major sports leagues, players and fans, the bankruptcy of a team is a very rare occurrence. Since the passage of the 1978 Bankruptcy Code ("Code"), only two major league sports teams have filed for Chapter 11 protection -- the Los Angeles Kings and the Pittsburgh Penguins. The *Kings* Chapter 11 case (unlike that of its owner) was short lived and was, in essence, designed only to approve the sale previously negotiated *and approved* by the National Hockey League ("NHL"). The pending *Penguins* case is a more typical free fall Chapter 11 case, with the competing interests all jockeying for position.

Other than these two cases, no Bankruptcy Court has had to deal with a major sports franchise in bankruptcy since the passage of the 1978 Bankruptcy Code. That *tabula rasa* is about to change, as the *Penguins* case proceeds to a conclusion and other sports franchises face economic problems. The Dallas Morning News on January 6, 1999 reported a rumor that the New York Islanders are on the verge of bankruptcy. The Dallas Morning News further reported that the Anaheim Ducks would lose "lots of money" for the first time in its brief history. This was confirmed by a Business Week report on February 15, 1999, entitled "Fire and Ice at the NHL" that the Ducks would lose $7-9 million dollars even if they play to 92% attendance at their new arena, the Arrowhead Pond.

These operating and cash flow issues, as well a team's need or desire to renegotiate unfavorable leases or contracts raise the probability that other sports teams will file for Chapter 11 protection. There are significant legal issues surrounding Bankruptcy Court sales of sports franchises, league restrictions and rights, as well as the enforceability of contractual prohibitions on the transfer of sports franchises to different locations, or the enforcement of covenants to play only in a specific locale.

B. **THE PENGUINS CASE COMES TO A CRITICAL JUNCTURE**

On March 19, 1999, there is a scheduled hearing in the *Penguins* case on a motion to dissolve the Court's *sua sponte* injunction which prevents the Penguins from negotiating, with anyone, to move the team from Pittsburgh (the "Relocation Negotiation Injunction"). Prior to the bankruptcy filing, the Penguins franchise had been sued by their lessor, the Civic Arena, and the Pittsburgh Sports Authority in the Pennsylvania State Court for an injunction seeking the Penguins' compliance with their contractual commitments, specifically:

> "(a) To continue to occupy and play all Penguins home games in the Civic Arena through September 1, 2012;
>
> (b) To refrain from relocating or attempting to relocate the Penguins from the Civic Arena until at least June 30, 2007; and
>
> (c) To refrain from entering into any discussions with third parties relating to the sale or relocation of the Penguins until June 30, 2007."

The Penguins have asserted that those restrictive covenants preventing relocation are improper and unenforceable under bankruptcy law. According to the participants at the last case status conference, the Bankruptcy Court is also contemplating converting the case to a Chapter 7 case to have a trustee sell the team, and the Court made a statement to the effect that the NHL may not be pleased with his choice for the new owner(s). If not the sort of comment that is only designed to compel all parties to a consensual resolution, the sale of the team by a trustee, over the objection of the NHL would squarely raise a veritable melange of bankruptcy, state and federal law issues.

C. **THE FINANCIAL BENEFITS OF THE LIMITED OWNERSHIP OF SPORTS TEAMS**

The jealously guarded, restrictive nature of sports club ownership is reflected not just in the various contractual provisions set forth in the various league constitutions, exhibit "A" hereto, but in the limited numbers of teams that exist. There are only 27 National Hockey League teams, 29 National Basketball Association franchises, 30 Major League Baseball teams and 31 National Football League franchises. This limited and restricted market has proven to be of significant financial benefit for owners when they sell their franchises. For example, the Washington Redskins, who had not even made the playoffs in approximately six seasons, received an offer of $800 million dollars, the then-highest price to be paid for a U.S. sports franchise. Further, according to the January 24, 1999 *Seattle Times*, the Baltimore Orioles, which sold for $70 million in 1988, were resold for $173 million in 1993, a 147% return. NBA expansion teams cost $32.5 million in 1988 but in November 1998, investors paid a total of $188 million for the New Jersey Nets. The NFL has seen an even quicker rise over the last four years. The Cleveland Browns expansion team was sold for $530 million last fall, whereas the Charlotte and Jacksonville expansion teams had paid the League $140 million each for their franchise rights approximately four years ago. It is projected that the team and stadium costs could approach $1 billion for the NFL's next expansion team, reportedly to be in Los Angeles or Houston. Television contract revenues undoubtedly account for a large part of this increased value. CBS, which paid $28 million in 1964 for TV rights to all NFL games, paid $4 billion last January for the package of television rights.

The financial risks of team ownership are, however, also significant, particularly on a cash flow basis. The NHL had significant cash flow problems with its recent strike and during the recent NBA lockout, the League reported that half of the franchises suffered operating losses. Players' salaries have also dramatically escalated in the NBA; the average went from $600,000 in the 1988-89 season to $2.6 million last year. The average NHL player now makes $1.17 million compared to $232,000 in 1989. Salary restraints have become the big labor issue, as owners and players, in every major sport, fight for control of the revenue streams. Boston Bruins General Manager, Harry Sinden, was quoted estimating that the hockey clubs pay 72% of their revenues to players, in the *Dallas Morning News*, January 6, 1999. That figure, if accurate, would be 15% higher, as a percentage of revenues, than NBA salaries were before the NBA players strike. NHL player salaries have risen 250% since 1993, and the NHL did not obtain a salary cap from the players during the 1995 contract negotiations. For the rest of this NBA season, the salary cap per team is $30 million, which is less than the majority of NHL teams payrolls. And, *Business Week* further reported on February 15, 1999 that each NHL team receives $16 million less in television contract revenue than each NBA team. Thus, in the NHL, arena revenues from tickets and concessions are a much more important source of revenue, and teams are more dependent upon a team drawing large hometown crowds.

Even with the economic stress of rising player costs, however, major sports franchises have an enviable record of avoiding bankruptcy. Owners have a less enviable record, as several of them have either had well-publicized financial troubles, or even filed bankruptcy petitions.

D. **ISSUES RAISED BY SPORTS TEAM BANKRUPTCY CASES**

There have always been significant tensions surrounding the relocation of sports franchises, and more than occasional litigation, and the new stadium economics have only exacerbated the issue for "hometowns" seeking to retain their local sports teams. Sports leagues, believing themselves to be invitation only private clubs, have created restrictive constitutions, bylaws and rules, which often, if not always, include provisions revoking the franchise upon the team's bankruptcy filing, and conditioning transfers of ownership on league approval. This article will examine the two major sports team cases that have been filed, and will focus upon the following issues:

1. Can a league terminate a franchise if a team files for bankruptcy protection?

2. Can a city or arena lessor enforce a restrictive covenant to prevent a team from relocating to another city or playing in a different arena?

3. Can a team assume and assign a franchise agreement to a third party without the consent of the league, subject to Bankruptcy Court approval?

