Sports Litigation Alert

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Moving Day: Oakley's Lawsuit Against McIlroy Highlights Challenges of Rights of First Refusal

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At the start of 2011, the sunglasses maker Oakley signed a two-year endorsement deal with Rory McIlroy. The agreement paid McIlroy an estimated $6 million for the term of the agreement, which covered "eyewear, apparel and accessories," and was set to run through the end of 2012. In addition, the contract included a right of first refusal, which afforded Oakley the opportunity to retain McIlroy as an Oakley endorser beyond 2012 by matching any offer covering the same product categories that McIlroy might receive for the period after the expiration of the Oakley deal.

At the time that Oakley embarked on its relationship with McIlroy, he was a somewhat unproven commodity, both as a golfer and as a brand endorser. Although his future stardom had been foretold since his teenage years in northern Ireland, McIlroy had yet to win any of golf's major championships or to be widely exposed in the U.S. By committing to McIlroy early in his career, Oakley was poised to benefit from McIlroy's meteoric rise to worldwide stardom after his dominant performance at the 2011 U.S. Open.

Fast forward to late 2012. McIlroy had risen to the top of the world golf rankings and had won two major championships and consecutive golfer-of-the-year awards. He also ruled the money lists in both the U.S. and Europe, and his youth and widespread appeal made him a marketer's dream. With the term of McIlroy's agreements with Oakley and with his other longtime sponsors Footjoy and Titliest scheduled to expire, Nike took dead aim at McIlroy. According to press reports, Nike entered into a highly lucrative, multiyear, "head-to-toe" endorsement agreement with McIlroy.[1] The Nike deal, commencing in 2013, reportedly obligates McIlroy to use Nike equipment and wear Nike footwear and apparel at all golfing appearances.

Oakley, however, was not ready to let its association with McIlroy lapse. When its negotiations with McIlroy broke down and reports of McIlroy's imminent signing with Nike surfaced, Oakley commenced litigation against McIlroy and Nike. According to the complaint that Oakley filed in December in federal court in Los Angeles, McIlroy violated the right of first refusal provision in his contract with Oakley by, among other actions, purportedly refusing to honor Oakley's contractual right to match Nike's proposal for the product categories included in the Oakley contract. Oakley contends that McIlroy's representatives failed to afford Oakley a bona fide opportunity to match Nike's offer – that, in effect, they had decided to proceed with the Nike deal and were determined not to allow Oakley to disrupt those plans by exercising its first refusal right.

While it is too early in the litigation to predict all of the issues that are likely to be contested or to assess the parties' respective chances of prevailing, it is already apparent that this lawsuit underscores some of the thorny issues inherent in crafting and later enforcing right-of-first-refusal provisions in athlete and celebrity endorsement deals.

The Parties' Duties under the Right-of-First Refusal Provision

Two of the central issues in the litigation are likely to be the nature of the parties' respective obligations under the "right of first refusal" provision and whether they satisfied those duties, including the level of detail about Nike's offer that McIlroy's representatives were required to divulge to Oakley. One of Oakley's contentions is that McIlroy's agent "only provided rudimentary information" to Oakley "about the total amount" of the Nike offer, and failed to share specific detail concerning

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the portion of the total amount of the Nike offer that was "covered by the right of first refusal, as opposed to other elements," such as golf equipment. Conversely, certain emails quoted in Oakley's complaint indicate that McIlroy's representatives took the position that McIlroy had satisfied his duties under the first refusal provision by disclosing the "material terms" of the Nike provision, though it is unclear exactly what the golfer's team told Oakley. A key issue could be whether McIlroy's disclosure included enough information to provide Oakley with a genuine opportunity to match Nike's offer.

