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## Bankruptcy Court Faces NHL's Right to Choose

### Phoenix Coyotes Decision and the Interplay of Bankruptcy and Sports Law

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**Editor's Note:** For more on this case, listen to the ABI Podcast with Coyotes lead counsel **Tom Salerno** (Squire, Sanders & Dempsey LLP; Phoenix) at <http://podcast.abiworld.org>.

The Phoenix Coyotes, a National Hockey League (NHL) team, spent a highly contentious and rocky six months in bankruptcy proceedings before reaching a resolution on Nov. 2, when it was acquired by the NHL in a \$363 sale. The NHL's bid was significantly lower than that of the other bidder; however, the NHL took the position, wearing its hat as the *NHL* (as opposed to its hat as a competing bidder) that it would not let the competing bidder own an NHL team.

#### Team History and Arena Lease

The Phoenix Coyotes were originally the Winnipeg Jets. The team started to have financial difficulties and was sold to two Phoenix businessmen who relocated the team to Phoenix in 1995. From 1996 until December 2003, the Coyotes shared an arena with the National Basketball Association's (NBA) Phoenix Suns. Although the facility was considered to be a state-of-the-art venue for basketball, it was inadequate for hockey, due in part to the poor sight lines.

In 2001, several entities owned and/or controlled by the then principal owner of the Coyotes, Steve Ellman, entered into an "Arena, Management, Use and Lease Agreement" (AMULA) with the

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City of Glendale, Ariz., to build a new venue for the Coyotes.<sup>2</sup> The Phoenix suburb advanced \$183 million to pay for construction of the arena and issued \$155 million in bonds to finance the project.<sup>3</sup> Glendale's plan was that the arena would be a multi-use sports and entertainment facility serving as the main feature of a planned 223-acre, \$1 billion development,<sup>4</sup> and the project's principal developer was Ellman.<sup>5</sup>

for funding and, pursuant to a consent agreement approved by the NHL, Ellman relinquished all ownership rights to Moyes.<sup>7</sup> Moyes advanced more than \$300 million to operate the Coyotes,<sup>8</sup> but the team failed to record a profit. The operations sustained annual losses in excess of \$36 million in 2006, 2007 and 2008.<sup>9</sup>

In August 2008, Moyes asked for financial assistance from the NHL. The NHL began advancing money to the Coyotes that was supposed to be repaid with the team's future shared league revenue.<sup>10</sup> In addition, the City of Glendale was requested to make economic concessions, but it did not offer any meaningful concessions.<sup>11</sup>

In early 2009, Moyes and the NHL began actively seeking a new owner

## Feature

Pursuant to the AMULA, the Coyotes agreed that they would play all of their home games at the Glendale arena through the 2035 season. Glendale had the right to seek specific performance, and the damages to Glendale would be a liquidated-damages amount calculated by a complex formula starting at nearly \$795 million with specified annual reductions if the agreement was terminated early and no specific performance was available.<sup>6</sup> The Coyotes have played all of their home games in Glendale since December 2003.

Jerry Moyes purchased a minority interest in the Coyotes in 2001. By 2006, Moyes had become its primary source

for the Coyotes. In April 2009, Moyes informed the NHL of interest by Jim Balsillie (co-founder and co-CEO of Research in Motion, the developer of the Blackberry), to buy the Coyotes and relocate the team to Hamilton, Ontario, Canada.<sup>12</sup> NHL Commissioner Gary Bettman told the Moyes group that the NHL would not approve of relocating the team.<sup>13</sup> During this time, the NHL continued to fund the operational shortfall of the Phoenix Coyotes.<sup>14</sup>

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at p. 34.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> Balsillie previously had made similar attempts to purchase the Nashville Predators and Pittsburgh Penguins, but those deals did not work out. Balsillie has been committed to relocating an NHL team to Hamilton, Ontario. In the early 1990s, Hamilton attempted to get an NHL team but lost out to Ottawa. Hamilton was readied with an NHL size arena, and Balsillie began negotiating to secure a lease of that stadium.

<sup>13</sup> June 15 Opinion at p. 34.

