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Feature

*18 TEXAS RANGERS PLAY BALL IN BANKRUPTCY ARENA
Part II: Possible Conflicts between Sports Leagues' Goals and the Code

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Part I discussed the early innings of the Rangers bankruptcy case. [1] Another article appeared in the September 2010 issue of the *Journal* on the potential conflicts between the goals of professional sports leagues and the Bankruptcy Code with regard to the sale of a professional sports franchise, and reviewed these potential conflicts in the context of the Rangers' and the Phoenix Coyotes' bankruptcy cases. [2] In this article, the authors will focus on the novel corporate governance issues addressed in the Rangers bankruptcy case. Let's first examine the line-up.

Who's on First?

The debtor, Texas Rangers Baseball Partners (Rangers Partners), a Texas general partnership, owned and operated the Texas Rangers (Rangers). Rangers Equity Holdings LP (REHLP) is a 99 percent general partner, and Rangers Equity Holdings GP LLC (REHGP) is a I percent general partner in the debtor (collectively, the "Rangers' equity owners"). The Rangers' equity owners are indirect subsidiaries of HSG Sports Group LLC, a Tom Hicks-led company. Certain lenders are creditors of HSG in excess of $525 million. The debtor guaranteed and pledged its assets to secure $75 million of this amount.

The debtor had not been profitable since its acquisition by Hicks in 1998. Hicks covered cash shortfalls through advances that totaled more than $100 million by 2008. By that time, Hicks determined that he would no longer advance funds to the debtor, and he began a process that ultimately led to an agreement to sell the Rangers to a group led by Pittsburgh attorney Chuck Greenberg and baseball hall of famer/former Ranger, Nolan Ryan--the "Greenberg-Ryan Group."

In March 2009, the lenders' loans to HSG fell into default due to the failure of HSG to make an interest payment. To fund its operations, the debtor entered into certain agreements with an affiliate of the Office of the Commissioner of Baseball. The debtor borrowed in excess of $20 million pursuant to those agreements, which contained provisions barring any sale of the Rangers not approved by the commissioner and the requisite percentage of owners of other major league baseball franchises.

In addition, the Major League Constitution (MLC), which governs Major League Baseball (MLB) franchises, requires a three-fourths vote of the major league clubs to sell or transfer a controlling interest in a team. [3] The commissioner's position in the bankruptcy proceeding--which was agreed to by the debtor and the Greenberg-Ryan Group--was that the MLC and the pre-petition financing agreements entered into between the debtor and the affiliate of the commissioner, barred any sale of the Rangers not approved by the commissioner and the requisite percentage of owners of other major league baseball franchises. [4] The lenders, on the other hand, took a decidedly different position. They argued that, under the terms of a pledge and security agreement (the "pledge agreement"), once their loan was in default, they had the power to control the equity interests of the Rangers' equity owners, and could exercise approval rights as to any sale of the Rangers. [5] The lenders exercised the approval rights under the pledge agreement and declined to approve the sale of the Rangers to the Greenberg-Ryan Group before the bankruptcy filing. [6] The commissioner, by contrast, asserted that the Greenberg-Ryan Group was the prevailing bidder in a properly-conducted auction process, and that the sale, which it approved, should be consummated. [7]

The lenders were at loggerheads with the commissioner. The lenders, seeking a purchaser that would pay more for the Rangers than the Greenberg-Ryan Group, would not consent to a sale to that group. [8] Yet the commissioner would not agree to seek and consider other offers for the Rangers. [9] Unable to resolve the impasse, the debtor filed its chapter 11 case.

