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Circumventing the NBA's Salary Cap: The Summer of Dwight

Circumventing the NBA's Salary Cap: The "Summer of Dwight"

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I. BACKGROUND

In the spring and summer of 2010, the biggest story in the National Basketball Association (“NBA”) did not revolve around championships or MVPs, but the free agency of LeBron James. As he listened to presentations from a number of teams, including the Cleveland Cavaliers, Chicago Bulls, New Jersey Nets, New York Knicks, Los Angeles Clippers, and the Miami Heat—teams which spent years creating clearing salary cap space to sign one, two, or three maximum salaried free agents—the rumor mill was churning.¹ Most famous was the rumor that LeBron James had a bonus in his endorsement deal with Nike if he plays in a large media market like New York City. Of course, not only was that rumor false,² but LeBron took a slight cut in pay to join Dwayne Wade and Chris Bosh in Miami. It was in the context of the 2010 free agency and potential involvement of Nike that I wrote an article entitled, “Circumventing the NBA’s Salary Cap: The ‘Summer of LeBron’ and Beyond.”³ It was worth asking what legal implications would arise if a third party introduced itself into free agency, and how the NBA’s collective bargaining agreement (“CBA”) limited such involvement.

After the “Summer of LeBron,” came the lockout of 2011, when the previous CBA expired. Although salary cap circumvention took a backseat to the mechanism that controls how the total basketball-related income splits between owners and players, it is all interrelated. As the players’ share of revenue has decreased from 57% to between 49% and 51%,⁴ maximum salary players gained significantly more motivation to supplement their income. And as luxury taxes for perennially big spending teams increased, NBA franchises were forced to become more

¹ See *Cavs, Bulls cap LeBron’s meetings*, ESPN.COM NEWS SERVICES (July 4, 2010), <http://sports.espn.go.com/nba/news/story?id=5351794>.

² Darren Rovell, *LeBron James Has No New York Nike Bonus*, CNBC.COM (Nov. 26, 2008), http://www.cnbc.com/id/27925375/LeBron_James_Has_No_New_York_Nike_Bonus.

³ 28 ENT. & SPORTS LAW. 11 (2010).

⁴ Larry Coon, *Breaking down changes in new CBA*, ESPN.COM (Nov. 28, 2011), http://espn.go.com/nba/story/_/page/CBA-111128/how-new-nba-deal-compares-last-one.

creative. It is the 2011 CBA that provided the backdrop for the 2013 free agency of Dwight Howard.

This article examines what issues related to salary cap circumvention have arisen during this “Summer of Dwight,” and how these issues will affect the league moving forward. Section II explores how the changes from the 2005 CBA to the 2011 CBA create incentives for salary cap circumvention. Section III lays out the rules against salary cap circumvention established in the 2011 CBA. Section IV then investigates how Dwight Howard’s free agency has implicated salary cap circumvention under this new framework. Section V concludes that the NBA needs to consider expanding the definition of compensation and take a hard look at team co-ownership of broadcasters as the motivation and opportunity for salary cap circumvention has increased.

II. HOW THE 2011 CBA AFFECTED BIG MARKET TEAMS

The salary cap “means the maximum allowable Team Salary for each Team for a Salary Cap Year, subject to the rules and exceptions set forth in [the CBA].”⁵ Although the 2005 CBA’s soft salary cap always provided some controls on the spending of the wealthiest teams, the 2011 CBA contains many provisions that aim to provide a more competitive balance. The biggest change for big market teams came in the form of luxuries taxes. The 2005 CBA required teams to pay \$1 for every \$1 their salary was above the luxury-tax threshold.⁶ After allowing teams to pay \$1 for every \$1 their salary is above the luxury-tax threshold in 2011-12 and 2012-13, starting this last season, the 2011 CBA required teams to pay an incremental tax that increases with every \$5 million above the tax threshold (\$1.50, \$1.75, \$2.50, \$3.25, etc.).⁷ In addition, repeat offenders (teams that pay the luxury tax at least four out of the previous five

⁵ National Basketball Association Collective Bargaining Agreement, art. I.I(ddd) (2011).

⁶ Coon *supra* note 4.