<sup>14</sup> *Id.*

<sup>1</sup> A special thanks to Melissa Mistretta, director of Levenfeld Pearlstein's Knowledge Management Group, for her assistance in performing research for this article.

<sup>2</sup> Order dated Sept. 30, 2009, at p. 4., *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488) (the Sept. 30 Order).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at p. 5.

<sup>6</sup> Opinion dated June 15, 2009, *In re Dewey Ranch Hockey LLC*, 406 B.R. 30, 33 (Bankr. D. Ariz. 2009) (No. 09-09488) (the June 15 Opinion).

## The Chapter 11 Filing

On May 5, 2009, the Coyotes' holding company, Dewey Ranch Hockey LLC, filed for chapter 11 in Arizona.<sup>15</sup> That same day, Moyes announced the sale of the Coyotes to PSE Sports and Entertainment (PSE), headed by Balsillie, for \$212.5 million.

The developments took many by surprise, including the NHL. The league was believed to be in the midst of negotiating the sale to Jerry Reinsdorf, the principal owner of the Chicago White Sox and Chicago Bulls. Reinsdorf's offer was much less than PSE's \$212.5 million, but Reinsdorf had no intention of relocating the team out of Glendale, which was very important to the NHL. The debtor filed a motion asking the bankruptcy court to approve the sale to PSE, and to allow PSE to relocate the team to Hamilton. The NHL and the City of Glendale (among others) opposed the motion.

The NHL vehemently argued that Moyes had no ownership authority regarding the Coyotes since the NHL had been funding the team since August 2008.<sup>16</sup> The NHL also argued that Moyes failed to file the necessary applications with the NHL for it to approve either the change in ownership or the relocation of the team.<sup>17</sup> The NBA, the National Football League (NFL) and Major League Baseball collectively filed an *amici curiae* brief supporting the NHL's position, taking the stance that approving the sale would ultimately disrupt the business of professional sports.<sup>18</sup>

Judge Redfield Baum did not grant the debtor's motion, holding that the court needed more time to decide the issues.<sup>19</sup> The decision did not rule out PSE's purchase of the Coyotes nor the relocation to Hamilton, but it did rule out any chance of the Coyotes' relocation in time for the 2009-10 season, as Balsillie had hoped.

## The Auction

On July 9, the court set two separate auction dates for the Coyotes. The first auction was to be only for bidders who would keep the team in Glendale for at least five years. The second auction would be for bidders who could try to

relocate at any time (with the approval of the NHL).<sup>20</sup> The first auction was initially set for Aug. 20, and the second auction was set for Sept. 10.<sup>21</sup>

Ultimately, one auction took place on Sept. 10, open to all bidders, regardless of intent to relocate.<sup>22</sup> Just before the auction, Reinsdorf and Ice Edge, another potential bidder, both publically stated that they would not be submitting bids for the court auction, leaving only PSE and the NHL.<sup>23</sup>

The NHL's final bid was for \$140 million, which was to be reduced by the payment of the secured debt due to New York-based lender SOF Investments and the NHL, and specific cure costs and trade debt (totaling \$11.6 million).<sup>24</sup> The court noted that the bid appeared to be intended to pay the unsecured creditors in full, in cash, but excluding in whole any claims by Moyes or Moyes' affiliates and any claims of hockey icon Wayne Gretzky (its coach and minority owner).<sup>25</sup> The NHL's bid committed to perform all obligations under the Glendale lease through the 2009-10 season, while working during that time to find a buyer who would keep the team in Glendale.<sup>26</sup> If at the end of that season there was no new owner, the NHL planned to sell the team "pursuant to a professionally conducted relocation sales process."<sup>27</sup>

PSE's final bid, on the other hand, was for \$212.5 million and was expressly conditioned on the court approving the relocation of the Coyotes to Hamilton.<sup>28</sup> PSE also agreed to pay the same group of unsecured creditors as the NHL, whose claims totaled approximately \$11.6 million.<sup>29</sup> In addition, PSE offered to pay Glendale \$50 million if it would withdraw its objection of the sale to PSE.<sup>30</sup>