The debtor filed a chapter 11 plan in which it proposed to sell the Rangers to the Greenberg-Ryan Group under the terms of an asset-purchase agreement negotiated before the bankruptcy filing. The plan provided that the lenders were to be paid $75 million in full satisfaction of their claims against the debtor. The lenders, however, contended that because of their rights that were triggered under the pledge agreement by HSG's loan default, their agent must authorize the sale of the Rangers, and the execution of the asset-purchase agreement was *ultra vires* and void. [10]

***70** On May 27, 2010. shortly after the debtor's bankruptcy filing, certain of the lenders filed involuntary bankruptcy petitions against REHLP and REGHP. Prior to these filings, the Rangers' equity owners were not parties to the bankruptcy proceedings. The lenders held a lien on the equity interests of the debtor, and the involuntary petitioners stated that the petition was filed to ensure that the equity interests received maximum value. In other words, the lenders' guaranty claim against the debtor was capped at $75 million.

The debtor's initial plan, which incorporated the Greenberg-Ryan purchase offer agreed to before the bankruptcy filing, would have paid this $75 million claim in full. The lenders, however, wished to test that offer in the market place to see if another bidder would pay more, and thereby increase the value of the equity interests of the debtor.

The Game Plan

In his June 2 order, Bankruptcy Judge D. Michael Lynn requested that the parties address several issues, including the following: (1) Does the debtor have a duty as debtor in possession to maximize the value of its estate, given that the plan provides for full satisfaction of all claims against the debtor and a substantial return to 100 percent consenting equity?

(2) Who is entitled to speak on behalf of the Rangers' equity-owners: the management of the Rangers' equity owners, or the lenders? and

(3) What duties do the Rangers' equity-owners owe to the lenders? [11]

Running Up the Score

The Debtor's Duty to Maximize Value

Seeking to maximize the value of the equity interests of the debtor, the lenders argued that the debtor had an obligation to maximize the value of the estate for the benefit of all stakeholders, including the debtor's shareholders. According to the lenders, the plan was premised on the debtor's purportedly incorrect assertion that it had no obligation to maximize the value of the estate. To support their argument, the lenders relied on Judge Lynn's previous decision in the *Pilgrim's Pride* bankruptcy case, in which they quoted the court as finding it to be "unquestionably true that Debtors' officers and directors have a duty to maximize Debtors' estates to the benefit of shareholders as well as creditors." [12] The lenders contended that this decision, as well as other cases, imposed a duty on the debtor to test the market place to obtain an offer that maximized the value of its estate.

The court disagreed, concluding that the cases relied on by the lenders were inapposite. [13] Judge Lynn reasoned that in none of those cases did the courts directly address the value maximization issue "where the facts were that (1) the debtor was clearly solvent and paying creditors in full and (2) all the equity owners had consented to accept a transaction that provided to them less than their potential maximum recovery." [14] In the Rangers' case, however, the debtor's original proposed plan (the court assumed accurately) to pay all creditors in full, and the Rangers' equity owners had agreed to the sale to the Greenberg-Ryan Group. [15]

The court concluded that "an underlying premise" of the Bankruptcy Code was that parties should be able to resolve how a debtor's estate satisfies claims and interests. For example, the court noted that one of the factors that a court must consider under § 305(a)(1) when determining whether to abstain from hearing a case, is whether the debtor and creditors are able to agree to a less expensive out-of-court workout that better serves all interests in the case. In addition, the best interest of creditors (or equity owners) test under § 1129(a)(7)(A)(i) does not apply to a class member if the member has accepted the plan. Similarly, §§ 1123(a)(4) and 1129(a)(9) permit a claimholder to agree to less favorable treatment than it would otherwise be entitled. [16] Further, allowing a class such as the Rangers' equity owners to accept "less than optimal treatment is sensible." [17] A class, especially a class of equity interests, "may have motives other than maximizing return." [18]

In the Rangers case, the court concluded that if the debtor's original plan in fact provided for payment in full to all creditors of the debtor, and if 100 percent of the debtor's equity interests accepted the plan, then the plan was confirmable even if another bidder would pay more for the Rangers than the Greenberg-Ryan Group. [19] The court held that the debtor did not have a duty to maximize the value obtained for its estate. [20] This did not mean, however, that the Rangers' equity-owners were necessarily free to accept a plan that did not maximize value for their creditors. [21]

Who Is the Rangers' Manager?

