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Can Money Still Buy the Postseason in Major League Baseball? A 10-Year Retrospective on Revenue Sharing and the Luxury Tax

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Can Money Still Buy the Postseason in Major League Baseball?

A 10-Year Retrospective on Revenue Sharing and the Luxury Tax

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[1] The author would like to thank Professor David Richardson for allowing her to write about this rather unconventional topic for his Taxation seminar and for all of his input and advice. She would also like to thank all of her friends and family for their continuing support and guidance.

"But in baseball no team can be successful unless its competitors also survive and prosper sufficiently so that the differences in the quality of play among teams is not 'too great'." ~ Simon Rottenberg[2]

Introduction

Fifty years ago, in the first article of its kind,[3] Simon Rottenberg identified the greatest obstacle facing Major League Baseball (MLB): each club naturally wants to win and be the best, but unlike most businesses, baseball clubs would be adversely affected if they ran their competitors out of business.[4] For, it is because of the other clubs, and because of the competition on the field, that there exists any market for the product baseball produces. The thrill of the competition is what draws fans into the stands to "root, root, root for the home team,"[5] as the song goes. The phrase "competitive balance" is the one most often thrown around to describe this paradoxical situation, unique to professional sports, where members of the industry must strive both to win and to maintain an even playing field with other members of the industry in order to increase their own revenue. The problem is circular: in order to generate revenue, a club must be good enough that fans pay for tickets and apparel, but the club cannot be so dominating that games become boring. Thus, the ultimate goal is to be the best by a slight margin, which means it is in a club's best interest that the other clubs in the league are nearly

[2] Simon Rottenberg, *The Baseball Players' Labor Market*, 64 J. POL. ECON. 242, 254 (June 1956).

[3] *See generally id.* This article is considered the first professional journal article on sports economics.

[4] *Id.* at 254.

[5] Jack Norworth, *Take Me Out to the Ballgame* (1908).

equal matches. All of this theory and strategy is neatly packaged with the frequent reference to the need for "competitive balance" in professional sports.

Each of the professional sports leagues in the United States has employed various methods by which they have attempted to create this competitive balance.[6] The focus of this Note is on the methods used, both past and present, in MLB, with an emphasis on the use of internal taxation to create competitive balance. However, one of the first methods used in MLB was the reserve clause, which began as a secret agreement among owners and evolved into a clause used in players' contracts.[7] The reserve clause gave exclusive property rights to keep or trade the player as desired to the player's current club and prohibited a free market from existing within MLB.[8] After the advent of the Major League Baseball Players Association (MLBPA), players realized they could make more money in a free market economy and they fought for free agency.[9] Free agency gave rise to the next type of economic regulation, restrictions on free agency. Free agency allows players who have six years of experience in the league, and who are

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[6]Currently, the National Football League (NFL) and the National Hockey League (NHL) each have a salary cap, the National Basketball Association has both a salary cap and a luxury tax, and Major League Baseball (MLB) has a luxury tax. All four of the leagues have some form of revenue sharing as well.

[7]Michael J. Haupert, *The Economic History of Major League Baseball*, Economic History Services, http://eh.net/encyclopedia/article/haupert.mlb (last visited Oct. 8, 2006).

[8]*See generally* Rottenberg, *supra* note 1, at 245-48.

[9]Haupert, *supra* note 6.

not under current contracts, to sell their services to whomever they choose.[10] By limiting the players who are eligible for free agency and requiring compensation by the player's new club to the player's previous club, free agency has not meant a free market for MLB.[11] Likewise, the restrictions on the First-Year Player Draft (Draft), whereby clubs acquire players new to the league, restrain MLB from operating as a free market economy.[12] Instead, as will be discussed *infra*, the Draft levels the playing field by allowing each club only one player per round of the Draft.[13] In addition, the selections are made in each round starting with the club that had the worst record in the previous season and ending with the club that had the best record.[14] Despite all these efforts, MLB felt compelled ten years ago to levy internal taxes in order to maintain competitive balance in the face of deep-pocketed owners.[15] The collective bargaining

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[10]2003-2006 Basic Agreement, art. XX(B)(1), http://roadsidephotos.sabr.org/baseball/BasicAgreement.pdf, Effective Sept. 30, 2002 (last visited June 21, 2007) (also referred to as "2002 CBA").

