Sports Litigation Alert

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Armstrong's Endorsement Contracts and the "Morals Clause"

By Brian Socolow

Lance Armstrong has had a bad fall, and that's before taking into account the morals clauses in his endorsement contracts.

In late August 2012, Lance Armstrong, seven time winner of the Tour de France, announced that he would no longer contest the U.S. Anti-Doping Agency's (USADA) allegations that Armstrong and his teammates used performance enhancing drugs in violation of international cycling rules. The following day, USADA stripped him of his Tour de France titles and imposed a lifetime cycling ban. In October 2012, USADA issued its report on Armstrong and the U.S. Postal Service Team, claiming that over 1,000 pages of sworn testimony, email messages, financial payments, and lab test results "shows beyond any doubt that the U.S. Postal Service Pro Cycling Team ran the most sophisticated, professionalized and successful doping program that sport has ever seen."

A few days later, the International Cycling Union announced it would not appeal USADA's decision, and in the weeks that followed, Nike, Trek and Oakley terminated their endorsement relationships with Armstrong.

It appears that these brands invoked the morals clause in their endorsement contracts with Armstrong. A morals clause allows a company to terminate, or otherwise take some corrective action against, an endorser who is tarnishing the company's reputation based on some "immoral" conduct. This type of protection seems reasonable considering what a company invests and its goals in entering into an endorsement agreement. The company might pay an athlete millions of dollars to be the public face for the company's products, and then spend millions more to build its advertising and marketing campaign around the athlete so that the athlete's name and achievements become associated with the company's products. When the athlete-endorser's talents and achievements are overshadowed by scandal or criminal conduct, that spells economic disaster for the company. When the association between the athlete-endorser and the company begins to damage the company, the company understandably wants to part ways.

When negotiating the morals clause in an endorsement agreement, the kind of behavior that will trigger the clause is a critical point. In general, an athlete will want a narrow morals clause with a short list of very specific actions that will trigger the clause, such as a conviction on criminal charges, and limited available remedies for the company. A company paying for the endorsement services will want a broadly-worded clause that lets the company determine, in its sole discretion, if the athlete's actions warrant termination, a fine, or some other remedial action. For example, there are many kinds of behavior that fall short of a criminal conviction that could tarnish a company's image, such as public fights, arrests for drunk driving, drug use, criminal accusations (even if the charges are later dropped), and domestic scandals. A company may also want to be able to take action if the athlete-endorser criticizes its product or management.

The more successful an athlete, the greater his or her bargaining power when negotiating a morals clause. As Armstrong's wins accumulated, he might have been able to negotiate a narrowly-worded morals clause in his endorsement contracts. For example, the morals clause in his contracts might have been triggered only if there had been a determination by a judi-

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cial body after a contested hearing that he used performance enhancing drugs, and that such a determination had become final and unappealable. If that were the case, then a public perception that Armstrong had engaged in improper conduct or even an investigation by federal authorities would not trigger the morals clause.

Although Armstrong chose to forego contesting USADA's arbitration proceeding against him, he has not admitted to any wrongdoing, and USADA's decision to invalidate Armstrong's victories was not a conviction nor was it a judicial decision. However, based on reports that several of his long-time endorsement relationships have been terminated, it seems likely that there was some language in the morals clauses of his endorsement contracts that allowed these companies to terminate the agreements.

If the morals clause language is triggered, a company may decide to sue the endorser to recoup payments made to the endorser and/or costs of creating advertising campaigns featuring the endorser. In Armstrong's case, because his alleged use of performance enhancing drugs began many years ago, a company seeking to assert a claim based on a morals clause violation might have a statute of limitations problem, depending on when the conduct at issue occurred and the nature of the claim. For example, would the claim be for breach of contract, which has a statute of limitations of six years in many jurisdictions? Would the claim be for fraud, based on Armstrong's misrepresenting at the time he signed a contract that he was not engaged in doping? Fraud claims often have a shorter statute of limitations, typically three years.

Armstrong won his first Tour de France in 1999 and his last in 2005. If the basis for a breach of contract claim arises from doping during that period, it would appear that any claim would be barred based on the statute of limitations, unless a plaintiff could invoke a tolling doctrine. Certain states allow for an equitable tolling of a statute of limitation if the conduct triggering the claim was concealed. If a company sought to sue Armstrong based on doping tests secured prior to 2005, for example, it might be able to claim that he concealed his doping, and the statute of limitations should therefore be tolled. A number of factual issues have to be determined in order for tolling to be allowed.

Even if a company can legally invoke the morals clause in an endorsement contract, it must still face the question whether doing so is a wise business decision. Is the conduct of the athlete of such a potentially damaging nature to the company that a continued relationship would be detrimental, and if so, what are the consequences to the company for terminating the agreement? In the case of an athlete endorsement agreement, for example, the company will typically consider several issues before terminating the agreement such as (1) the severity of the endorser's transgression and the company's audience, (2) the company's investment in the ad campaign, including production costs for commercials, purchases of on-air, online and print media space, and event sponsorship fees, (3) whether other commercials or individuals are available to fill the void created by terminating the endorser, and (4) the likelihood of litigation brought by the athlete.

There are alternatives to invoking the morals clause. Sometimes a company prefers not to terminate a contract, but wants to show that it disapproves of an endorser's actions; some agreements allow a company to levy fines and/or recoup payments rather than terminate for a morals-based contractual violation. The company may also demand a clause recognizing its sole right to pull an athlete's product from stores, such as happened with Michael Vick, or not using the athlete's image or likeness in advertisements.

If a company pursues litigation, it would also have to determine the costs and benefits: litigation is costly and can harm both the company and the endorser's public image and a company might not be able to recover enough in damages to make such investment worthwhile. A company may also have trouble proving that Armstrong was engaging in doping because such proof may not be readily available and because the alleged doping took place so many years ago. In addition, a prolonged, highly publicized lawsuit could suggest to the public that the company was somehow complicit in Armstrong's activities or that it turned a blind eye to conduct that it should have known about.

Some of these factors may play out in a recently

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filed lawsuit by SCA Promotions, a company that provides insurance coverage for the payment of prizes and bonuses.

Armstrong's contract with Tailwind Sports, the owner of the U.S. Postal Service team, apparently promised Armstrong a $10 million bonus if he won a sixth Tour de France title. As is common in the sports industry, Tailwind Sports took out an insurance policy to cover the possible payment of that bonus with SCA Promotions and other companies. When Armstrong won his sixth Tour de France race in 2004, SCA apparently balked at paying $5 million for the bonus when rumors of Armstrong's doping gained traction. Armstrong and Tailwind Sports sued SCA, and an arbitration panel ordered SCA to pay the bonus, plus another $2.5 million in interest and costs. SCA has recently stated that it is seeking repayment of several bonuses paid to Armstrong plus interest, totaling nearly $11 million. The outcome of this matter may not depend on the language of a morals clause, but it might provide an indication of what issues regarding doping Armstrong is willing to contest in court, and how vigorously.

Conclusion

Endorsement contracts are a significant source of income for top athletes and they represent significant expenditures by companies that probably hope for a long and profitable relationship. Because the stakes are so high, morals clauses are integral parts of endorsement contracts. It's unfortunate when an athlete of Armstrong's stature falls from grace so swiftly, but morals clauses give companies that hire athlete-endorsers powerful options when an endorser's actions threaten the goodwill of a company and its products.