The Authority to Act for the Rangers' Equity-Owners

The lenders asserted that, upon the occurrence of an event of default under the loans to HSG, the pledge agreement provided that management of the Rangers' equity owners automatically lost--and the lenders' agent acquired--the right "to exercise or refrain from exercising the voting and other consensual rights" of REHLP. [22] Because their loans were in default, the lenders argued that their agent--and not the management of the Rangers' equity owners--must authorize the sale of the Rangers, and that the execution of the asset purchase agreement by REHLP was *ultra vires* and void. [23]

On the other hand, the debtor and the Greenberg-Ryan Group, joined by the commissioner, pointed to a provision in the loan agreement and a parallel provision in the pledge agreement which, in their view, made the rights of the lenders' agent to exercise control over the debtor or its owners subject to the MLC. [24] The MLC, in turn, requires that any change in control of the Rangers be approved by the commissioner and/or the requisite percentage of baseball team owners. [25]

***71** The MLC requires that the approval of the commissioner and the major league owners be obtained for the lenders' agent to control the Rangers' equity owners, and through them, the debtor and the Rangers. The debtor and the Greenberg-Ryan Group contended that because the lenders had not obtained such approval, the lenders' agent was not entitled to exercise control over the Rangers' equity-owners under the pledge agreement. [26]

The court concluded that it was not clear that the rights of the lenders' agent to control the Rangers' equity owners under the pledge agreement was subject to the MLC, such that management of the Rangers' equity-owners retained all decision-making power for those entities. [27] The court concluded that, at the time of its memorandum opinion, the "management of REHLP and REHGP continues to speak for those entities." [28]

The court based its decision on several factors. After the loan went into default, the lenders acquiesced in continued control of the debtor, REHGP and REHLP by the management of the Rangers' equity-owners. [29] The lenders permitted the Rangers' equity-owners to act in connection with the sales process to the point of entering an agreement to sell the Rangers to the Greenberg-Ryan Group. [30] Further, the lenders did not dispute the authority of the Rangers' equity-owners to cause the debtor's chapter 11 filing. [31] Importantly, certain of the lenders commenced involuntary petitions against REHLP and REHGP. [32] If the lenders were entitled to act for the Rangers' equity-owners, as the lenders argued, the lenders would have (through their agent) commenced voluntary bankruptcy petitions on behalf of the Rangers' equity-owners. [33]

Duties of the Rangers' Equity-Owners

The debtor and the Greenberg-Ryan Group argued that the Rangers' equity-owners, as alleged debtors, did not owe a duty to any party that they would not owe a duty to outside of bankruptcy. [34] Although the management of the Rangers' equity-owners was obligated to exercise sound business judgment, the alleged debtors were not common law fiduciaries for their creditors, nor were they statutory fiduciaries whose actions were subject to the limitations of the Code and court control. [35]

The debtor pointed to § 303(f) of the Code in support of this position, which provides that, except to the extent a court orders otherwise, until an order for relief is entered in a case, "the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced." [36] Hence, argued the debtor, REHGP and REHLP could proceed without court oversight regarding the plan as long as their conduct satisfied the business-judgment rule. [37]

The Court agreed with the debtor's statement of the law, [38] but it chose to invoke its authority to order that § 303(f) did not apply in the involuntary cases of REHGP and REHLP, and that, even prior to the entry of any orders for relief, REHGP and REHLP must manage their sole asset--the debtor-- "consistent with the fiduciary responsibilities of debtors-in-possession." [39] The parties acknowledged that if § 303(f) did not apply, an involuntary debtor would have to manage or dispose of its assets in accordance with § 363 of the Code. [40] The court held that, as a result of its abrogation of § 303(f) in the cases of the Rangers' equity-owners, the Rangers' equity-owners owed the same fiduciary duty to their creditors--the lenders--as would a trustee.

