L.A. Dodgers Secret TV Deal With MLB Fuels Spending Spree

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A television camera focuses on catcher Dioner Navarro of the Los Angeles Dodgers in the dugout before the game with the Houston Astros at Dodger Stadium in Los Angeles. Photographer: Stephen Dunn/Getty Images

Sept. 27 (Bloomberg) -- The Los Angeles Dodgers have shot out of bankruptcy and into the ranks of baseball’s biggest spenders, fueled partly by a secret agreement between former owner Frank McCourt and Major League Baseball that may limit the revenue the team is obliged to share with less prosperous clubs.

A settlement ending their 2011 battle in U.S. Bankruptcy Court gives the Dodgers’ new owners a chance to cap income subject to revenue-sharing from a proposed regional sports network at about $84 million a year, according to five people familiar with the confidential “special terms.” With TV sports-rights experts saying the team could get as much as $225 million a year from a network’s rights fees, the Dodgers may enjoy an annual unshared windfall of as much as $141 million.

The “special terms” help explain the Dodgers’ improved finances since emerging from bankruptcy in April by being sold to a group led by Guggenheim Partners for $2.15 billion. That sum was almost twice the record price for a U.S. sports team, and the new owners have been acquiring stars such as infielders Adrian Gonzalez and Hanley Ramirez, committing more than $400 million to multiyear contracts.

"It's an incredibly great deal for the new ownership that was obviously a factor in the amount of money they were willing to pay," said Michael Cramer, who handled TV rights while president of the Texas Rangers and now heads a University of Texas sports and media studies program. "Any team in the league would say, 'Can I have that?' It's going to create a lot of owners saying, 'Where's mine?'"

MLB Dispute

While MLB disputes the extent of the revenue-sharing break afforded by these "special terms," the settlement cedes authority over their interpretation to a court-appointed arbitrator, retired federal judge Joseph Farnan. He acted as a mediator prior to the settlement and during the Dodgers' auction.

The "special terms" set the Dodgers' annual TV rights fees from the regional network at about $84 million, plus a 4 percent annual escalator, for the life of whatever contract the team signs setting up the network, said the people familiar with the terms. The special terms establishing the $84 million rights fee plus escalator was earlier reported by the Los Angeles Times.

That figure sets the amount of revenue the Dodgers must share. Baseball rules require that big-market teams share 34 percent of regional network rights fees with small-market teams. Unlike National Football League franchises, which get equal parts of league-negotiated TV rights fees, MLB teams have widely disparate broadcast revenues. The 34 percent revenue-sharing requirement is meant to level the financial playing field a bit, though Cramer said accounting techniques often limit the tab for teams with part-ownership of a regional network.

Money Stays

"You simply don't pay the team if you're the owner of the channel; the money stays in the network," he said. "It's a contractual relationship with yourself."

The Dodgers TV rights valuation was fixed almost one year before the start of talks on a new contract, under the terms of its current one with Fox Sports, at a time of soaring TV broadcast rights deals. Though $84 million is about double the Dodgers' present rights fees, it became a below-market sum the month after the settlement. Fox Sports is a unit of News Corp.

The Los Angeles Angels, the market's number two baseball team, signed a 17-year $2.5 billion regional network contract in December with Fox Sports, according to Forbes. The number one Dodgers' leverage on TV rights has been increased by intense competition for local sports programming in Southern California.

The Los Angeles Lakers more than tripled broadcast revenue by signing a deal with Time Warner Cable last year which brings $200 million a year over the contract's guaranteed 15 years, according to Forbes. The cable operator has built two new regional sports networks around the NBA team, one English-language and one Spanish-language.

Dodger Network

Ed Desser, a Santa Monica, California-based TV sports-rights consultant who advised the Lakers in negotiations, projects that the Dodgers' annual rights fees from a regional network would average $175 million to $225 million over a 20-year contract. If the team owned a stake in the enterprise, it could take the difference between $84 million and the Desser-projected range in dividends, an unshared source of income.

The settlement allows the Dodgers to create a network on which revenue-sharing would be effectively capped at about $84 million, plus the annual 4 percent escalator, depending on how the contract is crafted and the entity is structured, according to two people familiar with the special terms. Comparing the cap amount with Desser's highest estimate of rights fees means the network may generate an annual windfall of $141 million.

Actual Fees

It doesn't work that way, said Robert Manfred Jr., an MLB executive vice president who oversees revenue-sharing matters. If the Dodgers command a premium for TV rights, the team must share revenue based on its fees income from the actual contract, according to Manfred, not the settlement-set $84 million a year level.

"The basic treatment is exactly the same as every other team in baseball," Manfred said. "Any dollar that's actually received in rights fees or signing bonus by the Dodgers is subject to revenue-sharing."

He said the auction produced high offers not because of the special terms but because a flagship baseball team was available in America's second biggest media market and under favorable circumstances.