[11]*See generally* Haupert, *supra* note 7.

[12]*See generally* Dave Cohen, *The Major League Baseball Draft: A Primer*, http://baseball.about.com/od/newsnotes/a/draftprimer.htm (last visited Sept. 24, 2006). In fact, the simple institution of the draft improved competitive balance. Before the draft was instituted in 1965, clubs could sign any player they wanted. *Id.* This allowed the more financially sound clubs to sign the best talent. *Id.*

[13] *Id.*

[14] *Id.*

[15]Hal Bodley, *'Global Yankees' Fire Up the Boss*, USA TODAY, January 30, 2003,

agreements reached in both 1996 and 2002 featured two types of internal taxation: a luxury/competitive balance tax and a revenue sharing plan.[16] These two methods of internal taxation are the primary focus of this Note.

This Note explores in great detail the competitive balance tax and the revenue sharing plan contained in both the 1996-2000 and 2003-2006 collective bargaining agreements (the "1996 CBA" and "2002 CBA" respectively) between MLB and the MLBPA. In addition, this Note briefly highlights the provisions in the collective bargaining agreement reached for 2007-2011 (the "2007 CBA"). Looking back on 10 years of taxation and redistribution, this Note will trace the structure of both methods and the results achieved under each. This Note will demonstrate how other factors, such as the introduction of the Wild Card into post-season play

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http://www.usatoday.com/sports/baseball/columnist/bodley/2003-01-30-bodley_x.htm (George Steinbrenner, the Yankee's owner, surmising that the taxes are aimed at his big spending ways). More than a few commentators have suggested that internal taxation is aimed at the New York Yankees, who annually have one of the highest payrolls. They have also amassed 26 titles as World Series Champions, with the next highest club only coming in at 9 titles. *See,* Major League Baseball, *World Series History: Championships by Club*, http://mlb.mlb.com/NASApp/mlb/mlb/history/postseason/mlb_ws.jsp?feature=club_champs (last visited Sept. 22, 2006); *See also* Dave Sheinin, *Financial Reins Taming Yankees*, HOUSTON CHRONICLE, Feb. 5, 2005, http://www.chron.com/disp/story.mpl/sports/bb/3025800.html.

[16] 1996-2000 Basic Agreement, arts. XXIII and XXV, http://www.roadsidephotos.com/baseball/cba9701.pdf (last visited March 3, 2007) (also referred to as "1996 CBA"); 2002 CBA, *supra* note 10, arts. XXIII and XXIV.

and free agent's ability to choose between clubs, have made the tax and revenue sharing look more successful than it has really been. A close look at how the clubs that have profited from the system reveals a lack of monitoring and disincentives to maintaining winning ball clubs in low revenue markets. Lastly, suggestions for improvement, such as instating a minimum payroll and rewarding low revenue clubs that reach a certain level of achievement will be considered.

I. The History of Economic Regulation in MLB

The economic mechanisms MLB has turned to in order to maintain competitive balance include: 1) a reserve clause vesting player ownership in club owners; 2) restrictions on free agency that allow for some freedom of movement while still compensating owners; 3) restrictions on the Draft which attempt to evenly allocate new talent; and 4) internal taxation by the use of a tax on over-spending payrolls and revenue sharing between high and low revenue markets.[17]

Part I(A) studies MLB's first economic regulation, that of the reserve clause, and its eventual demise. Part I(B) discusses the restrictions placed on free agency that were deemed necessary after the fall of the reserve clause created more of a free market in MLB. In addition to restricting free agency, MLB placed restrictions on the drafting of first-year players. Part I(C) details these restrictions and their effect on distribution of talent between clubs. Part I(D) introduces the internal taxation levied in the 1996 CBA and the 2002 CBA, which is the focus of the remainder of this Note.