The Ninth Inning

Ryan Pitches Another Complete Game

Ultimately, the debtor moved the court to approve bidding procedures to sell the Rangers at auction. The court-approved bid procedures conditioned the sale of the Rangers upon, among other things, approval by the MLB and compliance with the MLC. The Greenberg-Ryan Group won the auction after many rounds of bidding, beating a group of investors led by Houston businessman Jim Crane and Mark Cuban, an entrepreneur and owner of the Dallas Mavericks. The court entered an order confirming the debtor's fourth amended bankruptcy plan on Aug. 5. 2010, and on Aug. 12, 2010, the commissioner, on behalf of the MLB, filed notice of its approval of the sale to the Greenberg-Ryan Group.

Footnotes

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1 *See* Jonathan S. Covin and David G. Gamble, "Texas Rangers Play Ball in Bankruptcy Arena; Part I: The Early Innings of the Case," XXIX *ABI Journal* 6, 36-37, 75, July/August 2010.

2 *See* Lawrence J. Kotler and Matthew E. Hoffman, "Rangers', Coyotes', Asset-Purchase Agreements: Trumping Bankruptcy's Fundamental Goats?" XXX *ABI Journal* 6, 26, 70-71, September 2010.

3 MLC, Article V. § (2)(b) ("The vote of three-fourths of the Major League Clubs shall be required for the approval of ... the sale or transfer of a control Interest in any Club.").

4 Memorandum opinion dated June 22, 2010, at 4 [Rangers Docket No. 257] (the "memorandum opinion").

5 Memorandum opinion at 4-5.

6 *Id.* at 5.

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.* at 19.

11 As Judge Lynn noted in his memorandum opinion, framing the issue in this manner does not mean that there were not other constituencies, including the Rangers' fans and the City of Arlington, Texas (home to the Rangers), that the Rangers' equity owners could not appropriately take into account in the management and disposition of the Rangers. *See* memorandum opinion at fn. 13.

12 *In re Pilgrim's Pride Corp.*, 407 B.R. 211, 218 (Bankr. N.D. Tex. 2009); *see* memorandum opinion at n. 16.

13 Memorandum opinion at 8.

14 *Id.* Judge Lynn explained that his earlier Pilgrim's Pride opinion (on which the lenders relied) addressed whether to appoint an equity committee in the Pilgrim's Pride case. The quotation cited by the lenders appeared in a discussion concerning whether equity was adequately represented in the chapter 11 case if an equity committee were not appointed. Judge Lynn concluded that the quotation was *dicta*, and "was offered in a context too remote from that of the case at bar to be relevant. Rather, the quoted language was part

of the court's explanation that simply maximizing a debtor's estate, in and of itself, does not ensure that equity owners are adequately represented." Memorandum opinion at n. 16.

15 *Id.* at 8.

16 *See* memorandum opinion at 8-9.

17 *Id.* at 9.

18 *Id.*

19 *Id.* As the court discussed in its memorandum opinion, it was not clear that the debtor's original plan met these conditions.

20 *Id.*

21 *Id.* at n. 17.

22 *Id.* at 10.

23 *Id.*

24 *Id.* at 12.

25 *Id.* The court noted that, at the insistence of the commissioner, it did not address the effectiveness of the MLC limitations on the debtor, or the Rangers' equity-owners, in a bankruptcy proceeding. While the MLC can affect the lenders' contractual rights, the court assumed, for the purposes of the memorandum opinion, that the MLC did not prevent the debtor and the Rangers' equity-owners from considering attematives to the purchase agreement with the Greenberg-Ryan Group. *See* memorandum opinion at 12, n. 21.

26 *Id.*

27 *Id.*

28 *Id.* at 13. After the writing of the memorandum opinion, the court entered orders approving the appointment of a chief restructuring officer for the Rangers' equity-owners.

29 *Id.*

30 *Id.*

31 *Id.*

32 *Id.*

33 *Id.*

34 *Id.* at 13.

35 *Id.* at 14.

36 11 U.S.C. § 303(f).

37 Memorandum opinion at 14.

38 *Id.*

39 *Id.* at 15.

40 *Id.*

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