Attractive Opportunity

"The Dodgers contract was expiring at a time when there was fierce competition in the L.A. broadcast market," Manfred said. "The opportunity to exploit that situation was very attractive to the bidders."

The Dodgers' spending spree on players hasn't paid off so far this season. Since an August 25 trade with the Boston Red Sox, which landed four players with more than $260 million of contract obligations, the Dodgers have lost 17 of 29 games, damaging their chances to make the National League playoffs.

Torie von Alt, a spokeswoman for Guggenheim, said executives at the firm would have no comment. Mark Walter, chief executive officer of the Chicago-based investment firm, is the Dodgers' controlling partner. Stan Kasten, the team's president, also declined to comment.

The "special terms" was only one of MLB's departures from its usual team sale procedures. McCourt, not Selig, picked the winning offer, from a list of bidders pre-approved by MLB. U.S. Bankruptcy Court Judge Kevin Gross, not baseball's owners, made the ultimate approval. Joseph Farnan, the retired judge, was empowered to resolve disputes in the course of the Dodgers' auction and decide the special terms' interpretation.

Eager MLB

Taken altogether, the settlement terms suggest MLB was so eager to get McCourt out as owner and to avert an open-court airing of charges he'd leveled against Selig in filings that it made significant concessions, said Phoenix bankruptcy attorney Thomas Salerno.

"McCourt had a lot of leverage, because MLB did not want a public hearing on the inconsistencies with which it treats teams," said Salerno, who represented the National Hockey League's Phoenix Coyotes in bankruptcy proceedings in 2009.

Robert Siegfried, a spokesman for McCourt, said the former owner declined to comment. Manfred said MLB's decision to settle was motivated solely by its desire to bring about a transfer of Dodgers ownership quickly.

After the settlement was reached, disagreements broke out about how to interpret the "special terms," according to four people familiar with the events. They are considered so sensitive that only a few numbered copies were made. Gross reviewed them, but didn't keep a copy and never made them part of the official court record.

Secret Language

Manfred said team owners were briefed on this provision of the settlement, but language of the "special terms" remains secret. How much money, if any, will be shared beyond the $84 million plus escalator limit depends on how the network's contract is structured. In case of disputes, Judge Farnan will have the final say.

At an April 13 court hearing to confirm the team's sale, Dodgers attorney Bruce Bennett said the mediator had already heard three disputes concerning the special terms during the auction process, and "in all three of these mediations, Judge Farnan found that Major League Baseball's interpretation was wrong and that the (Dodgers) or the bidder whose proposal was involved was correct."

Arbitration Powers

At the same hearing, MLB attorney Thomas Lauria argued that Farnan's arbitration powers should end with the close of the Dodgers' sale, saying, "Not one of the other teams has this mechanism where they can go to a mediator to get enforcement or seek enforcement or get other remedies that are not subject to anybody else's review. We've got a league. Everybody's got to be the same; you can't have the Dodgers and 29 others."

The argument didn't persuade Judge Gross. Still, special treatment for the Dodgers bodes ill for baseball, said Andy Dolich, a former Oakland Athletics executive vice president and member of one of the bidding groups in the Dodgers auction.

"If you don't have a codified set of rules that everybody is playing with then you have a different game," said Dolich, who has also held management positions in the other three major U.S. sports leagues. "The ongoing divide between top and bottom in all sports creates a dynamic of question marks."

In 2004, MLB violated its own 60/40 rule, requiring teams to maintain a ratio of 60 percent equity to 40 percent debt, in approving McCourt's $421 million purchase of the Dodgers. He did it "entirely with borrowed funds," according to a bankruptcy court filing by baseball's lawyers.

News Corp. Pressure

Selig bowed to pressure from seller News Corp. to approve McCourt, who, unlike some other potential bidders, had agreed to extend the Dodgers broadcast contract with Fox Sports for 10 years, according to people familiar with the transaction. Fox was paying baseball $420 million a year at the time for national broadcast rights.

News Corp. advanced almost half the purchase price, according to sale documents, with most of its $196 million of loans secured by McCourt-owned Boston real estate.

McCourt turned to Fox Sports for a financial lifeline again in June 2011, when the Dodgers were in a cash crunch and faced with the possibility of missing payroll. He negotiated a 17-year, $3 billion contract extension of the Dodgers broadcast deal, with a $385 million upfront payment which would have both provided liquidity to the team and enabled the owner to pay a divorce settlement and satisfy personal debts.

Selig rejected the deal, which in its first year would have paid the Dodgers $84 million in rights fees, saying in a June 20 letter to McCourt that a desperation-driven contract "failed to fully maximize rights fees through a competitive process, as the Los Angeles Lakers recently did... By disapproving the proposed transaction, I am ensuring that Los Angeles Dodgers LLC will have the opportunity to fully exploit its media rights."

A week later, McCourt put the Dodgers into bankruptcy.

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