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LESSONS LEARNED: KEEPING THE COYOTES

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- **Background and City of Glendale's role in the bankruptcy case of the National Hockey League's Phoenix Coyotes**
    - In 2001, the City negotiated a deal with the Coyotes to bring the team from downtown Phoenix to Glendale by building a state of the art hockey arena.
    - The $180 million investment was premised on a 25 year commitment by the Team to play its hockey games at the Glendale arena and no other location. The City's investment was part of its sponsorship of the $750 million private development of the Westgate City Center (shopping mall, hotel, entertainment, etc).
    - The Team's covenant not to relocate the Team was included in the Arena lease and use agreement, and was enforceable by specific performance.
    - Under the Agreement, if specific performance was not available (e.g., players strike in 2004 or arena destroyed by casualty event), then the City was entitled to liquidated damages in excess of $700 million (with the exact amount calculated based on expected tax revenue from the Westgate development).
    - The Coyotes' bankruptcy filing was premised on a new owner's moving the team to Canada and breaching the non-relocation covenant in its agreement with the City with the risk of losing the Team within 5 years of building the arena
    - The City immediately filed a complaint seeking injunction to prevent the Team from breaching the non-relocation covenant.
- **Does the City's right to specific performance survive bankruptcy?**
    - Outside of bankruptcy, state law permits specific performance if certain conditions are met:
        - contract;
        - the terms are certain and fair;
        - hardship of specific performance does not outweigh benefit to the party seeking specific performance; and
        - no adequate remedy at law.

      These elements were each stipulated by the Team in the contract.
    - Bankruptcy Code §365 – a debtor may reject contracts based on its business judgment - rejection power is used as an opportunity to shed burdensome contracts and allow fresh start. Rejection is deemed a breach and gives rise to damages, but the damage claim is subject to discharge.
    - City's Argument 1: Right to specific performance (an equitable remedy) is not impacted by the bankruptcy proceedings because it is not a dischargeable claim:
        - "Claim" – broadly defined but must ultimately be something that gives rise to a right to payment;

        - Line of cases that say the right to specific performance of non-compete agreements is not a "claim" because it cannot be reduced to a right to payment. Another case in 3rd circuit involving clean-up of environmental damages (Torwico) also held that such equitable remedy was not a claim;
        - Penguins bankruptcy case in 1998/1999 was on almost identical facts, judge held that the right to specific performance of non-relocation provision was not a claim and would not be discharged in bankruptcy*;*
        - Debtor focused on another line of cases that held that violations of non-competes can be reduced to a monetary figure; and
        - Case law uncertain but City of Glendale felt it had the more compelling argument because of non-economic aspects of having a professional sports team ("community asset," supports local economy, jobs).
    - City's Argument 2: Even if it is considered a claim, rejection of the contract should not be allowed because rejection would cause disproportionate harm to the City as compared to the marginal benefit to the debtors
        - We found unique 9th Circuit law that analyzes harm versus benefit; other courts generally defer to business judgment.
        - Harm = $500+ million in lost revenue, loss of community asset, jobs, goodwill
        - Benefit: higher sale price paid by buyers wanting to relocate (versus local bidder)
        - The City argued that even if you could get a higher price for a relocation sale, the City's claims from rejection (based on the liquidated damages calculation) would dilute recoveries to all creditors and thus there would actually be no benefit to creditors.
            - Stay sale: $140 million cash and $175 million in claims
            - Relocation sale: $220 million in cash and $750 million in claims
        - Ultimate test is what is in the best interest of creditors
    - The City believed that these arguments provided sufficient basis to prevent a relocation of the Team

- **Curve-ball: What if the City's damages claims were "capped?"**
    - The arena contract was a multi-part agreement providing for a license to use the arena for games, rights to manage the facility for a fee and a lease of locker rooms and office space. The Team argued that because the agreement also contained a fairly customary "lease" provision, the bankruptcy code section which caps claims of landlords to 3 years of rent (§506(b)(6) was applicable.
    - If it applies, then the City's claim is reduced to $6 million (from $750 million) and so in the "best interest of all creditors."

- The difficulty of having multiple agreements packed into one; limited applicable case law given the unique nature of the contract.
- It remains an unresolved issue in the case.

- **The Interim Result**
  - When these issues were briefed as part of the Team's attempt to close a sale to Jim Balsillie by June 29, the court ruled that it did not have enough time to resolve all of the issues (Glendale's and the NHL's) and so it vacated the auction date and sale process.
    - Interestingly, in the best interest of creditors analysis the court indicated that the split among creditors was an important factor to consider (Glendale, NHL and Aramark weighed in against relocation, while Jerry Moyes (owner) and the trade creditor committee supported relocation).
  - Following further briefing as part of subsequent auction process, the court again avoided ruling on the "numerous issues regarding Glendale and the [arena contract]" and ruled that a relocation sale could not be approved over the NHL's rights under its constitution to choose owners and the location of teams (subject to anti-trust rules).
  - As part of the sale of the Team to NHL, the debtors agreed that they would not seek rejection of the Arena contract until June 30, 2010. The debtors would not agree to an extension and have rejected the contract. The City has reached a deal with the NHL to keep the Team in Glendale for the 2010-2011 NHL season. So the City's issues remain open as the NHL continues to look for a buyer for the team
  - At present, the Team continues to play in Glendale, and Glendale remains subject to the risk of losing the Team leaving after the 2010-2011 NHL season.

- **Lessons learned**

1. The Agreements for the long-term exclusive use of a municipal-owned stadium, arena or other significant facility should be split into 3 separate agreements: (i) a management agreement, (ii) a lease and (iii) an agreement related to the exclusive use covenant. Each agreement should expressly state that it is independent from the other agreements and separately enforceable. Each agreement should describe the consideration provided/received. As there seems to be little gained by having them (as a practical matter), consider having no cross-default provisions (to minimize risk of the 3 agreements being deemed as one in substance).

2. The exclusive use covenant should contain an acknowledgment by the parties that it is not a "lease" under state law.

3. The exclusive use covenant should make clear that it is binding on subsequent owners of the actual user (such as the Coyotes NHL franchise) (in addition to the standard language that it is binding on successors and assigns).

4. The "lease" document should clearly pertain only to the "exclusive spaces" and expressly provide that it is not a lease of the entire facility.

5. Where applicable, the agreement should also recite that the "rent" payable under the separate "lease" is merely compensation for the use of the rental space, and does not constitute consideration for the many other benefits provided by the municipality to the user (especially the use of the facility's other spaces for games and other events).

6. In an ideal world, the municipality would get a separate promise (even some sort of limited covenant) from the user's sponsor itself to not move the franchise except under very specific conditions (e.g., gross financial failure of the Coyotes in Glendale, NHL consolidation, etc.).

7. It is important to obtain a "bad boy" guaranty if at all possible from the ultimate owner or other financially capable party, kicking in only if the exclusive use covenant is violated.

8. If at all possible, take a pledge of the ownership interests in the user (such as from the owner of the NHL's Coyotes) to secure (even if on a non-recourse basis) the exclusive use covenant. This pledge, in the case of a professional sports league, would require league approval (as, for example, the NHL Constitution prohibits the pledge of an owner's stock).