II. **THE LOS ANGELES KINGS BANKRUPTCY**

On Friday, May 13, 1994, Bruce P. McNall, the owner of the Los Angeles Kings, was placed into an involuntary bankruptcy case by some of his creditors. This occurred while Mr. McNall and his wholly owned subsidiaries, which owned 100% of the Los Angeles Kings hockey team, were in the process of selling a majority interest in the team to LAK Acquisition Corp. ("LAK"). The sale closed approximately five minutes before a Monday, May 16, 1994 hearing on the appointment of an interim trustee, which if ordered, would have delayed, if not stopped the sale. Majority ownership of the team was however, transferred and a minority ownership was retained by the bankruptcy estate. After a troubled year and a half of ownership, and litigation with the McNall trustee, LAK agreed with the McNall trustee, the NHL and Bank of America to sell the team to Majestic Anschultz Ventures ("MAV"), which hoped to build a new arena for the team. In order to accomplish the sale, and largely because of the excessive debts, including substantial deferred compensation owed Wayne Gretzky and $8.4 million owed to the NHL, LAK filed a Chapter 11 case. LAK also filed an immediate motion to assume the sale agreement, and consummate the sale transaction. Under the sale agreement, MAV assumed all of LAK's hockey-related obligations (*e.g.*, player contracts, player deferred compensation agreements, arena contracts, television contracts and bank loans). Most important, the NHL Constitution was assumed by LAK and assigned to MAV, with the express consent of the NHL. The *Kings* bankruptcy case was short-lived, and the sale had been negotiated by the major parties, the bank which had financed the team, the NHL and the creditor constituents. Thus, no major controversies were litigated, and many potential issues were avoided by agreement.

A. **THE NHL STAKES OUT ITS TURF**

In order to ensure that no one could possibly dispute the supremacy of the NHL's ownership transfer consent rights, in a short but clear pleading, the NHL set forth its views regarding the enforceability of its various contractual rights under applicable bankruptcy law. Attached hereto as exhibit "B" is a copy of the NHL's "comments" which we will summarize below.

The NHL Constitution, exhibit "A," expressly prohibits the transfer of membership in the league or of any ownership interests except pursuant to its approval process. Citing an 1876 Supreme Court case, *Hyde v. Woods*, 94 U.S. 523, 24 L.Ed. 264 (1876), the NHL's position was that membership in a voluntary association may be transferred only pursuant to the association's rules, even after an individual member's bankruptcy. The *Hyde v. Woods* case involved the transfer of a seat on the San Francisco Stock Exchange Board and the use of proceeds to pay debts of the exchange memberships. The Supreme Court in *Hyde v. Woods* held that:

> "A seat in this Board is not a matter of absolute purchase. Though we have said it is property, it is encumbered with conditions when purchased, without which it could not be obtained. It never was free from the conditions of (the rule requiring such payments at transfer), neither when the debtor bought, nor at any time before or since. That rule entered into and became an incident of the property when it was created, and remains a part of it in to whose hands soever it may come."

Hyde at 525.

The NHL also relied upon *Board of Trade of City of Chicago v. Johnson*, 264 U.S. 1, 44 S.Ct. 232, 68 L.Ed. 533 (1924), in which the Supreme Court held that while the interest in a membership in the Board of Trade Exchange did pass to the bankruptcy estate, it was subject to the Exchange's transfer rules. A similar situation was dealt with by a Bankruptcy Court in *In re Reinstein*, 165 B.R. 303 (Bankr. S.D. Fla. 1994).

While the NHL recognized the prohibition on *ipso facto* clauses in Section 365, it argued that this did not override "otherwise legal restrictions on sale." Furthermore, Section 541(c)(1) which provides for the debtor's pre-bankruptcy property to be included in the estate, notwithstanding an *ipso facto* clause, does not provide authority for the trustee to sell that property to a third party without regard to such restrictions, *State of California v. Farmers Markets*, 792 F.2d 1400, 1402 (9th Cir. 1986), which held that the debtor's liquor license was subject to state transfer restrictions. See also *Rice v. Shoney's, Inc.*, 174 B.R. 787, 790-91 (Bankr. E.D. Ark. 1994), which held that the estate succeeds only to the interest of the debtor.

The NHL further noted that while under Section 365(f) of the Bankruptcy Code, a trustee or debtor-in-possession can assume or assign a contract notwithstanding a prohibition on assignment, Section 365(f) is expressly subject to Section 365(c), which prohibits the assignment of contracts if applicable law would excuse the non-debtor from accepting performance from a stranger, including personal service contracts, and all contracts based on confidence and trust. The NHL then concluded that:

> "The detailed application and approval process for membership in the League itself demonstrates the importance to the League and its members that confidence and trust in each new member. Therefore, any effort to 'assign' rights under the Constitution pursuant to Section 365(f) without the League's consent would fail."

Thus, the NHL set out its views on the enforceability and ultimate supremacy of the League's rights and remedies. To summarize, while an ownership interest is a property right, the NHL's view is that it is subject to the transfer restrictions that are contained in the League Constitution. Further, since Section 365 prohibits the assignment of non-delegable personal services contracts, and since the sports franchise arguably is such an agreement, it cannot be assumed and assigned without the NHL's consent. Unstated in those comments, was the NHL's presumed ultimate position, that since Section 365 (e)(2) contains an exception to Section 365(e)(1) which invalidates *ipso facto* clauses, such clauses would be valid in the League Constitution, and the NHL could terminate the franchise due to the bankruptcy filing, once it obtained relief from the automatic stay. Whether such termination would be allowed, or would be disallowed as a forfeiture is, however, an open question. This position was not tested during the *Kings* bankruptcy case, as no party in interest sought a sale without League approval.

III. **THE PENGUINS CASE**

On October 13, 1998, the Pittsburgh Penguins filed a Chapter 11 bankruptcy petition. The Penguins' owner, Roger Marino, alleged losses of $37 million over the last two seasons and the inability to negotiate a more favorable lease at the Civic Center, one of the NHL's oldest facilities, as a precipitating event. Newspaper articles repeated the NHL's refrain that under league rules, the NHL could seize an insolvent franchise but had not yet made that determination. Mario Lemieux, the Pittsburgh Penguins' retired star, emerged as the largest unsecured creditor, purportedly owed some $31 million in deferred compensation. According to an October 13, 1998 article in the *Pittsburgh Post Gazette*:

> "When the prospect of a Penguins bankruptcy filing first was raised this summer, Gary Bettman, the NHL's commissioner, made it clear that he would be strongly opposed to the Penguins declaring bankruptcy. He cited the NHL Constitution, which states that an owner 'risks forfeiture' of a franchise that goes through bankruptcy, and said he would exercise his authority to take over the franchise from Marino and Baldwin in such an instance. The Commissioner's powers, however, are far-ranging enough that he also can choose to take no action if he determines that there are special circumstances.
>
> The Penguins this summer began seeking to renegotiate at least three long-term agreements, with only partial success -- their lease at the Civic Arena, their broadcast rights deal with Fox Sports Network and their contract with retired superstar Mario Lemieux."

