

Are Baseball Franchises Actually Franchises?

By David Gurnick and Tal Grinblat

Since Baseball Commissioner Bud Selig's announcement on April 20, the media has reported widely on the takeover of the Los Angeles Dodgers by Major League Baseball. One question was not reported in the media, the answer to which may be a shield and sword for Dodger owners, Frank and Jamie McCourt. Are the Dodgers a business franchise? This question applies equally to all professional baseball, basketball, football and hockey teams.

Statutes in California, several other states and a Federal Trade Commission Franchise Rule, regulate business franchises. The FTC requires the preparation of a disclosure document to be provided to prospects, and a cooling-off period before the sale of a franchise may be completed. Thirteen states, including California, require pre-sale registration. (California Corporations Code Section 31000). In addition, California and 17 other states regulate the on-going relationship between the franchisor and franchisee, many restricting termination and non-renewal without notice and a cure opportunity for most defaults. (California Business & Professions Code Section 20000).

Under these laws a business relationship of any kind is subject to regulation as a franchise if three elements are present: one party licenses the use of a logo or brand name with which the licensee becomes substantially associated; the licensor provides the licensee a marketing plan; and the licensee pays the licensor a fee of any kind. There is strong potential that all three elements are present in the Dodgers' relationship with Major League Baseball; and in the relationship between every professional sports team and its league.

Major League Baseball owns the MLB brand and the famous Major League Baseball logo, which the Dodgers are licensed to use. As an example, the logo appears on the back of the Dodgers uniform, at the neck, and on the Dodgers Web site: www.losangelesdodgers.mlb.com. The MLB brand even appears in the Dodgers Web address. Likewise, in professional football, basketball and hockey, every team is licensed to use

its league's logo and brand name.

The Dodgers follow a marketing plan prescribed by Major League Baseball. The plan includes a 182 game season, rules of play, rotation of umpires, publication of team standings, the all-star game, league playoffs, participation in the league's broadcast contract, publicity through the league's mlb.com Web site, restrictions against out-of-league play, an exclusive geographic territory, revenue sharing, participation in the college draft, restriction against transfer of the team, League membership, the commissioner's right to investigate any matter, rule on transactions, ability to impose penalties, and the right to act in the best interests of baseball (MLB Constitution Article II, Sections 2 and 3). Also included are other rules, procedures and League oversight of the team's operations, schedule and marketing. Teams in the NFL, NBA and NHL follow marketing plans with similar requirements.

The Dodgers and teams in all professional sports pay fees to their league. In baseball, these also include the commissioner's ability to impose fines on the team up to \$2 million. (MLB Constitution, Article II, Section 3). The NFL's Constitution requires an applicant for league membership to submit a payment of \$25,000, to be increased by another \$25,000 if the application is accepted. (NFL Constitution, Article III, Section 3.3(B)). These fees resemble initial franchise fees common in typical retail business franchises. The NFL Commissioner also has the right to make assessments against members. (NFL Constitution, Article III, Section 3.10). The NHL Constitution provides for annual dues assessments to be paid by each team. (NHL Constitution, Article IX).

What is the significance for Major League Baseball and the McCourts (and the other leagues and owners) if the league and team are in a business franchise relationship?

California's Franchise Investment Law prohibits a franchisor, including Major League Baseball should it be deemed a franchisor, from soliciting the franchise owner (the McCourts) to materially modify the terms of their franchise without first registering the proposed modification with the Department of Corporations, or qualifying for an exemption from registration. If Major League Baseball recently forced a modification on the McCourts

without franchise law compliance, the McCourts may have a remedy, including the right to rescind the modification and a claim for damages suffered due to the modification. (California Corporations Code Sections 31125; 31300; California Civil Code Section 1692).

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A franchisor also cannot terminate a franchise, except in compliance with conditions under California's Franchise Relations Act. A termination not in compliance with the Act, may subject the franchisor (Major League Baseball) to damages. (See *JRS Products v. Matsushita Electric Corp.* 115 C.A.4th 168 (2004) (franchisee was entitled to pursue damages claim for wrongful termination of franchise in violation of Franchise Relations Act)).

A claim by the McCourts that they are entitled to protection under the franchise laws would not be entirely novel. It has been recognized that the broad scope of the term "franchise" "can surprise even a sophisticated party." (*To-Am Equipment Co. v. Mitsubishi Caterpillar Forklift America* 152 F.2d 658 (7th Cir. 1998)). The franchise laws were enacted for the purpose of protecting franchisees, and franchise laws have been held applicable to sports teams.

The Indiana Supreme Court held that the right to operate a basketball team as part of a league was a franchise under that state's franchise law. The court found that the team had the right to use the league's logo, the league provided a marketing plan, and the team owner was required to pay a franchise fee. (*Continental Basketball Association v. Eilenstein Enterprises* 669 N.E.2d 134 (Ind. 1996)). Were the McCourts to make such a claim, Major League Baseball might find it difficult to distinguish the Dodgers relationship from that found to be a franchise in *Eilenstein*.

In a sense, as the owner of the Dodgers, the McCourts have two strikes against them, given the pressure they are under from Major League Baseball and the media. But the franchise laws were enacted to level the playing field between franchisees and their franchisor. Were the McCourts to look to these laws, they might discover a bat in their arsenal, with which to strike back, instead of striking out.



David Gurnick is a State Bar certified specialist in franchise and distribution law with Lewitt Hackman in Encino. He can be reached at dgurnick@lewithackman.com



Tal Grinblat is a State Bar certified specialist in franchise and distribution law with Lewitt Hackman in Encino. He can be reached at tgrinblat@lewithackman.com