[17]This is not a complete list, but merely a sampling of the most pronounced forms of regulation seen through MLB's history.

A. The Reserve Clause

One of the first methods of economic regulation advanced as maintaining competitive balance was the reserve clause. During the 1878-1879 winter meetings, the club owners secretly agreed to the reserve of five players by each club, with a list to be circulated around to the other clubs. The reserve clause gave exclusive property rights in a player to his current club and disallowed other clubs from offering the player a contract.[18] The result was that owners had the ability to renew a player's contract at the end of its term, with only restrictions on the amount by which the club could reduce the player's salary.[19] It also meant that other clubs could not directly contact a player to negotiate for his services, but instead had to contact the club that had reserved him.[20] In 1878, the owners were only permitted to reserve five players, but by 1887 the number eventually grew to include the entire club.[21] Because owners essentially owned the player and had the power to set salaries and control trades, players' salaries were depressed.[22] Those familiar with MLB today might find it hard to believe, but in the beginning the players

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[18]Haupert, *supra* note 6.

[19]*Id.*

[20]*Id.*

[21]*Id.* In 1878-1879, the club owners secretly agreed to the reserve of five players by each club, with a list to be circulated around to the other clubs. However, by 1887 the reserve clause became a part of the average contract between a club and a player. *Id.*

[22]Rottenberg, *supra* note 1, at 248.

were actually convinced that the reserve clause was necessary to maintain competitive balance in baseball.[23]

The first attack on the reserve clause was by Curt Flood, who was traded from the St. Louis Cardinals to the Philadelphia Phillies in 1970 and refused to report to Philadelphia.[24] The nature of the reserve clause meant a player who was traded either had the choice to report to his new club or not play in MLB at all.[25] After refusing to report to Philadelphia, Flood decided not to play baseball at all and sued MLB for violating antitrust laws.[26] Unfortunately for Flood, the Supreme Court decided not to overturn its previous decision[27], made in 1922, that baseball was not interstate commerce and thus not subject to antitrust laws.[28]

Despite the Supreme Court being unwilling to rule against the reserve clause, several players began to rebel after the Curt Flood decision. Andy Messersmith and Dave McNally had their contracts renewed by their clubs in 1975 but refused to sign the contracts.[29] At the end of the season, they argued that they were no longer subject to the reserve clause because neither

[23]Haupert, *supra* note 6. In fact, some players testified at the Celler Anti-monopoly Hearings in the 1950s in favor of the reserve clause. Andrew Zimbalist, *Baseball Economics and Antitrust Immunity*, 4 SETON HALL J. SPORT L. 287, 290 (1994).

[24]Haupert, *supra* note 7.

[25]*Id.*

[26]*Id.*

[27]*See* Fed. Baseball Club, Inc. v. Nat'l League of Prof. Baseball Clubs, 259 U.S. 200 (1922).

[28]Flood v. Kuhn, 407 U.S. 258 (1972).

[29]Haupert, *supra* note 7.

signed their contract for that year.[30] By this time, player grievances were heard by independent arbitrators, and the Messersmith/McNally grievance was heard by MLB arbitrator Peter Seitz.[31] Seitz urged the owners to negotiate with the players, but upon their refusal he sided with the players and struck down the reserve clause.[32] McNally retired, but Messersmith was picked up by new Atlanta Braves owner Ted Turner, despite efforts by all of the other owners to keep Messersmith from returning to play in MLB.[33] The reserve clause had been penetrated and Andy Messersmith became the first free agent in baseball as we know it today.[34]

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[30] *Id.*

[31] This Great Game 1976: The Big Leaguer Emancipated, http://www.thisgreatgame.com/1976.html (last visited Sept. 24, 2006). Ironically, Seitz had previously helped NBA player Rick Barry strike down that league's identical reserve clause. *Id.*

[32] *Id.*

[33] *Id.*

[34] Under Article XX, Section A of the 2002 CBA, clubs still have the ability to reserve up to 40 player contracts. Because a club's active roster is a 40-man roster, a club can reserve its entire active roster. The difference today is that any player who has six years of service in MLB and whose current contract has expired is a "free agent" and may freely sell his services to whomever he chooses. Under the old system, players contracts were either assigned to a new club or their current club resigned them; players had no choice about which club they were going to or how much money they would earn. *See infra* Part I(B) for more on free agency.