⁷ *Id.*

seasons) must pay an additional \$1 more at each increment (\$2.50, \$2.75, \$3.50, \$4.25, etc.).⁸

This steep increase in luxury taxes dramatically impacts the bottom line for perennial taxpayers like the Los Angeles Lakers.

In addition, with respect to revenue sharing, the 2005 CBA allowed some of the undistributed funds from the luxury tax to be given to teams in competitively disadvantaged markets, whereas the 2011 CBA approximately tripled the amount of money that is to be revenue-shared. Whereas teams like the Los Angeles Lakers will be perennial payers into this system, teams like the Charlotte Bobcats will be the likely beneficiaries.

III. SALARY CAP CIRCUMVENTION UNDER THE 2011 CBA

Salary cap circumvention is covered under Article XIII of the 2011 CBA.⁹ Interestingly, Article XIII remains largely unchanged from the 2005 version of the CBA.

a. General Prohibitions

Article XIII begins by laying out the general prohibitions relating to salary cap circumvention: “It is the intention of the parties that the provisions agreed to herein, including . . . those relating to the Salary Cap . . . be interpreted so as to preserve the essential benefits achieved by both parties to this Agreement.”¹⁰ This initial clause is followed by the general prohibition against Salary Cap circumvention:

Neither the Players Association, the NBA, nor any Team (or Team Affiliate) or player (or person or entity acting with authority on behalf of such player), shall enter into any agreement, including, without limitation, any Player Contract (including any Renegotiation, Extension, or amendment of a Player Contract), or undertake any action or transaction, including, without limitation, the assignment or termination of a

⁸ *Id.*

⁹ See National Basketball Association Collective Bargaining Agreement, art. XIII (2011).

¹⁰ *Id.* at art. XII § 1(a).

Player Contract, which is, or which includes any term that is, designed to serve the purpose of defeating or *circumventing* the intention of the parties as reflected by all of the provisions of this Agreement.¹¹

Section 1(b) of Article XIII then lays out exactly what qualifies as Salary Cap circumvention as follows:

It shall constitute a violation of Section 1(a) above for a Team (or Team Affiliate) to enter into an *agreement or understanding* with any sponsor or business partner or third-party under which such sponsor, business partner or third-party pays or agrees to pay compensation for basketball services (even if such compensation is ostensibly designated as being for non-basketball services) to a player under Contract to the Team.¹²

Compensation is defined in Article I as the “compensation that is or could be earned by, or is paid or payable to, an NBA player . . . in accordance with a Player Contract (whether such payment is sent to the player directly or to a person or entity designated by a player).”¹³

Therefore, it is a violation for Teams or Team Affiliates to enter agreements, or even just an implicit “understanding,” to circumvent the Salary Cap via third party compensation.

Furthermore, a violation of this section may be inferred by the NBA when:

(i) such compensation from the sponsor or business partner or third-party is *substantially in excess of the fair market value* of any services to be rendered by the player for such sponsor or business partner or third-party; and (ii) the Compensation

¹¹ *Id.* (emphasis added). Note that this section may be violated by either a Team or a Team Affiliate—a Team Affiliate being (i) any individual or entity that holds an ownership interest in the Team less than 5%; (ii) any individual or entity which controls any individual or entity affiliated with the Team; (iii) any individual or entity that is controlled by those described in (i) and (ii) above; or (iv) any entity which holds 10% or more of the ownership interests in a Team or entity described in (ii) above. *Id.* at art. X § 1(III).

¹² *Id.* at art. XIII § 1(b) (emphasis added).

¹³ *Id.* at art. I § 1(j).

in the Player Contract between the player and the Team is *substantially below the fair market value* of such Contract.¹⁴

The “compensation” discussed in Section 1(b)(i) is not the player’s contract with the team; rather, it is the compensation to be received for the sponsorship or business opportunities. If it is “substantially in excess of the fair market value” of a typical endorsement deal, then a violation may be inferred. By contrast, the “Compensation” described in Section 1(b)(ii) refers to the Compensation in the Player Contract from the team. If it is “substantially below the fair market value” of a typical Contract, then, again, the NBA may infer a violation.

