Poorly Crafted Endorsement Contracts Leave Athletes Exposed

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Sports Law: Poorly crafted endorsement contracts leave athletes exposed

Published June 04, 2007 : Page 14

Fame is fleeting. Regardless of how they attained their status, celebrities rely upon their popularity to enter into substantial endorsement deals based upon their most lucrative commodity: fame. We see celebrities on television every day touting the benefits of wireless networks, fashion accessories and a plethora of other objects.

What happens, though, if the company being endorsed goes bankrupt?

The days when household names were immune from financial disaster are long gone. A review of the news over recent years proves the point. Companies such as Enron, Delta, Kmart and many others show that “household name” status is no shield against bankruptcy.

MCI-WorldCom joined this list of companies and is in bankruptcy court dealing with the issue of celebrity endorsement. The U.S. Bankruptcy Court for the Southern District of New York recently reached a decision regarding Michael Jordan’s 10-year, $25 million endorsement deal with MCI-WorldCom. In so doing, the bankruptcy court made painfully clear the impact a household name’s bankruptcy can have on endorsement deals of even the most well-known celebrities.

Because fame is fleeting, it is critical for celebrities to maximize the benefits of their fame quickly and take the steps necessary to protect their vital interests in endorsement contracts. If celebrities fail to do so, they run the risk of not only losing income they are entitled to, but also of having to engage in protracted and costly litigation, further diminishing the contract’s value.

The Jordan case

In 1995, Jordan entered into an endorsement contract with MCI-WorldCom that required him to be available for four hours four times per year to film commercials and complete other promotional materials. In return, MCI-WorldCom agreed to pay Jordan $2 million per year along with a $5 million signing bonus. All told, Jordan stood to earn $25 million through the course of the contract.

In 2002, MCI-WorldCom filed for bankruptcy. Shortly thereafter, Jordan filed a claim with the bankruptcy court seeking $2 million plus contingent and unliquidated amounts that he claimed were due under the contract. The debtor rejected Jordan’s claim. Consequently, he filed a new claim seeking $8 million, which was the remaining value of the contract.

MCI-WorldCom argued that the court should disallow Jordan’s claim based on two legal principles. First, that Jordan was an MCI-WorldCom “employee” under the contract and his claim was thus capped according to the Bankruptcy Code. Second, that Jordan failed to mitigate his damages after MCI-WorldCom rejected his initial claim.
The Bankruptcy Code provides that an employee who files a claim for damages resulting from the termination of an employment contract is entitled to only one year of pay under the employment agreement. Thus, MCI-WorldCom was claiming that Jordan was only entitled to payment of $2 million. The bankruptcy court rejected MCI-WorldCom's argument.

In reviewing the contract, the court observed that the contract identified Jordan as an independent contractor and did not require MCI-WorldCom to withhold taxes. Furthermore, the court noted that Jordan had more control over MCI-WorldCom's activities than it had over him. For example, MCI-WorldCom had to submit copies of all packaging, advertising and promotional materials for Jordan's approval before releasing them to the public. Additionally, any work that Jordan did for MCI-WorldCom was subject to his schedule.

Consequently, the court found that Jordan was not an MCI-WorldCom employee. However, the court did find that Jordan had a duty to mitigate his damages and that he failed to do so under the doctrine of avoidable consequences. This doctrine "bars recovery for losses suffered by a non-breaching party that could have been avoided by reasonable effort and without risk of substantial loss or injury."

Despite Jordan's failure to mitigate his damages, the court found that MCI-WorldCom nonetheless had a duty to establish "the amount by which the damages would have been reduced." Consequently, the court decided that it must hold an additional evidentiary hearing on the amount Jordan's claim should be reduced for failing to mitigate damages.

### Celebrity endorsement contracts

A rock-solid endorsement agreement may not be enough to protect the celebrity from the rigors of an endorsee's bankruptcy. Celebrities should routinely take steps that establish that they are a "hot commodity" that is in demand. To avoid any obligation to mitigate damages, a celebrity endorser should:

1. Consistently engage in discussions about other endorsement deals and document those discussions.
2. Accept only endorsement deals that improve or build upon the celebrity's image.
3. Publicly express an intent to maximize their endorsement value.
4. Maintain a sufficient number of endorsement contracts that keep the celebrity's name public, but not so many that the celebrity's image is diluted and unmarketable.

The short duration in which most celebrities have to capitalize on their fame requires them to take strategic steps to protect their long-term interests. While no celebrity wants to lose his or her fame, only a fickle public stands between them and life on the "C" list. Therefore, a bullet-proof endorsement contract may ensure that the celebrity can maintain their lifestyle after their fame has faded or, worse, after their gravy train hits financial disaster.

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### Crafting the endorsement contract

1. Never title an endorsement contract an "employment agreement."
2. Clearly state that the celebrity is an independent contractor.
3. Limit the amount of control the endorsee can exercise over the celebrity's activities.
4. Provide that the celebrity's work is subject to the celebrity's preferred schedule.
5. Provide that the location of any work is subject to the celebrity’s preference.

6. Give the celebrity the right to review, approve, and veto all promotional materials using his or her name or image.

7. Declare that the endorsement provided by the celebrity is unique due to, among other things, the product being endorsed.

8. Allow the celebrity to assign the contract with the endorsee’s approval. Never make the contract expressly non-assignable.

9. Declare that the Bankruptcy Code does not apply to the endorsement relationship.

10. Declare that the celebrity has, within human possibility, the capacity and intent to enter into unlimited endorsement arrangements.