B. Free Agency

Free agency brought about problems of its own, namely the ability of wealthier clubs to acquire the best talent by offering the highest salaries. This concern is one of the most frequently cited when competitive balance is discussed. While arbitration allowed the birth of free agency, MLB was able to set certain restrictions to prohibit free agency from making MLB a free market economy. The 2002 CBA states that a free agent is a player who has at least six years of MLB service and has not signed a contract for the next season.[35] In addition to needing six years of service to be eligible, a player is restricted, for the first several months after filing for free agency, to arbitration with his previous club.[36] If he is offered and accepts arbitration, he is considered a signed player for the next season and enters arbitration with the club to determine the amount of his salary.[37] If he declines, he is free to negotiate and sign with another club.[38]

In order to protect clubs from losing players as soon as they become free agents, the 2002 CBA also provides some incentives and concessions for the player's previous club. First, as

[35] 2002 CBA, *supra* note 16 and accompanying text.

[36] *Id.* art. XX(B). A player has 15 days after October 15 (or the last day of the World Series, whichever is later) to file for free agency. *Id.* From then until December 7th, the player's previous club can offer salary arbitration to the player. *Id.* He then has until December 19th to accept or decline arbitration. *Id.*

[37] *Id.*

[38] *Id.* A player's previous club is free to negotiate with a player who declines their offer of arbitration until January 8th and then is unable to negotiate with that player again until after May 1st. *Id.*

discussed above, the player's previous club has the right to offer arbitration to the player. Second, and most importantly, is the compensation available to a club that loses a player to free agency. If a club offers arbitration that is declined and the player later signs with another club, or if the player signs with another club prior to December 7th, the player's previous club is compensated with draft picks in the upcoming Draft.[39]

Obviously, the players would profit the most, in the short run, from a free market economy with no restrictions. Why then do they agree to these restrictions on free agency? The most likely explanation is that players and owners have agreed to these restrictions, placed over the years into collective bargaining agreements, because a free market economy does not coalesce with the paradoxical situation baseball must maintain to be successful as an industry, that of encouraging competition without driving clubs out of business.

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[39] *Id.* Unlike the NFL, NBA and NHL leagues, MLB does not allow clubs to trade draft picks as compensation for a player. Therefore, the only way to acquire additional or higher draft picks is if a club receives them as compensation for a free agent. The amount and type of draft picks are dependent upon what type of player was lost as a result of free agency. Players are ranked by category as follows: Type A (a player statistically ranked in the upper 30 percent of players in his position); Type B (a player statistically ranked in the upper 50 percent of players in his position); or Type C (a player statistically ranked in the upper 60 percent of players in his position). 2002 CBA, *supra* note 10, art. XX(B)(4). The number and type of draft picks correspond to the level of player lost, with higher compensation for Type A than Type B, and higher for Type B than Type C. *Id.*

C. The First-Year Players Draft

Just as restrictions are placed on free agents, they are also placed on the drafting of new players into the league. New players enter the league through the Draft. Streamlining the process for bringing in new players by creating a draft was first implemented in 1965.[40] The advent of the draft meant that a new player could only negotiate with the club that selected him in the draft.[41] This prevented wealthier teams from signing all the best new talent.[42] In its most basic format, each team gets one draft pick per round, with the order of the draft starting with the club that had the worst record during the previous season and working its way to the club with the best record from the previous season.[43] This format allows clubs with poor records to have the first shot at drafting the best new talent coming into the league, once again in the hopes of creating competitive balance.