Without further information about the controlling contractual language and the level of detail that McIlroy's representatives shared with Oakley, it is difficult to assess the merits of the parties' competing claims on this issue. As a matter of ordinary practice, McIlroy's team would typically be expected to share at least enough information to inform Oakley of the components of the proposal that Oakley had an opportunity to match, so as to put Oakley on notice of the offer that it would need to make in order to extend its deal. But in this case, one of the wrinkles of the Oakley-Nike-McIlroy situation is that the Nike proposal encompassed more product categories than did the expiring Oakley deal, and may well have been structured differently from the Oakley endorsement agreement. Under these circumstances, there could be a significant issue as to whether the level of detail about the Nike offer that McIlroy's team disclosed was sufficient to enable Oakley to determine the value of the portion of the Nike proposal that could reasonably be allocated to "eyewear, apparel and accessories." If it turns out that McIlroy's representatives disclosed only certain aspects of the Nike offer, the court may be called upon to decide whether all of the relevant terms were disclosed and whether the information provided to Oakley sufficed to enable Oakley to formulate an appropriate matching offer.

Additionally, there could be a dispute as to the appropriate legal standard to be applied under these circumstances. Courts have frequently required that exercises of first refusal rights be exact matches of all of the relevant and material terms of the competing offer, namely, the components of the competing offer that are coextensive with the subject matter of the original contract.[2] In this situation, though, there could be some question as to whether a more flexible matching standard should be applied when the differences between the original contract and the competing offer are not conducive to a clear determination of what an exact match would be. Moreover, assuming that all of the relevant components of the Nike proposal were shared with Oakley, the parties may well disagree over whether Oakley's offer was a sufficiently exact match to constitute a valid exercise of its first refusal right. Oakley's complaint alleges that, when it offered to match the applicable portions of the Nike proposal, Oakley proposed to value them at 30 percent of the overall Nike package. (This assertion might be construed to suggest that Oakley may have been given enough information about the Nike offer, which could cut against its claim to have received only "rudimentary information.") It is somewhat unclear from Oakley's complaint how it arrived at this calculation and whether McIlroy's team disputed it at the time. At any rate, the determination of whether McIlroy satisfied its disclosure duty to Oakley is likely to turn in the final analysis on the precise wording of their contract, the factual details of what was disclosed and when, the legal standard that the court chooses to apply, and possibly expert testimony regarding industry custom.

Did Oakley Waive Its Rights?

Another hotly contested issue is likely to be whether Oakley waived its right to match a competing offer by sending McIlroy's representatives an email that stated, in part: "We're out of the mix."[3] Oakley's complaint indicates that the email in question, which its representatives allegedly sent while awaiting details of Nike's proposal, prompted McIlroy's representatives to assert that Oakley had waived its first refusal right and relieved McIlroy of any further obligations. To complicate matters, it appears that, despite this email, substantive communications between the parties continued for several weeks thereafter, which Oakley will presumably argue superseded or amounted to a retraction of any alleged waiver. As tends to be the case in virtually every lawsuit in which a waiver of a contractual right is asserted by one litigant and disputed by another, the language of the contract and the specific facts will dictate the outcome of this issue. As a general matter, though, this dispute should serve as a reminder to any party to a contract with a first refusal provision that its words and actions from the time that a competing offer is made may later be placed under a microscope. If the party with the first refusal right is considering matching a competing offer, it should take extreme care to avoid words or actions that might later be construed – even misconstrued – as inconsistent with an intention to exercise that right.

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Some Difficulties in Fashioning a Remedy if a Breach Occurred

Oakley's attempt to enforce its first refusal right highlights still additional risks and pitfalls presented by such provisions (and by other conditional, future-looking terms, such as rights of first negotiation). Even if Oakley were to succeed in proving that McIlroy failed to honor his first refusal obligations, Oakley would face serious obstacles in calculating its damages with sufficient certainty to recover a significant monetary award. As a matter of basic contract law, a non-breaching party is typically entitled to seek damages sufficient to put it in the position that it would have been in had its contractual rights been honored, provided that its damages were reasonably foreseeable to the contracting parties at the time they formed their agreement, are reasonably ascertainable, and are not unduly speculative. But unlike those situations in which a party's damages may be based on unpaid amounts that the defaulting party owed under the contract, endorsement deals such as the one between Oakley and McIlroy require the company to make payments to the athlete, not the other way around. The ways in which companies benefit from their athlete endorsement deals are far less straightforward and considerably more difficult to quantify. Indeed, the extent to which quantifiable correlations exist between the heightened brand exposure and positive consumer associations that endorsements bring, on the one hand, and increases in product sales, market shares or stock prices, on the other, has been the subject of recent scholarly debate and analysis.[4]