One of the first substantive actions that occurred in the *Penguins* case was a stipulation with the NHL, which effectively postponed the dispute over the automatic termination of the franchise under the League Constitution. Attached hereto as exhibit "C," is a copy of the stipulation entered into between the NHL and the debtors, to postpone indefinitely any dispute over whether the bankruptcy filing caused an automatic termination of the Penguins' membership in the League. The stipulation also suspended the requirement that the Penguins turn over to the NHL Commissioner all hockey-related assets, including the lease to their arena and all player contracts. The stipulation seemed to recognize that the League would have to seek relief from the automatic stay of 11 U.S.C. Section 362 before exercising its rights under the termination provisions of the League Constitution, and provides for a 20-day notice period to the debtors if the NHL decides to exercise its rights to terminate the franchise. Thus, there has been no determination as to whether or not the NHL Constitution provisions may effectuate a termination of the Penguins' franchise while the parties attempt to negotiate a consensual resolution to the Penguins' financial difficulties.

The Penguins estimate that they have debts of $125 million and the Bankruptcy Court has estimated the value of the team at less than $100 million, in connection with a financing hearing. The NHL has convened an all-parties meeting prior to the March 19, 1999 hearing and, if an agreement is reached, the ultimate issues raised by the *Penguins* case may not be resolved until the next sports team bankruptcy case.

A. **THE INJUNCTION AGAINST RELOCATION NEGOTIATIONS**

In a November 13, 1998 hearing on a motion for relief from stay by the Penguins' lessor and cross motions to dismiss an adversary proceeding, the Bankruptcy Court *sua sponte* issued an injunction staying the adversary action and enjoining the debtors and everyone affiliated with them from:

> "(a) Initiating or engaging in discussions with third parties concerning the sale or relocation of the Penguins hockey team;
>
> (b) Relocating or attempting to relocate the Penguins hockey team to a venue other than the Civic Arena; and
>
> (c) Causing or permitting the Penguins hockey team to play any portion of its regular season and playoff season scheduled for the Civic Arena to be played at any other venue."

Exhibit "D" November 25, 1998 Order (previously defined as the "Relocation Negotiation Injunction.")

This extraordinary relief seems unwarranted, except to Pittsburgh Penguins hockey fans. The creditors of the bankruptcy estate certainly have an economic interest in having the value of the team ascertained, tested and perhaps maximized by at least considering a move to another location. The Penguins team itself can probably only adequately negotiate with its landlord/lessor and other contractual parties if it has the option, standard in a bankruptcy case, to reject its executory contracts and leases and move the team if necessary. That is, unless the restrictive covenant is fully enforceable even in a bankruptcy case, which will be discussed below. That issue was not, however, briefed prior to the time of the issuance of the Relocation Negotiation Injunction.

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 in the *Penguins* case. Thus, the normal bankruptcy policy of maximizing the value of assets to the estate seems to have been inverted in favor of a policy seeking, at all costs, to retain the franchise in Pittsburgh. This perhaps proves the "truism" that any community's most visible and cherished asset is a major league sports franchise.

While the teams may be cherished by the fans, the ability to move teams to take advantage of the new stadium economics has become cherished by owners:

> "Cleveland Browns owner Art Modell recently entered into an agreement to relocate his franchise to Baltimore prior to the expiration of his stadium lease, despite a fifty-year history of exceptional fan support and without considering Cleveland's offer of $175 million in stadium improvements. Houston Oilers' owner, Bud Adams, decided to move his profitable franchise to Nashville after Houston government officials rejected his take-it-or-leave-it demand for a new $245 million, domed stadium. He is leaving Harris County taxpayers saddled with approximately $50 million of outstanding bond indebtedness, incurred to finance 1987 stadium improvements in an effort to prevent Adams from relocating his team to Jacksonville. Meanwhile, Seattle Seahawks' owner, Ken Barry, expressed a desire to relocate to Los Angeles to fill a market void created after the former Oakland-Los Angeles Raiders relocated to Oakland, and the former Cleveland-Los Angeles Rams moved to St. Louis because the former Chicago-St. Louis Cardinals had relocated to Phoenix."

Mitten, *Professional Sports Franchise Relocations from Private Law and Public Law Perspectives: Balancing Marketplace Competition, League Autonomy and a Need for a Level Playing Field*, 56 Md.L.R. 57, 62 (1997).

These and other relocation efforts have spawned substantial litigation and contractual provisions such as those found in the *Penguins* case which severely limit or restrict the ability of a sports team to relocate. While general litigation issues are beyond the scope of this article, the issue of the enforceability of such restrictions in contracts and leases is an important component of the bankruptcy issues raised in professional team bankruptcies.

IV. BANKRUPTCY TERMINATION OF TEAM FRANCHISE AGREEMENTS: IPSO FACTO CLAUSE

Ipso facto clauses, which terminate a contract or lease based upon the bankruptcy or insolvency or financial condition of a party, generally are unenforceable against a debtor in bankruptcy under Code Sections 365(b) (1)-(2) and (e)(1). In addition, an interest of the debtor in property becomes property of the estate notwithstanding any *ipso facto* clauses that purport to terminate the debtor's property interest upon an event of insolvency or a bankruptcy filing. However, as discussed below, under Code Section 365(e)(2), an *ipso facto* clause in a franchise agreement is enforceable to the extent that the franchise agreement is found to be either non-delegable or non-assignable pursuant to applicable law, or to constitute a financial "accommodation agreement."

A. NON-ASSIGNABLE AND NON-DELEGABLE CONTRACTS: CAN A TEAM ASSUME AND ASSIGN ITS FRANCHISE AGREEMENT OVER THE OBJECTION OF A LEAGUE? CAN THE LEAGUE TERMINATE A FRANCHISE BASED ON THE BANKRUPTCY FILING OF A TEAM?

The Bankruptcy Code generally provides for parallel treatment of financial accommodation contracts and "non-delegable" contracts. Code Section 365(c)(1) codifies the non-bankruptcy legal concept that certain contractual obligations are "non-delegable." Generally, there are two types of non-delegable executory contracts relevant to franchising. First, there is the classic "personal services" contract, pursuant to which a party contracts with a person or entity to provide a highly unique product or service; thus, only that person or entity may give the party the benefit of their bargain. Section 365(c)(1) provides, in relevant part, as follows:

> "The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if-
>
> (1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor-or-the debtor in possession whether or not such contract, or lease, prohibits or restricts assignment of rights or delegation of duties; and
>
> (B) such party does not consent to such assumption or assignment."

11 U.S.C. Section 365(c)(1).

The classic personal services contract would be an agreement in which a renowned artist agrees to produce and sell his or her own unique artwork. Clearly, this kind of product is highly personal in nature and, therefore, this artist should not be able to assign his or her duties to some other artist absent the consent of the other contracting party.

Second, any other executory contract that cannot be assigned by a debtor or debtor-in-possession absent consent of the other party under applicable non-bankruptcy law constitutes a non-delegable agreement. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 348 (1977). *See also In re Pioneer Ford Sales, Inc.*, 729 F.2d 27 (1st Cir. R.I. 1984) (Court addressing whether Section 365(c)(1) proscription applied when Rhode Island statute prohibited franchisee from assigning automobile franchise without franchisor consent); *In re James Cable Partners, L.P.*, 148 B.R. 59 (Bankr. M.D. Ga. 1992) (Court addressing whether Section 365(c)(1) proscription applied to Tennessee city ordinance that prohibited assignment of cable television franchise).