The Draft operates to encourage competitive balance in two ways. First, by allowing clubs with the worst records to draft first, those clubs get a chance to sign the best new talent available. Most importantly, the drafting club has exclusive rights to negotiate with the player.[44] Clubs have 15 days after the Draft to offer the player a minor league contract or he becomes a free agent who can sell his services to other clubs.[45] The second mechanism built into the Draft

[40]Cohen, *supra* note 11.

[41]*Id.*

[42]*Id.*

[43]*Id.*

[44]*Id.*

[45]*Id.*

to maintain competitive balance is the one-year no trade rule on draftees. The rule simply states that no draftee can be traded for at least one year.[46] This restriction arose after Pete Incaviglia asked for a large contract his drafting club could not afford, forcing them to trade him to a club that could.[47]

Though these restrictions are an improvement over the previous state of affairs, where the highest bidders could get the best prospects, there are still loopholes. Many players straight out of high school do not get drafted by the club of their choice, or they fail to get an acceptable offer from the drafting club, and they choose to go play college ball until they can enter the Draft again following their junior year.[48] Recent years have seen an even less subtle strategy where a player's agent makes well known the price his client is looking for, discouraging clubs from wasting a draft pick on a player they know they cannot afford.[49] As long as these loopholes are still present, the Draft does little to help achieve competitive balance.

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[46]Cohen, *supra* note 11.

[47]Major League Baseball, *Evolution of the Draft*, http://mlb.mlb.com/NASApp/mlb/mlb/news/mlb_news.jsp?ymd=20020516&content_id=26646&vkey=news_mlb&fext=.jsp (last visited Sept. 24, 2006).

[48]*Id. See e.g.,* Bill Shanks, *2002 Braves Draft Review* (May 31, 2003) http://braves.scout.com/2/113612.html (recounting that the Braves first-round draft pick in 2002, Jeff Francoeur, told the other clubs he would go to college at Clemson if he was drafted by anyone other than the Braves).

[49]Major League Baseball, *Evolution of the Draft*, http://mlb.mlb.com/NASApp/mlb/mlb/news/mlb_news.jsp?ymd=20020516&content_id=26646

D. Internal Taxation

In the early 1990s, MLB began to discuss the idea of revenue sharing.[50] Put simply, revenue sharing is the sharing of operating profits and is most often seen amongst partners in a limited partnership or amongst companies in an alliance. The topic of revenue sharing was first broached at meetings between the owners in 1993, and was unanimously approved by owners in early 1994.[51] However, revenue sharing would not appear in a collective bargaining agreement until 1996 because of its continual pairing with a salary cap by MLB, which the players have routinely refused.[52] In addition to adding revenue sharing to the 1996 CBA, owners and players agreed to add a luxury tax, later renamed the "competitive balance tax" in the 2002 CBA.[53] Both revenue sharing and the competitive balance tax were created to slow the growth of player salaries and to restore (or finally achieve) competitive balance within baseball. Both underwent major changes under the 2002 CBA and are expected to continue to adapt to the changing nature of the game in future collective bargaining agreements.

II. 1996 Collective Bargaining Agreement

&vkey=news_mlb&fext=.jsp (last visited Sept. 24, 2006).

[50] Maury Brown, *The Upcoming CBA and the Battles Within It: Part 1*, Feb. 27, 2006, http://www.hardballtimes.com/main/article/the-upcoming-cba-and-the-battles-within-it-part-1.

[51] *Id.* Revenue sharing did exist prior to this, but in an entirely different format. Prior to 1996, the only revenue sharing involved 20 percent of gate receipts going to the visiting team in the American League and 5 percent going to the visiting team in the National League.

[52] *Id.*

[53] 1996-2000 Basic Agreement, *supra* note 15, art. XXIII.