b. Unauthorized Agreements

In addition, Section 2 of Article III disallows any Unauthorized Agreements, whether “express or implied, oral or written, or promises, undertakings, representations, commitments, inducements, assurances of intent, or understandings of any kind” between a player and a Team.¹⁵ This section works with the General Prohibitions described above to prevent the player for reaching a deal with the Team to receive Compensation from a third party or sponsor. A violation of this section “may be proven by direct or circumstantial evidence, including, but not limited to, evidence that a Player Contract or any term or provision thereof *cannot rationally be explained* in the absence of conduct violative of Section 2(a).”¹⁶

c. Penalties for Violations

Although the 2011 CBA did not alter the basic rules of salary cap circumvention, Section 3 of Article XIII laid out stiffer penalties for violating the General Prohibitions or engaging in

¹⁴ *Id.* at art. XIII § 1(b) (emphasis added).

¹⁵ *Id.* at art. XIII § 2(a).

¹⁶ *Id.* at art. XIII § 2(c).

Unauthorized Agreements.¹⁷ Suspected violations of Article XIII go before a System Arbitrator, who retains exclusive jurisdiction and authority to resolve disputes arising under Article XIII granted by Article XXXII of the CBA.¹⁸

It is the level of punishment, however, that differs the 2011 CBA from the 2005 CBA. Under the 2011 CBA, if a System Arbitrator found a violation of Section 1 occurred, he may (i) impose a fine of up to \$3,000,000 on any Team found to have committed such violation for the first time; (ii) impose a fine of up to \$4,500,000 on any Team found to have committed such violation for at least the second time; (iii) direct the forfeiture of one first round draft pick; (iv) void the contract between the player and Team; and/or (v) void any other transaction or agreement found to have violated Section 1 above.¹⁹ These punishments have increased from \$2,500,000 for first time offenders and \$3,000,000 for second time offenders.

As for violations of Section 2, the System Arbitrator may (i) impose a fine of up to \$6,000,000 on any Team found to have committed such violation; (ii) direct the forfeiture of draft picks; (iii) when both the and the Team are found to have committed such violation, (A) void the contract, (B) impose a fine of up to \$250,000 on any player, and/or (C) prohibit any future contracts between such player and such Team; (iv) suspend for up to one (1) year any Team personnel found to have willfully engaged in such violation; and/or (v) void any other transaction or agreement found to have violated Section 2 above.²⁰ These punishments have increased from \$6,000,000 and \$100,000 per player.

IV. THE FREE AGENCY OF DWIGHT HOWARD

¹⁷ *Id.* at art. XIII §3.

¹⁸ *Id.* at art. XXXII (describing, in detail, the many procedures required for such arbitration).

¹⁹ *Id.* at art. XIII(3)(a).

²⁰ *Id.* at art. XIII § 3(b).

After a frustrating season with the Los Angeles Lakers, Dwight Howard did what no star basketball player had ever done before; he left the NBA's glamour franchise as a free agent. Announcing via Twitter on July 5, 2013, and officially signing a new contract on July 13, 2013, Dwight Howard joined the Houston Rockets. However, much like LeBron in 2010, Dwight Howard gave each suitor—the Los Angeles Lakers, Houston Rockets, Dallas Mavericks, Golden State Warriors, and Atlanta Hawks—a chance to make their pitch.²¹

By all accounts, the delegation from the Los Angeles Lakers met with Dwight Howard in three separate groups: players Steve Nash and Kobe Bryant, along with Coach Mike D'Antoni; general manager Mitch Kupchak and executive vice president of player personnel Jim Buss; and Lakers vice president of business operations Tim Harris and the representatives from Time Warner Cable and AEG.²² This is the same Time Warner Cable that, in 2012, provided the Lakers with a record television deal that could be worth \$5 billion over 25 years.²³ According to a source, the NBA did not have a problem with a representative of Time Warner Cable being involved in the pitch, albeit noting that if Time Warner were to offer further compensation, it would be in violation of league rules.²⁴ According to one league source, "They could simply be presenting ideas about how they plan to cover Howard and the Lakers in the future. That is allowed."²⁵

Of course, nothing ever became of this conversation as the Los Angeles Lakers lost their pursuit of their prized free agent. But the Lakers were not the only organization to pitch their

²¹ Dave McMenamin & Ramona Shelburne, *Lakers, Mavs meet with Howard*, ESPN.COM (July 3, 2013), http://espn.go.com/los-angeles/nba/story/_/id/9445741/dwight-howard-meets-los-angeles-lakers-dallas-mavericks.

