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Properly Drafted Right of First Refusal Helps Sponsors Keep Stars

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The thought of LeBron James endorsing a sneaker other than Nike, or Shaun White riding a snowboard other than Burton, is almost unimaginable. One reason why athletes such as those superstars become indelibly linked to a particular brand or team is the right of first refusal provision in their endorsement and playing contracts.

The right of first refusal is a common clause in endorsement contracts between athletes and sponsors. It typically allows the sponsor to match a third party's offer to keep the athlete on its marketing team. Because sponsors invest significant time and resources in athletes, they will often insist upon a first refusal right to protect their exclusive relationship with the athlete and retain the ability to keep the athlete from joining a competitor.

Drafted correctly, the right of first refusal can be a powerful tool for sponsors. The key is drafting a clause broad enough to encompass likely future scenarios and specific enough to address the athlete's circumstances. A properly drafted clause can increase the athlete's market value by creating competitive bidding for the athlete's services. An overly broad clause may deter potential sponsors since third-party offers may be used by the athlete as leverage to "up" the offer from the athlete's existing endorser.

A sponsor can't anticipate every possible situation, of course, especially if a competitor tries to lure away an athlete with an offer containing exceedingly unique provisions.

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For example, in addition to more money, a company may be able to entice an athlete who endorses a competitor's product with the opportunity to appear in a movie or even design a clothing line. Such provisions, which the athlete's original company can't match or would be forced to go to extraordinary lengths to match, are commonly known as a "poison pill."

A playing contract poison pill occurred in 2006 when the Minnesota Vikings offered to make Seattle Seahawks free agent offensive lineman Steve Hutchinson the highest-paid offensive lineman on their team after the first year of the contract, with the entire \$49 million contract becoming guaranteed if he was not. The Seahawks already had a very highly paid offensive lineman, meaning that the Vikings' poison pill would be prohibitively expensive for the Seahawks to match. They declined to match and lost Hutchinson to the Vikings after losing an arbitration challenging the clause.

To avoid a poison pill, sponsors need to define exactly which elements of an offer must be matched. Not surprisingly, the athlete might be adamant about requiring the original sponsor to match every element. For example, a third party's offer might include lower base compensation in exchange for higher incentives, increased budget for

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special projects such as movie and television productions, higher royalties for signature product lines and other non-cash items that may be more valuable to the athlete in the long run. A right of first refusal provision might state that the existing sponsor has the right to match the “material, matchable and measurable” terms of a third-party offer. The subjective nature of what constitutes a “material” term clearly creates room for dispute but also gives the existing sponsor some flexibility to offer new elements as part of its package.

As an athlete gains exposure, sponsors seek to align themselves with the next megastar. Multiple endorsements from sponsors in various product categories create the potential for conflicting endorsements. In some cases, the conflict may be more perceived than real. For example, a winter sports athlete with an existing outerwear endorsement deal (i.e., jackets and pants) may endorse a hard goods (i.e., skis or snowboards) sponsor that also manufactures outerwear. The outerwear sponsor then faces a potentially worrisome situation because advertisements distributed by the athlete’s new hard goods sponsor may create consumer confusion as to the scope of the endorsement. An action shot of the athlete featuring the athlete’s skis may lead the average consumer to assume that the sponsor is the athlete’s “head to toe” sponsor for both skis and outerwear, diluting the value and brand equity of the outerwear sponsor’s endorsement. Including a pre-approval right in the first refusal clause to allow the athlete’s existing sponsor to review all advertising for any new sponsors may alleviate this concern. Requiring that new sponsors include a disclaimer in any advertisement referencing the athlete is also an option.

Another concern relating to the right of first refusal is how vigorously to enforce it. As a last resort, a sponsor might

seek an injunction requiring the athlete to fulfill his or her endorsement obligations, but this type of injunction is rarely sought or obtained, and the sponsor faces the stark choice of protecting its investment by forcing a reluctant athlete to perform, potentially risking its standing among other athletes, and letting the athlete jump to a competitor. As a compromise, the parties may reach interim agreements on the timing of the new sponsor’s announcement of signing the athlete or splitting the athlete’s compensation during this interim period.

Anticipating future developments is critical to drafting an effective right of first refusal clause. For example, the recent spate of corporate mergers, particularly in the financial industry, may create conflicting obligations among sponsored athletes who have exclusive arrangements in specific categories. A well-drafted right of first refusal clause should account for such developments and clearly define the scope of endorsement rights.

With sponsorship budgets tightening during this challenging economic climate, the right of first refusal has increased importance. The next Tiger Woods or Danica Patrick is being signed to an endorsement deal today and, without a properly drafted right of first refusal provision, sponsors may be unaware that their investment is vulnerable and that their star athlete may soon be their competitor’s brand ambassador.

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