A. Revenue Sharing

The Basics - Revenue sharing, in its inaugural form, was implemented on a gradual basis from the 1996 season through the 2001 season.[54] First, three types of revenue sharing plans were created: the Straight Pool Plan, the Split Pool Plan and the Hybrid Plan.[55] The Straight Pool Plan called for all participating clubs to contribute 39 percent of their Net Local Revenues (defined as a club's local revenue minus its actual stadium expenses) to a putative pool that is then split equally between all participating clubs.[56] The Split Pool Plan calls for participating clubs to contribute 20 percent of their Net Local Revenues to the putative pool, with 75 percent of that pool being equally divided amongst participating clubs and the remaining 25% being divided between participating clubs with a Net Local Revenue that falls below the arithmetic mean for all clubs' Net Local Revenues in proportion to that club's distance from the mean.[57] The Hybrid Plan assigns to a club the more favorable result, both with the club as payor and payee, of either the Straight Pool Plan or the Split Pool Plan.[58] For the 1996 and 1997 seasons, the Hybrid Plan

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[54] *See generally* Art. XXV.

[55] *Id.* The 1996 CBA specified which plan was in place for each year covered under the Agreement.

[56] *Id.* Due to their status as expansion clubs, the Colorado Rockies and the Florida Marlins were not considered "participating clubs" until the 1998 season, and the Tampa Bay Devil Rays and Arizona Diamondbacks were not considered "participating clubs" until the 2000 season.

[57] *Id.*

[58] *Id.*

was implemented on a 60 percent basis.[59] For the 1998 season, the Split Pool Plan was implemented on an 80 percent basis.[60] For the 1999 season, the Split Pool Plan was implemented on an 85% basis.[61] For the 2000 season, the Split Pool Plan was implemented on a 100 percent basis.[62] The agreement contained an option for the 2001 season exercisable by the MLBPA, permitting the MLBPA to implement the Split Pool Plan on a 100 percent basis.[63] The MLBPA exercised that option for 2001.[64]

Results and Reactions – Increased revenue sharing occurred immediately after the 1996 CBA was implemented. In 1993, when revenue sharing consisted solely of sharing gate receipts with the visiting team,[65] overall money transferred into the system by all clubs hovered around

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[59]*Id.* The 1996 CBA provides more technical specifications in the event that the payments into the putative pool are insufficient to cover the payments out because of the nature of the Hybrid Plan.

[60]1996-2000 Basic Agreement, *supra* note 15, art. XXV. The 1996 CBA provides for some adjustment in the event a club would have had a more favorable result had the Hybrid Plan been in place and the Straight Pool Plan applied thereunder.

[61]*Id.* The 1996 CBA provides for some adjustment in the event a club would have had a more favorable result had the Hybrid Plan been in place and the Straight Pool Plan applied thereunder.

[62]*Id.*

[63]*Id.*

[64]*Id.*

[65]*Supra* note 51.

$20 million.[66] This amount escalated from $50 million in 1996 under the 1996 CBA to $169 million in 2002.[67] The revenue sharing plan obviously resulted in more money being moved within the industry, but there has been considerable debate over whether it has actually done anything to improve competitive balance within the game.

One of the most outspoken opponents is the Yankees owner, George Steinbrenner. MLB.com reporter Barry Bloom wrote an article in August of 2002, just before the 2002 CBA was approved and executed, wherein Steinbrenner expressed his concern over revenue sharing and its effect on clubs.[68] One of Steinbrenner's concerns was the way in which payee clubs were spending the amounts they received.[69] Under the 1996 CBA, there was no solid direction as to how revenue sharing dollars were to be spent by payee clubs and Steinbrenner, among others, was unhappy with the ability of clubs to use the money to offset owner losses.[70] Steinbrenner

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[66]Brown, *supra* note 50; Michael K. Ozanian & Cecily J. Fluke, *Inside Pitch*, FORBES, April 28, 2003, http://www.forbes.com/forbes/2003/0428/064_print.html.

[67]Dan Rovell, *Follow the Money* (March 20, 2003) http://espn.go.com/mlb/s/2003/0320/1526812.html. The 1996 CBA expired after the 2001 season, but a new CBA was not executed until September of 2002, which covered the 2003-2006 seasons.

[68]*See generally* Barry Bloom, *Steinbrenner Reiterates Economic Views* (Aug. 11, 2002) http://www.mlb.com/NASApp/mlb/mlb/news/mlb_news.jsp?ymd=20020811&content_id=102140&vkey=news_mlb&fext=.jsp.