²² *Id.*

²³ Dave McMenamin & Ramona Shelburne, *Source: Lakers got jump on Rockets*, ESPNLOSANGELES.COM (July 1, 2013), http://espn.go.com/los-angeles/nba/story/_/id/9440466/source-dwight-howard-met-lakers-gm-meeting-houston-rockets.

²⁴ *Id.*

²⁵ *Id.*

team with the help of a broadcaster. According to a source, the Houston Rockets, the eventual winners of the Dwight Howard sweepstakes, also presented Howard with television opportunities with Comcast SportsNet Houston.²⁶ If Comcast SportsNet Houston and the Houston Rockets have an agreement to provide Dwight Howard with his own television show, such an agreement would seem to be in clear violation of Section 1(a) of Article XIII, as it seems to be “designed to serve the purpose of defeating or *circumventing* the intention of the parties as reflected by all of the provisions” of the CBA as an “agreement or understanding” for a sponsor, business partner or third-party to pay Compensation for basketball services (even if such compensation is ostensibly designated as being for non-basketball services).

However, what might get the Rockets off the hook is the definition of compensation. After all, compensation by a third party would only be inferred to be in violation of Section 1(a) if either the deal was “*substantially in excess of the fair market value* of any services to be rendered by the player for such sponsor or business partner or third-party” or the “Compensation in the Player Contract between the player and the Team is *substantially below the fair market value* of such Contract.” Given that it is unknown how much money (if any) Dwight Howard is being compensated, it is impossible to know whether he is being paid at all, let alone the fair market value for being on a television show. And, given that he signed a maximum contract, he certainly is not being paid below the fair market value of his services. Therefore, there would be no burden shifting or inferences to be made suggesting circumvention. Although there would be interference by a third party in terms of player movement, it does not qualify under the CBA’s predetermined inferences.

²⁶ Dave McMenamin & Ramona Shelburne, *Sources: Dwight Howard, Hawks meet*, ESPNLOSANGELES.COM (July 2, 2013), http://espn.go.com/los-angeles/nba/story/_/id/9443188/dwight-howard-meets-atlanta-hawks-los-angeles-lakers-finalize-pitch-according-sources.

But what makes this pitch so fascinating (and troubling from the perspective of salary cap circumvention) is the fact that the Houston Rockets own more than 30 percent of Comcast SportsNet Houston.²⁷ Dwight Howard's potential compensation is not even from a "sponsor, business partner, or third-party," but an entity *partially owned* by the team itself. Therefore, he would be receiving compensation for his basketball related services from the same source as his television activities. Although he might be getting fair market value for both services, there would simply be too much intermingling of funds.

V. CONCLUSION

Unless Dwight Howard actually obtains *financial* compensation for a television deal with Comcast SportsNet Houston, which would certainly seem to be in violation of the CBA, the Houston Rockets are probably in the clear. But moving forward, the league must reconsider its definition of "compensation." Even without the direct transfer of money, in this multimedia era of the Twitterverse, increased exposure in itself adds value. Every time Dwight Howard appears on television through some sort of reality show on Comcast SportsNet Houston, his brand gains more exposure and his indirect compensation increases. Failure to address all forms of compensation, be they financial or otherwise, will only encourage teams, broadcasters, and players to develop these mutually beneficial relationships in the age of higher luxury taxes. Although the league might want the increased exposure it would gain from a Dwight Howard television show, such an arrangement certainly is contrary to the spirit of Article XIII.

²⁷ *Id.* In this way, the battle over Howard's services was not merely between the Lakers and Rockets, but also between Time Warner Cable and Comcast. The day after Howard announced his decision, Comcast SportsNet Houston announced, "The Rockets have landed the biggest free agent in the world... Dwight Howard is coming to Houston." Alex Sherman, *Dwight Howard Houston Move Boosts Comcast Over Time Warner Cable*, BLOOMBERG.COM (July 5, 2013), <http://www.bloomberg.com/news/2013-07-06/dwight-howard-houston-move-boosts-comcast-over-time-warner-cable.html>. Just as Comcast will likely see a rise in ratings and advertising revenue, Time Warner may very well lose some viewers.