## Failure of Both Bids to Provide Adequate Protection

Both bidders submitted voluminous documentation in support of their bids and opposing the other.<sup>31</sup> PSE argued that the court had the power and authority to approve the sale to PSE, as well as

authorize and mandate the relocation to Hamilton.<sup>32</sup> PSE asserted that §365 allowed the debtor to assume and assign the executory contract rights of the Coyotes, and that §363 then allowed the sale of those rights free and clear of the contractual restrictions of the NHL and Glendale that required the Coyotes to play all home games in Glendale.<sup>33</sup>

PSE further argued that the NHL's actions regarding its bid constituted a breach of the duty of good faith and fair dealing.<sup>34</sup> To support those claims, PSE made many arguments, including the assertion that once the NHL became a bidder for the Coyotes, it forfeited its right to decide the membership or relocation requests by the Coyotes and PSE and/or to determine the relocation fee due it.<sup>35</sup>

The NHL, among other points, argued that §365 did not provide a basis for a forced relocation of the team, but rather allowed only for the assumption and assignment of a contract that required the Coyotes to play their home games in Glendale.<sup>36</sup> The NHL claimed that the debtors and Moyes had breached their duty of good faith and fair dealing, and asserted that the PSE bid could not adequately protect the interests of the NHL, as required by §363(e).

Glendale argued that its claimed contractual right to specific performance under the lease was an interest under §363, and that the Bankruptcy Code did not allow a sale free and clear of that interest. Glendale also asserted that its interest could not be adequately protected by §363(e), and that the proposed relocation to Hamilton did not meet the good-faith requirements of §363. Glendale further argued that the bankruptcy case and the proposed sale to PSE were used solely to benefit Moyes, and that Moyes' control of the auction process had improperly chilled bidding.

On Sept. 30, Judge Baum rejected both parties' auction bids, denying the PSE bid *with prejudice* and the NHL bid *without prejudice*. Judge Baum determined that PSE could not adequately protect the NHL's noneconomic interests, and therefore found that §363(e) required him to prohibit any sale to PSE that would result in a forced relocation from Glendale.<sup>37</sup>

Judge Baum noted that in most cases, a party's interest in property sold under §363 is purely an economic interest,

<sup>15</sup> In its bankruptcy petition, the debtor named approximately 30 creditors. The main creditors were Moyes, the NHL, the City of Glendale, Aramark and SOF Investments. Aramark was the exclusive manager of concessions at the Glendale stadium, and SOF Investments was the largest secured creditor with a debt of \$80 million. See debtor's chapter 11 petition, *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>16</sup> June 15 Opinion, *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at p. 35.

<sup>20</sup> Sept. 30 Order at p. 8., *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>21</sup> *Id.*

<sup>22</sup> The NHL requested and received a continuance of the first nonrelocation bidders-only auction to the Sept. 10, 2009, date (*Id.* at p. 12-13), but the court denied the NHL's request to continue the relocation auction until after the end of the 2009-10 season. *Id.* at p. 13.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at p. 13-14, 17.

<sup>25</sup> *Id.* at p. 14.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at p. 17.

<sup>29</sup> *Id.*

<sup>30</sup> PSE would lower its overall bid by \$20 million if the offer to Glendale was accepted. In other words, if Glendale accepted the \$50 million offer, a net total of \$30 million would be effectively added to the PSE bid, raising it to \$242.5 million. Both were cash bids. *Id.*

<sup>31</sup> *Id.* at p. 18-25.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at p. 22-23.

capable of being adequately protected by impounding funds to protect such interest. In the case at hand, the court found that the NHL had three important *noneconomic interests*: (1) the right to admit only new members who met the NHL's written requirements, (2) the right to control where its members play their home hockey games and (3) the right to a relocation fee, where appropriate.<sup>38</sup> The court found that the NHL's noneconomic interests could simply not be adequately protected by PSE's proposed payment of a relocation fee.