[69]*Id.*

[70]*Id.*

thinks owners of low revenue teams know what they are getting into when they buy that sort of club and that they should be prepared to subsidize the club until it can generate sufficient profit, just as in any other business situation.[71] Steinbrenner characterizes each club as a business that should be run as such by the businessmen buying the clubs. However, this fails to factor in that MLB as a whole is a business, and that revenue sharing allows this one large business to subsidize weaker departments (i.e., low revenue clubs) by forcing clubs like the Yankees to share in the wealth they are blessed with as a product of their location in New York and their resulting substantial local media deals.

Another opponent of the revenue sharing system under the 1996 CBA was Scott Boras, an infamous agent for many of baseball's highest paid players.[72] Fans often blame Boras because of his reputation for getting his players exorbitant contracts, but Boras blames the system for the fact that clubs cannot afford to keep their homegrown talent and star players.[73] Because Boras sees the system as punishing successful teams and rewarding teams that make no effort, he put forth several suggestions, discussed *infra* in Part V, for attempting to maintain competitive balance while still providing incentives for clubs at both ends of the revenue spectrum.[74] Despite criticism from all interested parties - from high revenue clubs to low revenue clubs to players (some of whom think that revenue sharing discourages owners from

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[71] *Id.*

[72] Wikipedia, Scott Boras, http://en.wikipedia.org/wiki/Scott_Boras (last visited Oct. 2, 2006).

[73] Bob Nightengale, *Boras: Revenue Sharing Should be Earned*, USA TODAY, Jan. 25, 2001, http://www.usatoday.com/sports/bbw/2001-01-24/2001-01-24-majors.htm.

[74] *Id.*

offering higher salaries to players) - revenue sharing was modified only slightly in the 2002 CBA.[75]

B. Competitive Balance Tax

The Basics - Also introduced in the 1996 CBA was the luxury tax, later named the "competitive balance tax" by the 2002 CBA. For years owners have wanted a salary cap placed on each club's payroll, similar to that found in the other professional sports leagues in the United States, but the luxury tax was as close to a salary cap as could be agreed upon by players. The basic idea is to tax teams that exceed a certain salary threshold. In the 1996 CBA, there was a gradual phasing in of the luxury tax, with adjustments to the threshold each year to account for cost of living and other adjustments.[76] The luxury tax was only to be implemented in the 1997, 1998 and 1999 seasons under the 1996 CBA.[77] The initial thresholds were as follows: $51 million in 1997, $55 million in 1998 and $58.9 million in 1999.[78] From there, the threshold could be adjusted based on the midpoint between the payrolls for the fifth and sixth highest club payrolls.[79] Basically, if the midpoint was more than the threshold designated for that year, then the midpoint became the threshold.[80] The tax rate for the 1997 and 1998 seasons was 35 percent,

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[75]*See infra* Part III(A).

[76]*See generally* 1996 CBA, *supra* note 16, art. XXIII.

[77]*Id.*

[78]*Id.* art. XIII(B)(2).

[79]*Id.* art. XXIII(B)(3).

[80]*Id.* This has sometimes been referred to as a "floating threshold." The actual rule in the 1996 CBA is a little more detailed than this basic explanation. For example, if the 1997 midpoint is

and the tax rate for the 1999 season was 34 percent.[81] By December 21 of any year where a luxury tax was in effect, the club was to receive a bill indicating any luxury tax owed, which became due the following January 31.[82]

Calculating the Actual Club Payroll - Calculating a club's payroll upon which a tax may be assessed is a complicated matter that requires taking into account the possibility of assignment of player contracts, termination of contracts, multi-year contracts, performance bonuses and a whole host of other payments and payment issues. The attitude of some is very similar to the attitude taken by some with individual taxes: find the loopholes and exploit them. Clubs can use mechanisms of deferred compensation and other creative solutions to decrease not only the strain of a player's salary on the club's budget, but also to bring the club's aggregate payroll down low enough to incur little or no luxury tax. Accordingly, there are very detailed rules as to the calculation of a club's payroll for luxury tax purposes and the Office of the Commissioner of MLB completes the calculations.[83]