At least one court has taken a more restrictive view, and concluded that only true personal service contracts fall within the ambit of Code Section 365(c)(1). *See In re Terrace Apartments, Ltd.*, 107 B.R. 382 (Bankr. N.D. Ga. 1989) ("Section 365(c) is limited to contracts which are dependent upon a special relationship, special knowledge, special skill, or talent which, under applicable non-bankruptcy law, are non-delegable").

The classic example where this issue arises in the franchise context would be automobile franchises, which, under a variety of state statutes, are frequently non-assignable absent consent of the franchisor. *See e.g. In re Van Ness Auto Plaza, Inc*., 120 B.R. 545 (Bankr. N.D. Cal. 1990) (under California statute, Court looks to reasonableness of Porsche, the franchisor, in deciding that proposed assignee should be rejected as a suitable franchisee).

Non-delegable contracts are subject to the same proscriptions as financial accommodation contracts: They cannot be assumed or assigned. *See Pioneer Ford Sales, Inc.; Tom Stimus Chrysler-Plymouth, Inc.; Wills Motors, Inc.; Van Ness Auto Plaza, Inc.*

As noted by the First Circuit Court of Appeals, Section 365(c)(1) is "an exception to a more general provision, Section 365(f)(1), that allows a trustee in bankruptcy (or a debtor-in-possession) to assign many of the debtor's executory contracts even if the contract itself says that it forbids assignment." *In re Pioneer Ford Sales, Inc.* Moreover, these non-delegable contracts are subject to termination pursuant to the presence of an *ipso facto* clause. *See* 11 U.S.C. Section 365(e)(2)(A).

In the franchise context, Section 365(c)(1) issues have been litigated most frequently when the franchisee wishes to assume and assign the franchise agreement to a third party, over the franchise's objective. *See Pioneer Ford Sales, Inc*. (automobile manufacturer acted reasonably in withholding consent because assignee could not meet working capital requirements); *Tom Stimus Chrysler-Plymouth, Inc*. (debtor allowed to assume automobile franchise agreement, but assignee required to satisfy Section 365 assignee requirements); *Wills Motors, Inc.* (Saab franchisee allowed to assume and assign dealership agreement); and *Van Ness Auto Plaza, Inc*. (franchisor's objection to assumption and assignment upheld on the basis that assignee would not be a suitable Porsche dealer).

In applying Section 365(c)(1) to a franchise agreement, the court must scrutinize the nature of the relationship and applicable non-bankruptcy law. To the extent that a franchisee truly has a unique talent that is being relied upon by the franchisor, or applicable non-bankruptcy law proscribes assignment without consent of the franchisor, the franchisee should be precluded from assuming the franchise agreement without the consent of the franchisor.

As is typical under bankruptcy law, a provision in the franchise agreement that states that it is "non-delegable and personal in nature" would not be dispositive on this issue. *See Pioneer Ford Sales, Inc*. Thus, a sports league's proclamations concerning its franchise agreements are not self-enforcing; the court must make its own determinations.

The court's inquiry in those instances should center on whether a franchisee performs a truly unique service to the franchisor that is non-delegable pursuant to the applicable law. If a franchisee's knowledge or reputation was somehow crucial to its franchisor's willingness to enter into a franchise agreement (for example, the well-known expertise of the franchisee in managing businesses such as this franchise), the franchise agreement could rise to the level of a traditional "personal service" contract. *See* Garner, *Franchise And Dealer Agreements Under Chapter 11 Of The Bankruptcy Code*, 59 American Bankruptcy L.J. 99, 121 (1985).

Where an assignee had a record of losing money and made no showing that it could supply working capital requirements for an automobile dealership, an automobile manufacturer acted reasonably in withholding its consent for the debtor dealership to assign its franchise to assignee. Thus, a franchise was not assignable under Rhode Island and bankruptcy law. *Pioneer Ford Sales, Inc.*

Similarly, due to a California statute prohibiting assignment of automobile dealership franchise rights, if the franchisor reasonably withholds consent; the general rule that anti-assignment provisions were invalid did not apply. *In re Claremont Acquisition Corp., Inc.*, 186 B.R. 977 (Bankr. C.D. Cal. 1995), *affirmed* 113 F.3d 1029, motion to dismiss denied 113 F.3d 1240; *accord, In re Van Ness Auto Plaza, Inc*., 120 B.R. 545 (Bankr. N.D. Cal. 1990).

The courts in these cases do perform a reasonableness review. To translate that into the world of sports, it would presumably be very difficult for any league to demonstrate that the Walt Disney Company or Universal Studios would not be a suitable owner of a professional sports franchise. That would probably apply even in the event that there was a rule, for example, prohibiting hockey team owners from owning a basketball team. However, if a wealthy but eccentric individual, or an individual with a checkered past sought team ownership, the reasonableness threshold would be lower for a league if it refused to consent to an assignment of a franchise.

In a recent case that may prove analogous and which demonstrates the harsh result that might obtain, *In re Catapult Entertainment, Inc.*, 165 F.3d 747 (9th Cir. 1999), the Ninth Circuit decided that federal patent law made a nonexclusive patent license personal and non-delegable, because the identity of the non-debtor party is material. Thus, Section 365(c)(1) barred *even the debtor* from assuming the patent license without the licensor's consent, even where the debtor did not seek to assign the agreement to a third party.

If applied to a sports franchise case, this power to allow for the termination under an *ipso facto* clause of a sports franchise, gives the Leagues' tremendous power in an insolvency situation. So far, no one has been willing to test either the Leagues' resolve, or the court's interpretation of these various provisions, risking the total loss of the franchise, or having to rely upon a relief from forfeiture argument to prevent the termination.

B. **FRANCHISE AGREEMENTS AS FINANCIAL ACCOMMODATION AGREEMENTS**

Under Code Section 365(c), a Chapter 11 debtor is also not allowed to assume or assign an executory contract that is a "contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor." 11 U.S.C. Section 365(c)(2). The NHL has lent funds to its teams on a regular basis, it is not known whether or not other leagues have, as a matter of policy, required lending to their member teams, or provide financing as part of their contractual franchise agreements.

The prohibition against assumption or assignment of a financial accommodation agreement applies even with the consent of the non-debtor parties to the contract. *In re Sun Runner Marine, Inc.*, 945 F.2d 1089 (9th Cir. 1991). Moreover, since an executory contract must be assumed or rejected in its entirety, an executory contract with a financial accommodation clause is generally unassumable in its entirety. *See U.S. Dept. of Air Force v. Carolina Parachute Corp*., 907 F.2d 1469 (4th Cir. N.C. 1990) ("a debtor may not assume the favorable aspects of a contract . . . and reject the unfavorable aspects of the same contract"); *In re Nitec Paper Corp*., 43 B.R. 492 (Bankr. S.D.N.Y. 1984) (debtor cannot assume an executory contract in part and reject in part); *In re Rovine Corp*., 6 B.R. 661 (Bankr. W.D. Tenn. 1980) ("An executory contract must be rejected in its entirety or not at all").

The purposes of the prohibition of assuming/assigning accommodations contracts is to protect a creditor from being forced to extend financing to a party that is under the protections of the Bankruptcy Code. This also protects all other creditors in a Chapter 11 bankruptcy case by forcing a debtor to obtain credit in accordance with Code Section 364.