In the case of Oakley and McIlroy, assuming the media reports of the total value of the Nike deal are accurate, Oakley presumably would have been required to commit to pay McIlroy tens of millions of dollars over a period of at least five years to prolong his relationship with Oakley. As such, in order to prove a right to recover significant monetary damages, McIlroy will be required to demonstrate that its profits from a multiyear extension of McIlroy's endorsement deal would have eclipsed the fees that it owed to the golfer – and to calculate with some reasonable certainty *the amount* of those foregone profits, presumably with the aid of economic and marketing experts. This burden would pose a significant hurdle for Oakley to overcome; under California law, for example, trial judges are granted considerable discretion to exclude from trial any expert opinion testimony offered in support of a claim of foregone profits that is unduly speculative, not based on sound methodology, or insufficiently rooted in factual evidence or logic.[5] The defense team may certainly be expected to argue that, in this case, any such alleged damages are excessively speculative and so dependent on a multitude of external variables and unpredictable future events as to be incapable of calculation with any reasonable certainty – though it would be more than a little ironic for Nike to be in the position of seeking to undermine an attempt on the part of a corporate sponsor to make the case for the financial benefits to a corporation of athletic endorsement arrangements.

Beyond the issue of damages, if Oakley's lawsuit were to result in a finding that Oakley properly exercised its first refusal right or was prevented from doing so by McIlroy's wrongful conduct, the future of the golfer's lucrative deal with Nike could be placed in some jeopardy. In addition to seeking monetary remedies, Oakley's complaint requests an order prohibiting McIlroy from promoting and endorsing Nike products that qualify as "eyewear, apparel and accessories" under Oakley's contract. Further, Oakley seeks to have the court *compel* McIlroy to *resume* his endorsement relationship with Oakley. It is questionable how sincere these requests for injunctive relief really are – whether, given all that has transpired, Oakley still would *want* to invest tens of millions of dollars in McIlroy, much less force him to serve as the face of Oakley's products for the next five to ten years under the compulsion of a court order – or whether they are primarily intended as pressure points to give Oakley leverage in the event of future settlement discussions. (Notably, Oakley announced a new endorsement deal with another star golfer, Bubba Watson, at the end of 2012.) But if McIlroy were to press these requests for equitable relief and the court were to rule on them, it would be somewhat surprising – even assuming a finding that McIlroy violated his first refusal duties – if the court were to order the dissolution of the Nike-McIlroy alliance or to compel McIlroy to return to the Oakley fold. Courts are generally loathe to force individual athletes or entertainers to perform services against their will, and are only slightly more willing to enforce negative covenants in personal services contracts by enjoining individuals from proceeding with alternative employment that conflicts with their prior commitments. In one illustrative case decided in 1980, a New York appellate court found that a local sportscaster had breached the first refusal and good

faith negotiation provisions of his contract with ABC by accepting an offer from CBS without first giving ABC an opportunity to match CBS's offer, yet refused to order the sportscaster to afford ABC the right to match the CBS offer or to enjoin the sportscaster from working for CBS. While noting that "equity has fashioned injunctive relief in other right of first refusal cases," the court reasoned that specific performance of personal services contracts is highly impractical, especially when litigation has "exacerbated an already strained relationship."[6]