Prior to this ruling, the NHL Board of Governors voted *unanimously* on July 29 not to approve PSE's/Balsillie's application because Balsillie did not have the "character and integrity" required under NHL bylaw 35 to be an owner of a NHL team.<sup>39</sup> In addition, although Balsillie had "sufficient financial means to ensure the financial stability of the Coyotes" there was a belief among the governors that Balsillie "was not willing to comply with League rules and procedures and would not be a good business partner."<sup>40</sup> Throughout its various briefings, the NHL stressed that it had the right to choose its owners and that "ownership involves relationships of trust and confidence" and set forth numerous reasons for the apparent dislike of Balsillie.<sup>41</sup>

At the end of the day, the court appeared to rely most heavily on the case law championed by the NHL that provides that unincorporated associations (like the NHL) have the "sole power to say who shall belong and who shall not."<sup>42</sup> As the NHL argued, "courts have repeatedly recognized that the governing bodies of sports leagues have the right to choose their fellow owners."<sup>43</sup> The NHL repeatedly emphasized "how important...character and trustworthiness considerations are in the context of professional sports leagues. The NHL Board of Governors, like the governing bodies of every professional sports league, is made up of

joint decision makers in an economically interdependent venture."<sup>44</sup>

The court found itself bound by the mandatory restrictions under §363(e) and prohibited the sale to PSE. To put the nail in PSE's coffin, the court expressly stated that "[t]his conclusion effectively is the end for the efforts of PSE, Balsillie, Moyes and the Coyotes to force a sale and relocation of the hockey team."<sup>45</sup>

While the NHL bid was also rejected, it was done so with a far softer hand, with the court opening its analysis by stating that "[t]here are multiple factors that support the NHL bid."<sup>46</sup> The court looked favorably on the fact that the NHL's bid would pay the secured creditors in full and would make a substantial payment to the unsecured creditors.

Judge Baum rejected that bid, however, because it permitted the NHL to unilaterally select the creditors that would be paid, and it appeared that the NHL intended to pay all of its creditors with the sole exception of Moyes, Moyes affiliates and Gretzky. Recognizing that a 363 sale could deprive parties of rights inherent in the plan confirmation process, Judge Baum determined that the NHL's bid should not be allowed to discriminate unfairly among the unsecured creditors.<sup>47</sup> The court held that it would be "inherently unjust for this court to deprive [Moyes and Gretzky] of their possible rightful share of any proceeds without first providing all involved a fair trial on their claims" and allowed the NHL the opportunity to cure this defect and present a revised bid.<sup>48</sup> The NHL revised its bid and resubmitted it to the court.

### **NHL Becomes the Proud (Interim) Owner**

On Oct. 26, 2009, Moyes agreed to sell the Coyotes to the NHL for \$140 million: While \$128 million is the official figure, the NHL will spend another \$11.6 million to purchase the claims of certain unsecured creditors. Judge Baum approved the sale on Nov. 2. Moyes had stood to make approximately \$100 million from the sale to PSE, but the sale to the NHL, on the other hand, left less than \$11 million to be divided amongst Moyes, Gretzky and Glendale.

The NHL will work to find a buyer for the Coyotes that will keep the team in the Phoenix area and try to stabilize the team's operations as quickly as possible. If the NHL cannot find a buyer that will keep the team in the area, then the NHL will consider relocating the team.

### **Other Aspects of the Case**

Throughout this arduous process, a number of interesting side issues were raised by the various parties, which colored the arguments but did not appear to have a direct impact on the court's final ruling. Here are a few examples:

- The NHL raised the argument that the bid with the highest numerical dollar amount in a §363 sale is not always the highest and best bid.<sup>49</sup> This argument, while correct, does not appear to have required extensive consideration by the court. Under the court's holding, the PSE bid was never a viable bid that it could have considered and approved, regardless of the dollar amount.
- PSE raised allegations of bad faith with respect to the NHL's bid.<sup>50</sup> The NHL countered that it submitted a bid to preserve the possibility of the auction because all other bidders had dropped out.<sup>51</sup> Again, this was not a driver.
- The debtors tried to discredit the NHL's bid on the grounds that the "NHL Bid contemplates a possible relocation sale of the Phoenix Coyotes after the NHL purchases it, despite demonizing the debtors for attempting the sale thing pre- and postpetition."<sup>52</sup> This argument side-stepped the NHL's clear intent to find a buyer who would keep the team in Phoenix, allowing relocation only if those efforts failed, and also what ended up being the most significant driver in the case: the NHL's right to decide who could join its association.