While *ipso facto* clauses generally are unenforceable against a debtor in bankruptcy under Code Sections 365(b) (1)-(2) and (e)(1), Section 365(e)(2) provides an express exception in the case of financial accommodation contracts. 11 U.S.C. Section 365(e)(2).

C. **DETERMINING WHETHER A FRANCHISE AGREEMENT IS A FINANCIAL ACCOMMODATION AGREEMENT**

While the Bankruptcy Code does not define what constitutes a "financial accommodation," the Ninth Circuit Court of Appeals has defined the term to mean an "extension of money or credit to accommodate another." *Sun Runner Marine, Inc.*; *see also In re Adana Mortg. Bankers*, Inc., 12 B.R. 977 (Bankr. N.D. Ga. 1980).

Franchise agreements frequently include financing arrangements pursuant to which a franchisor directly or indirectly provides financing or credit to its franchisee to allow the acquisition of equipment, inventory, and/or services such as training. For example, franchisors sometimes enter into a variety of indirect financing arrangements with lenders, such as guarantees, repurchase or other similar arrangements, in order to induce the lender to provide its franchisee with various kinds of operating credit. *See* Mazero, *Bankruptcy of the Franchisee: The Franchisor's Initial Strategy*, 4 Franchise L.J. 17, n. 2 (1984). Sports leagues often lend money to teams, and if this is an integral part of the franchise agreement, the league may be able to threaten to revoke the franchise pursuant to Section 365(e)(2). This threat of revocation is a powerful weapon that the NHL has attempted to preserve, as seen above.

Even if the franchise agreement is ultimately found to be a financial accommodation contract, although the franchisor would not be forced to extend trade debt or other financial accommodations to its franchisee, the automatic stay of Section 362(a) should preclude the franchisor from terminating the rights of the franchisee. *See, e.g., In re Computer Communications, Inc*., 824 F.2d 725 (9th Cir. 1987) (even assuming Section 365(e)(2) allowed party to terminate contract with debtor, termination efforts were subject to the automatic stay); *In re Wegner Farms Co.*, 49 B.R. 440 (Bankr. N.D. Iowa 1985) (same).

Therefore, a league will be required to obtain a determination from the Bankruptcy Court that the automatic stay should be lifted before it pursues its remedies. As a practical matter, this determination can also be requested in the form of a cross-motion in the context of objecting to the assumption of the franchise agreement. Clearly, to the extent a franchisee is unable to assume the franchise agreement because it is a financial accommodation contract, this should constitute "cause" for the granting of stay relief under Section 362(d)(1).

In the event that a franchisor supports its franchisee's decision to assume a franchise agreement with a financial accommodation aspect, it is possible to fashion an appropriate solution. The franchisee and franchisor would jointly request that the court approve the franchisee's decision to assume the franchise agreement as modified-the sole modification being the deletion of the financial accommodation aspect of the franchise agreement. Then, to the extent that the franchisor and franchisee wanted to implement this financial accommodation as well, they would do so pursuant to a separate agreement in accordance with Section 364.

V. RESTRICTIVE COVENANTS BARRING RELOCATION OF SPORTS TEAMS IN CONTRACTS UNDER CHAPTER 11 CASES: CAN THEY BE REJECTED?

One of the most potent powers in the arsenal of any debtor is the ability to "reject" executory contracts. Contracts are executory when material "performance remains due to some extent on both sides," where "the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Rejection takes place either as a matter of law or on the motion of the debtor or trustee (whomever is in control of the estate), provided the motion meets the "business judgment" test. The Bankruptcy Code provides that the rejection of an executory contract "constitutes a breach of such contract... immediately before the date of the filing of the petition..." As a result of this deemed breach of the contract, the creditor has an unsecured claim for damages, calculated as of the situation immediately prior to the filing of the bankruptcy petition. The debtor is also excused from further performance with regard to the contract, with the exception of allowing the non-debtor party an appropriate claim to compensate it for the breach.

The nearest analogy to a lease or an agreement with a sports team that includes a covenant to play in a specific arena, or to agree to stay only in one city and not to relocate to another city is an entertainer's agreement to work exclusively for a studio or recording company. In those cases, generally, under state law, the studio or recording company will be entitled to an injunction preventing the artist from working for any other company performing the same type of services for the contract period. There are only a handful of such cases that have been litigated with reported decisions, but there are many similarities to the enforcement of a covenant preventing the relocation of a sports team in bankruptcy, or requiring that a team play only in a specific stadium or arena, particularly one built specifically for that team with public financing. The debtor's good faith in seeking to reject the offending agreement with its restrictive covenants will be of critical importance, just as it has been in cases involving entertainers.

A. REJECTION AND GOOD FAITH

One of the first major cases to consider the issues of the release of a debtor from an entertainment contract under the Bankruptcy Code is *In re Noonan*, from the Southern District of New York. A singer and songwriter known professionally as "Willie Nile" was under contract with Arista Records to produce two records and Arista had the option to extend the contract. Arista had invested $300,000 in Noonan's first two albums, but despite critical acclaim had not recouped its money, and therefore chose to exercise its option requiring that Noonan produce two more records. Noonan filed a Chapter 11 bankruptcy petition, and shortly thereafter converted his case to Chapter 7 so that the Arista contract would be rejected as a matter of law 60-days after the conversion.

Arista, faced with being left with nothing but a monetary claim against an estate with virtually no assets, proposed that the Court reconvert Noonan's case to Chapter 11 and allow Arista to propose its own plan of reorganization. Arista's plan was based upon Noonan being compelled to assume the contract with Arista (*i.e.*, to make it fully enforceable in and after bankruptcy) and continue to exclusively perform under it, while Arista would then contribute some money for Noonan's other creditors.

The *Noonan* Court realized that Arista's plan depended upon Noonan essentially being placed in a form of involuntary servitude, and that this could not be allowed under either bankruptcy or non-bankruptcy law. Further, "Arista's proposed plan would defeat a primary purpose of the Code 'to allow the individual debtor to obtain a fresh start, free from creditor harassment and free from the worries and pressures of too much debt.'" As a result, Arista's motion was denied and the Arista contract was rejected.

The issues raised in the *Noonan* case were revisited, to a radically different conclusion in *In re Carrere*. Tia Carrere had a contract with ABC in August 1985 to perform on the soap opera "General Hospital" until August 1988. She was then offered a lucrative contract to become a regular on "The A-Team" which would pay her considerably more. Carrere filed a Chapter 11 bankruptcy petition in Los Angeles, California, and moved the Court for permission to reject her contract with ABC. ABC opposed the motion for rejection and moved the Court to dismiss the case as being filed in bad faith.

Although noting that the "practical issue" was whether ABC could be deprived of its cause of action for a negative injunction to bar Carrere from working for anyone else in violation of her General Hospital contract, the *Carrere* Court analyzed whether a debtor could reject a personal services contract under 11 U.S.C. Section 365. While *Noonan* held that a personal services contract could not be assumed by the estate, *Carrere* went on to hold that it could not be rejected either. This shifts the "default" position with regard to such contracts from rejection (unless the debtor individually agreed to be bound) to having them "flow through" the bankruptcy process unaffected.