Conclusions

Given the legal uncertainty, financial risks and business considerations that this dispute poses for all of the involved parties, it would hardly be surprising if the parties were to reach an out-of-court settlement before trial. Regardless of the ultimate outcome, however, the Oakley-McIlroy-Nike litigation is instructive on many levels. Among other things, this dispute underscores the need for parties to right-of-first-refusal provisions in endorsement agreements to anticipate future scenarios and to document the parties' duties as precisely as possible at the time of contracting. The litigation also serves as a reminder that, when a party's first refusal right is implicated, the other contracting party may be held to account if it behaves in a manner inconsistent with affording the right holder a genuine, bona fide, good faith opportunity to exercise its matching right. Furthermore, for parties with first refusal rights, this litigation could become a cautionary tale about the difficulty of enforcing such provisions – even if the right has been violated. Above all, this dispute should give parties entering into endorsement deals cause to reflect on the wisdom and practicality of a first refusal provision – including whether, if the athlete or celebrity is ready to move on to another corporate patron when the term of the deal expires, it makes good business sense for the company to seek to force that individual to continue endorsing its products.

Notes

1 There have been conflicting reports about the duration of the Nike deal and its value to McIlroy. A number of media accounts initially described it as a ten-year deal and estimated its total amount at more than $200 million and possibly as high as $250 million. Some more recent stories quoted a source as saying that it is a five-year deal "significantly less than the $200 million that has been widely reported for months…." B. Harig, *Rory McIlroy, Nike ink deal*, ESPN.COM (Jan. 14, 2013, updated Jan. 15, 2013, 5:56 PM ET), http://espn.go.com/golf/story/_/id/8842623/nike-5-year-sponsorship-deal-rory-mcilroy-worth-less-reported-200-million-sources-say; *see also* D. Rovell, *A closer look at Rory McIlroy's Nike deal*, ESPN.COM (Jan. 14, 2013, 4:14 PM ET), http://espn.go.com/blog/playbook/dollars/post/_/id/2759/a-closer-look-at-rory-mcilorys-nike-deal. Another recent article characterized the undisclosed deal terms as worth anywhere from "$100 million over five years to $250 million over 10 years provided McIlroy reaches a long list of incentives." K. Crouse, *McIlroy's Well-Remunerated Risk*, N.Y. TIMES (Jan. 14, 2013), http://www.nytimes.com/2013/01/15/sports/golf/rory-mcilroy-announces-deal-with-nike-golf.html?_r=0.

2 *See, e.g., Miller v. LeSea Broadcasting, Inc.*, 87 F.3d 224, 226-28 (7th Cir. 1996); *USA Cable v. World Wrestling Federation Entertainment, Inc., et al.*, 766 A.2d 462, 466 & nn. 8-9 (2000).

3 Oakley's First Amended Complaint, ¶ 45, Case No. SACV12-02138 JVS (MLGx), U.S.D.C. C.D. Cal. (filed Dec. 17, 2012).

4 *See*, *e.g.*, A. Elberse & J. Verleun, *The Economic Value of Celebrity Endorsements*, 52 JOURNAL OF ADVERTISING RESEARCH, No. 2, 149-65 (June 2012); J. Agrawal & W. Kamakura, *The Economic Worth of Celebrity Endorsers: An Event Study Analysis*, 59 JOURNAL OF MARKETING 56-62 (July 1995); *see also* C. Knittel & V. Stango, *Celebrity Endorsements, Firm Value and Reputation Risk: Evidence From the Tiger Woods Scandal*, http://web.mit.edu/knittel/www/papers/tiger_latest.pdf (Nov. 20, 2012), at 3-4 ("The key question from a firm's perspective, of course, is whether a celebrity endorsement generates value sufficient to offset its possibly considerable cost. Quantifying that benefit-cost tradeoff is hard, and consequently the question of whether celebrity endorsements are value-enhancing remains open.").

5 *See*, *e.g.*, *Sargon v. University of Southern California*, 55 Cal. 4th 747, 781 (2012) (directing trial judges to "vigilantly exercise their gatekeeping function when deciding whether to admit testimony that purports to prove [lost future profits] claims").

6 *American Broadcasting Cos. v. Wolf*, 430 N.Y.S.2d 275, 283-84 (1980).

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