### **Conclusion**

In the end, a far lower bid prevailed because the court could not find that the interests of the NHL were adequately protected by the higher bid. This is an interesting case for a number of reasons:

<sup>38</sup> *Id.* at p. 24.

<sup>39</sup> *Id.* at p. 8. The Board of Governors did approve an ownership transfer to the Reinsdorf group. *Id.*

<sup>40</sup> *Id.* at p. 11.

<sup>41</sup> "As Mr. Balsillie told the press on May 15, 2009, 'I spent five years looking for a front door... We couldn't find a front door. I found a side door.' Similarly, Mr. Rodier [Balsillie's attorney] told the press on May 19, 2009, that his and Mr. Balsillie's 'strategy is to buy an NHL team out of bankruptcy and then move it over the league's objections, by winning an antitrust lawsuit if necessary.'" NHL's Reply in Support of Determination that Debtors' NHL Membership Rights May Not Be Transferred to PSE or an Affiliate Thereof (public version), dated Aug. 31, 2009 (NHL's Membership Rights Reply), at p. 15, *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>42</sup> *Id.* at p. 19 (citing *Arnstein v. Am. Soc'y of Composers, Authors & Publishers*, 29 F.Supp. 388, 393 (S.D.N.Y. 1939)).

<sup>43</sup> *Id.* at p. 20 (citing *Levin v. NBA*, 385 F.Supp. 149, 151-53 (S.D.N.Y. 1974); *Fishman v. Estate of Wirtz*, 807 F.2d 520, 562 (7th Cir. 1986); *Mid-S. Grizzlies v. NFL*, 550 F.Supp. 558 (E.D. Pa. 1982)).

<sup>44</sup> Motion of National Hockey League for a Determination that Debtors' NHL Membership Rights May Not Be Transferred to PSE or an Affiliate Thereof, dated Aug. 31, 2009, at p. 10, *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>45</sup> Sept. 30 Order at p. 25.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at p. 26. This argument was raised by the debtors in their objection to the NHL's Offer to Purchase the Assets of Coyote Hockey and Arena Management, dated Sept. 1, 2009 (Debtors' Objection to NHL's Offer), p. 3, *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>48</sup> *Id.* at p. 27.

<sup>49</sup> NHL's Brief in Support of the Sale of Assets to and Assumption of Liabilities by Coyotes Newco LLC and Arena Newco LLC (public version), dated Sept. 10, 2009, at p. 14-15; *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>50</sup> See, e.g., PSE's Motion for Determination that the Coyotes May Be Relocated to Hamilton Notwithstanding the NHL's Refusal to Consent, dated Aug. 28, 2009, at p. 2, 8-9; *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>51</sup> The NHL's Omnibus Reply in Support of the Sale of Assets to and Assumption of Liabilities by Coyotes Newco, LLC and Arena Newco, LLC, dated Sept. 4, 2009, at p. 2, 4-5; *In re Dewey Ranch Hockey LLC*, 406 B.R. 30 (Bankr. D. Ariz. 2009) (No. 09-09488).

<sup>52</sup> Debtors' objection to NHL's offer, p. 3.

- It certainly has some worthwhile discussion about good and bad faith in the context of a sale process.
- It is a good place to look for cites to cases to support the argument that a highest bid is not always entitled to win an auction.
- It is a great case to see world-class lawyering. From our seats in the proverbial stands, we applaud counsel for what we believe must have been a tactical decision not to try to take the “you can’t join my club” line of cases head-on and, instead, for choosing to get the result its client wanted by making the legal arguments it did make.

The court’s decision is a welcome one from the perspective of all professional sports leagues and serves as a warning to potential buyers of franchised teams that bankruptcy will not likely be an easy way of circumventing league rules and regulations regarding team ownership and relocation. ■

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