The *Carrere* Court felt (strongly) that it would be inequitable to allow a debtor to reject a personal services contract and so deprive an employer of the unique remedy of an injunction. Carrere did not have significant debts, and her primary motivation behind filing for bankruptcy was to reject the ABC contract. The unsympathetic Court stated that "[t]he Bankruptcy Court is a court of equity, as well as a court of law. It would be inequitable to allow a greedy debtor to seek the equitable protection of this Court when her major motivation is to cut off the equitable remedies of her employer."

Finally, the *Carrere* Court held that even if the contract were rejected, this would just affect the monetary rights of the creditor, and not the equitable remedy of obtaining a negative non-competition injunction under applicable state law. The Court did not provide any extensive analysis to support this conclusion.

The next significant case was *In re Taylor*. James Taylor, the leader of the band "Kool and the Gang" ("The Group") from 1979 until mid-February 1988, was in considerable financial difficulty. The Group was under contract to Delightful Music, Ltd. ("Delightful") and Polygram Records, Inc. to compose and perform at least eight full albums, and even if Taylor left The Group, he would still remain personally obligated under a "leaving member clause." Meanwhile, as the Third Circuit noted,

> “[b]eginning as early as 1985, The Group and its various related corporate entities experienced financial difficulties, apparently due in large part to life-styles involving unduly lavish expenditures, in excess of the substantial income generated by their performances. They borrowed money, from banks, their agent, and their pension funds, and these advances were secured by assignments of future revenues under the recording agreements, as well as by personal guarantees of The Group members, including Mr. Taylor.”

Taylor filed a Chapter 11 petition on May 23, 1988, after only one of the eight required albums had been produced, and moved to reject the contracts. The Court denied motions to dismiss and granted the motions for rejection, and the District Court and the Third Circuit each affirmed in turn.

The Court's rationales were as follows. First, dismissal was inappropriate, as Taylor's liabilities far exceeded his assets, even leaving aside his contingent liabilities for the debts of The Group. As of the petition date,

> "Taylor was in the following unenviable position; he was owed substantial amounts by Group entities, but with virtually no prospect of payment; he was contractually obligated to write and perform enough musical compositions to provide at least seven additional albums, but any revenues these efforts might generate would be retained by The Group's creditors; and he had personally guaranteed the obligations of The Group and its related entities in amounts greatly in excess of the remaining equity in his home, which was his only significant asset."

Second, the Court found that 11 U.S.C. Section 365 did not impose any limits on rejection of personal services contracts, but rather that all executory contracts were rejected unless they were expressly assumed, so that even if a contract could not be assumed without the express consent of the debtor (who would have to perform under the contract), it was still part of the estate and could be rejected, either by motion or as a matter of law. The *Carrere* decision was distinguished as being primarily a bad faith case that should have been dismissed, which thereby mooted the question of whether the contract in that case was eligible for dismissal. Rejection of the contracts would benefit the estate, as it would make available some of the revenues that Taylor would earn from his post-petition work to fund a plan of reorganization. Therefore, the Court approved the rejection.

The *Taylor* decisions did not discuss the issue of whether the rejection of the contracts would expressly terminate the viability of any non-competition clauses or the ability of Polygram or Delightful to seek an injunction to bar Taylor from working for any other record company, but it is clear from the text that the Court believed that Taylor would not be subject to such limitations in the future.

The key principle from the preceding case law, relevant to sports teams, is that a debtor must be acting in good faith in accessing the bankruptcy system. There must be legitimate, quantifiable, economic distress traceable, at least in part, to the contract that the debtor seeks to reject. A pretextual bankruptcy filing merely to obtain a better "deal" for the owner's profit will likely be found to be in bad faith, and will lead to dismissal of the bankruptcy case.

A good faith finding, and even a court approved rejection does not mean, by itself, that the terms of the contract may never be enforced against the debtor in the future. What is not clear is whether rejection will allow for the equitable rights of the non-debtor party to the contract to be terminated as well, leaving the non-debtor party with nothing but a monetary claim for damages against a, perhaps, insolvent estate, or whether such a result could occur even if the contract is deemed non-executory and therefore cannot be rejected. The critical question, therefore with regard to the right to an injunction, has now become not whether the contract is property of the bankruptcy estate, or can be rejected, but whether the debtor's discharge bars the creditor from seeking later equitable relief.

B. INJUNCTIONS, CLAIMS AND THE BANKRUPTCY DISCHARGE: DOES THE EQUITABLE RIGHT TO SEEK AN INJUNCTION CONSTITUTE A CLAIM DISCHARGEABLE IN BANKRUPTCY?

The foundation of the modern American bankruptcy process is the discharge. With certain statutory exceptions a debtor in Chapter 7 or under a confirmed Chapter 11 plan will eventually receive a discharge from his or its debts. Whether a contract is executory, whether it has been formally rejected, if the debtor is going to refuse to comply with the non-competition provisions of an agreement, the question to be decided, either in state or bankruptcy court, is whether non-competition or restrictive covenant provisions (such as agreements not to relocate or to play on in one arena) are still valid and enforceable in spite of the discharge. The specific legal question becomes: does the equitable right to seek an injunction constitute a claim dischargeable in bankruptcy?

A debt, which is subject to the discharge, is defined by the Bankruptcy Code as "liability on a claim." A "claim" is defined in Code Section101(5)(B) in relevant part as a:

> **“right to an equitable remedy for breach or performance if such breach gives rise to a right to payment,** whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.”

The issue to be decided is whether subsection (B) includes a restrictive covenant preventing a sports team from relocating or in the equivalent of a non-competition clause, preventing the team from playing in any other arena or stadium.

One of the most important decisions to examine the meaning of "claim" in depth was the Supreme Court's unanimous opinion in *Ohio v. Kovacs*, 105 S. Ct. at 707. In that case, the state of Ohio had obtained a prepetition judgment against the debtor for violations of environmental laws at a hazardous waste disposal site. The judgment included an injunction to stop any further pollution and to clean up the site, and an award of $75,000 for past damage to wildlife. When Kovacs failed to comply, the state had the option to prosecute him under environmental law or to seek civil or criminal contempt, but instead it obtained the appointment of a receiver over the disposal site, who began the cleanup procedures. Kovacs then filed a personal Chapter 11 petition, which was subsequently converted to Chapter 7.

Ohio sued Kovacs in bankruptcy court, arguing that his obligation to clean up the site was not a claim and therefore could not be discharged in bankruptcy. The Supreme Court unanimously rejected the state's arguments, holding that by appointing the receiver Ohio had chosen to seek damages (as opposed to a criminal prosecution) and thereafter only wanted money to defray the cleanup costs, not any further personal performance. Ohio's rights therefore constituted a claim against Kovacs' estate, which could be discharged in bankruptcy.

The *Kovacs* Court concluded by specifying what it had not decided. Kovacs' discharge did not protect him from criminal prosecution for contempt or for violation of the environmental laws, nor would it cover monetary fines and penalties imposed by the state, which are statutorily exempt from discharge. But the Supreme Court carefully did not determine whether the injunction against polluting the property in the future was dischargeable or not, or if it were not, on what basis. This left for future cases to decide the meaning of *Kovacs* and how it should apply to prospective injunction claims.

The most prominent case that has championed a very limited view of discharge and magnified protection for non-competition agreements is *In re Udell*. Udell was subject to a three-year covenant not to compete against his former employer, Carpetland. After a preliminary injunction was granted to Carpetland to enforce the covenant, Udell filed bankruptcy. Carpetland argued that the injunction (as opposed to its allegations for monetary damages) was not a claim and could not be discharged in bankruptcy. On appeal to the Seventh Circuit, two judges wrote a majority opinion in favor of Carpetland, and a third concurred in the result, though on completely different grounds.

Carpetland argued that its right to an equitable remedy was not a claim because it did not obtain a right to payment from the remedy itself. Udell responded that an equitable remedy was a claim if the breach gave rise to damages. The *Udell* majority began by framing the argument as follows: "[w]e must decide whether Section 101(5)(B) requires any connection between the equitable and the legal remedies beyond the fact that both remedies arise from the same breach of performance." The Court answered the question in the affirmative, holding that an equitable remedy was only dischargeable as a claim *if the remedy itself* also gave rise to monetary damages, not just the originating breach. Damages for breach of a non-competition agreement were only for past violations, while injunctions were designed to deal with future violations. This was in contrast to the cleanup order in *Kovacs*, which was essentially an order to pay money, either directly for the cleanup or to the receiver for his expenses in the clean up. As such, the injunction in question was not a claim dischargeable in bankruptcy, and Carpetland was free to pursue its equitable rights in state court.

Several other courts and commentators have followed the functional rationale of *Udell* that if the injunction is to remedy future violations of the non-competition covenant, and if it does not require the enjoined party to spend any money but rather only requires them to refrain from action, it is not a claim and cannot be discharged. While concurring, Judge Flaum wrote that although he agreed "with the Court's eventual outcome, I am unable to accept the Court's approach which, in my view, dodges this statute's plain language in an effort to reach a sensible result."

Flaum began by admitting that the statute was not ambiguous and said what it said, that a right to an equitable remedy for breach of performance was a claim if the breach gave rise to a right for payment, not the equitable remedy itself. Judge Flaum's concern was that he was unwilling to let Udell escape from the consequences of his wrongdoing (the violation of the contract), but the statute seemed to require him to do so. Therefore, he chose a "different tack" and invoked the "patent absurdity" exception to the plain language canon, the judicial power to ignore the plain language of the statute when to do otherwise would lead to "patently absurd consequences." Judge Flaum expressed his need to do so as follows:

> “If we were to apply the plain text of Section 101(5)(B) to individuals restrained by court orders -- *e.g.* trespassers, polluters, stalkers, batterers -- theoretically, simply by filing bankruptcy, the violator could escape from any restraining order prompted by a breach that also gave rise to an award of monetary damages. Certainly the parade of horribles is extensive, and I need not belabor it further.”

Judge Flaum therefore concurred in the judgment in favor of Carpetland.

The most persuasive response to both *Udell* opinions was written by Judge James Queenan in *In re Ward*. The Wards had formerly operated a franchised maintenance and cleaning service. After their five year franchise expired, the Wards continued to operate a similar service in the area, though under a different name, and the franchisor sued for the violation of the non-competition covenant in the franchise agreement. The Wards then filed joint Chapter 7 bankruptcy petitions, and the franchisor sought an injunction against the Wards' future business activities.

Judge Queenan focused on the key issue: Was the franchisor's right to seek an injunction a claim under the Bankruptcy Code? The plain language of the Code appeared to say that it was. *Kovacs* was "vague" in that it appeared to tie the "claim" nature of an injunction to the requirement that the injunction be used to compel the debtor to pay money, but it also limited its reach to the facts of that case. Other cases either were predicated upon a debtor acting in bad faith (such as *Carrere*) or failed to acknowledge the ability of litigants who were otherwise entitled to an injunction in state court to also receive damages (whether they requested them or not) as part of their overall package of remedies. Queenan analyzed injunctive relief as a preferred remedy, one that avoided the need for future injury, proof of damages, and collection, but still one that was a choice of the plaintiff, who could also sue for damages as they arose. "As an alternative remedy, this right to payment permits a dollar sign to be placed on the equitable remedy, as is done with other claims. Including equitable remedies within the statute's definition of 'claim' is therefore supported by a strong bankruptcy policy -- equal treatment of similar rights."

Udell was the next obstacle. Judge Queenan began by reviewing the same selection from the legislative history of the Code that had been relied upon by the *Udell* majority:

> "Section 101(4)(B) [now Section 101(5)(B)] represents a modification of the House-passed bill to include [sic] the definition of 'claim' a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. This is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative equitable remedy with the result that the equitable remedy will be susceptible to being discharged in bankruptcy. For example, in some states, a judgment for specific performance may be satisfied by an alternative right to payment, in the event performance is refused; in that event the creditor entitled to specific performance would have a 'claim' for purposes of proceeding under Title 11.
>
> On the other hand, rights to an equitable remedy for breach of performance with respect to which such breach does not give rise to a right for payment are not 'claims' and would therefore not be susceptible to discharge in bankruptcy."

This statement parallels the plain language of Section 101(5)(B) that if the breach gives rise to a right for payment, any right to an equitable remedy for that same breach is also a claim. But the *Udell* majority had seized on the phrase "with respect to which such breach does not give rise to a right to payment" in the last sentence as modifying "equitable remedy" instead of "breach of performance" to create a test that was virtually impossible for any injunction to meet (to be classified as a claim), "because equitable remedies are typically designed to provide non-monetary relief." The *Ward* decision also criticized the holding of *Udell* that all rights to payment must be an alternative to the equitable remedy in order for it to be a claim. In *Udell*, Carpetland (outside of bankruptcy) was entitled to a monetary award for its past damages (through a liquidated damages clause), and either an injunction against future violations of the non-competition covenant or a financial claim for lost profits. The fact, therefore, that Carpetland was entitled to both money (for the prior violations) and an injunction did not mean that the injunction was not equivalent to damages (and therefore not a claim). Rather, the injunction was a substitute remedy for a separate set of damages, and therefore was a claim.

With regard to Judge Flaum's concurrence in *Udell*, Judge Queenan noted that Judge Flaum's areas of concern were not truly affected by a straight application of 11 U.S.C. Section 101(5)(B). In the words of Judge Queenan, "[t]he case concerned breach of contract, not trespass, pollution, stalking or battery. Moreover, trespass and the like is prohibited by law, without regard to the existence of an injunction [based on a contractual provision]. So a bankruptcy discharge does not terminate the obligation to refrain from such conduct." Further, although Judge Queenan did not return to it, the *Kovacs* decision specifically stated that a discharge would not affect a debtor's criminal liabilities for prepetition pollution (and also for other criminal activities). The Bankruptcy Code does provide that criminal proceedings and the use of police and regulatory powers are exempt from the automatic stay during the pendency of the bankruptcy case.

The Court therefore concluded that because the franchisor's right to an injunction derived from a breach which was also fully remediable through an award of damages, it was a claim and therefore dischargeable in bankruptcy. *Ward* is not the first decision to hold that if the equitable relief at issue was a substitute for monetary damages, it was a claim. But it is the first to "put it all together," to summarize a coherent analysis of 11 U.S.C. Section 101(5)(B) and dissect the leading case for the opposing point of view. Any party seeking to enforce a non-competition or non-relocation agreement in a bankruptcy case will have to focus upon the *Ward* decision.

One other recent case, *In re Brown*, also analyzed this issue and ruled in favor of dischargeability, though in a somewhat different fashion. The cases of several recording artists were consolidated for determination of the rejection of several entertainment-related contracts and the discharge of the related rights of the non-debtors for injunctive relief to prevent the artists from working for other parties. Bankruptcy Judge Scholl approved the rejection of all of the subject contracts, but held that the issue of whether the non-competition covenants were still valid was either not ripe or not properly before him. On appeal, the District Court held that the matter was ripe for decision, but instead of relying upon either the plain language of the Bankruptcy Code or some combination of legislative history and case law, turned to the underlying state law (that of California) to determine whether or not a state court would consider damages an acceptable alternative. As Brown (the appellant) was not a star at the time the subject contract was signed, but rather was struggling to be discovered, the Court ruled that an injunction was not warranted under California law, and therefore the rejection had terminated all rights of Death Row Records against Brown except for a monetary claim against his bankruptcy estate.

Brown represents a middle position between *Udell* and *Ward*, in that on the one hand the state law was applied directly (as the creditor desired), while on the other the Federal Court reviewed the application in a somewhat more favorable manner than might have been utilized by a state court acting in its own name, and thereby aided the debtor.

C. **THE PENGUINS MARCH 19, 1999 HEARING SEEKING TO DISSOLVE THE RELOCATION NEGOTIATION INJUNCTION**

The Penguins, along with their minority owner, Howard Baldwin, have now renewed the motions to reconsider the Relocation Negotiation Injunction. They rely in large part on the following arguments in seeking to dissolve the Relocation Negotiation Injunction, focusing upon Third Circuit precedents. A claim is "construed broadly to enable a debtor to meet all their legal obligations in bankruptcy and to enable holders of claims to participate in the bankruptcy proceedings." *Airline Pilots Association v. Continental Airlines (In re Continental Airlines)*, 125 F.3d 120, 132 (3rd Cir. 1997), *cert. denied* 118 S.Ct. 1049 (1998). If a breach of a contract gives rise to both an equitable right to relief and to the payment of money, it can be held to be a claim. *See, e.g., U.S. v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1008 (2nd Cir. 1991) (holding that an order to clean up a site to the extent it imposes obligations distinct from obligations to stop or ameliorate ongoing pollution is a claim if the creditor obtaining the order has the option which CERCLA allows, to do the clean up work itself and sue for response costs, thereby converting the injunction into a monetary obligation).

According to the debtors and Baldwin, the Third Circuit, where the Penguins case is pending, has in two cases construed Bankruptcy Code Section 101(5)(B) in a manner which would indicate that the claimed injunction rights, having been reduced to a form of liquidated damages pursuant to the contractual agreements, could be construed to give rise to payments; thus a claim could exist which would therefore be discharged in a bankruptcy. In *In re Torwico Electronics,* 8 F.3d 146, 150 (3rd Cir. 1993), *cert. denied*, 511 U.S. 1046, 114 S.Ct. 1576 (1994), the state of New Jersey sought to force Torwico to clean up an environmentally contaminated site. Torwico no longer owned the site post-petition. The Third Circuit found that because New Jersey had no right to compel payment by Torwico, the clean up order could not constitute a claim within the meaning of Section 101(5)(B). There was no right to payment; thus the injunction would not be dischargeable.

In *Continental Airlines*, the airline pilots' assertions of a breach by Continental of the contractual agreement were held to be a claim that could not be enforced by an injunction or for specific performance. The Court held that the breach of the agreement gave rise to a right to payment and thus it was a claim under the Bankruptcy Code, which could be discharged and not enforced by an injunction.

Since the automatic stay prohibits the enforcement of a claim during a bankruptcy, *See, e.g., In re White Motor Corp.*, 831 F.2d 106, 111-12 (6th Cir. 1987), these same types of claims would be subject to restructuring and discharge under a plan of reorganization under 11 U.S.C. Sections 1129 and 1141. Accord, 124 Cong.Rec. 32393 (1978) (remarks of Rep. Edwards: "Section 101(5) is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative remedy with the result of the equitable remedy will be susceptible to being discharged in bankruptcy.")

The debtors also rely upon Judge Queenan's analysis in *Ward*, as persuasive but not controlling authority.

The opposing parties, seeking to uphold the Relocation Negotiation Injunction (query how necessary an opposing party may be, since this was a *sua sponte* injunction issued by the Court) are not surprisingly those parties who have the contractual benefits of their agreements with the debtors, and seek to keep the Penguins in Pittsburgh without modification of the relocation covenants, or risking rejection of those agreements. The Pittsburgh Arena ("SMG") and the Pittsburgh Authority have cross-moved for a permanent injunction to enforce their lease and agreements, and prohibiting relocation of the team, or even initiating discussions concerning a sale and relocation or a relocation of the Penguins. In addition to seeking to demonstrate that cause exists for the issuance of an injunction to prevent irreparable harm, SMG and the Pittsburgh Authority point to the testimony of the debtors' own expert witness that established teams with a local support base are worth more than new teams starting elsewhere, and that there would be a "devastating drop in local support, in city support and in attendance" if the team committed the disloyal act of shopping itself to other cities. SMG and Pittsburgh Authority believe that the issue of whether the non-relocation covenants can be rejected in bankruptcy is a question of law beyond the scope of the March 19, 1999 hearing, yet they have also moved for a permanent injunction based upon the relocation prohibition covenants in their agreements. They conclude, with respect to the public interest issue that "the presence of a professional hockey team is of incalculable value to the community. Every reduction in the number of home games affects a community's visibility and reputation and removes a unique asset from the quality of life there."

VI. **CONCLUSION**

The *Penguins* case, if it continues to be contentious and no global agreement is reached, will test the limits of the heretofore-special relationships that professional sports have, to a degree, relied upon. The NHL, if forced, may seek to terminate the franchise, and/or may refuse to approve a purchaser that other parties seek to have approved. The Penguins, if they cannot renegotiate their lease and other financial commitments, will seek to sell the team to an entity that will relocate it to another city that will agree to build an arena replete with luxury skyboxes. Or, if the Bankruptcy Court refuses to authorize such a sale, the financially strapped team may simply decide to shut down operations. The debtors made this threat express in their recent motion seeking to dissolve the Relocation Negotiation Injunction: "[T]he Penguins will suffer operating losses of approximately $21,000,000 during the first year of these Chapter 11 cases . . . no reasonable person could expect the debtors' existing partners, or any third party investor, to infuse more than $20,000,000 annually to fund a reorganization plan in these cases which offers no potential return on investment. In sum, the Injunction has radically altered the traditional dynamic between the debtors and their creditors. With the Injunction in place, the debtors' have absolutely no leverage with which to re-negotiate existing credit relationships."

Except, of course, the leverage option that every debtor always has, the right to liquidate. Or, in an apt cross between sports analogies and bankruptcy terminology, there's always the old murder-suicide play.