As a starting point, the 1996 CBA defines "Actual Club Payroll" to be the sum of: (a) 1/28th of player benefit costs (MLB administers such things as worker's compensation and player pensions, so each of the 28 clubs are expected to pay their share), (b) the yearly salaries of

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higher than the stated threshold, then in 1998 the higher of either the 1997 midpoint multiplied by 1.078 or the midpoint for 1998 is used. The same is true if the 1998 midpoint is the higher amount, with the multiplier decreasing to 1.071 for determining the 1999 threshold.

[81] *Id.* art. XXIII(B)(5).

[82] 1996 CBA, *supra* note 15, art. XXIII(B)(6)(a).

[83] *See generally id.* art. XXIII(C).

all players under a Uniform Player Contract with the club for that year, and (c) other sums defined under the rules.[84] The most complicated aspect of the calculation is which player contracts, or portions of player contracts, are attributable to the current year's Actual Club Payroll calculation. The easiest point to start from is to include the salary, attributable to that contract year, for each player who remains on a club's active list for the entire season.[85] While this may sound simple, it can get far more complicated when attempting to determine the value of a multi-year contract for any single season and when attempting to attribute deferred compensation to any one season. For a multi-year contract, an Average Annual Value is calculated as follows: the sum of (a) the base salary for each guaranteed year[86] plus (b) any signing bonus, or portion thereof, which is attributed to a guaranteed year[87] plus (c) any deferred compensation attributed to a guaranteed year.[88] The total sum derived from this calculation is then divided by the number of guaranteed years to give an Average Annual Value of the

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[84]*Id.* art. XXIII(C)(1). Other sums may include such things as player signing bonuses and portions of deferred compensation.

[85] *Id.* art. XXIII(C)(2)(a).

[86] Some contracts have optional years that can be exercised, but those are not treated here. *See infra* for more on option years.

[87] 1996 CBA, *supra* note 17, art. XXIII(E)(3). Signing bonuses are divided pro rata over guaranteed years in a multi-year contract or are attributable to the first year in multi-year contract with no guaranteed years. *Id.*

[88] *Id.* art. XXIII(E)(2).

contract.[89] Other types of bonuses, such as performance and award bonuses, are attributable to the year in which they are earned.[90] Similarly, a contract clause which increases the base salary in future guaranteed years for performance in a prior year is added to the Average Annual Value for each of those years.[91]

As mentioned above, some player contracts include option years, which are years in a contract that are not guaranteed, but which are exercisable at the option of either the player or the club, depending on how the option is structured. Not surprisingly, any option year which is exercised results in the base salary for that year being includible in the calculations for that year's Actual Club Payroll. However, many contracts require payment to the player of some monies if the option is not exercised by the club, sometimes referred to as an option buyout. These monies are deemed a signing bonus and are thus either distributed pro rata over the guaranteed years in the contract during the Average Annual Value calculation or are attributed to the first full year if there are no guaranteed years.[92] If the player then never receives the option buyout, there are provisions by which the club is credited or refunded the amount of the option

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[89] *Id.*

[90] *Id.* art. XXIII(E)(4).

[91] *Id.* The Average Annual Value is not recalculated. *Id.* Instead, the additional monies are added to the Average Annual Value of each year in which the monies are due. *Id.*

[92] 1996 CBA, *supra* note 15, art. XXIII(E)(5)(b). If there is more than one option buyout in the contract, then only the first is deemed a signing bonus and treated accordingly under this section. *Id.*

buyout that has already been included in the Actual Club Payroll for any previous years.[93]

The last complication in calculating an Actual Club Payroll relates to deferred compensation. Put simply, deferred compensation is any amount due to a player after the last season of his contract has been performed. This mechanism is sometimes used to defer some of the burden of a player's salary so that a team can afford to acquire him without taking a current hit to its budget. Presumably because it might also be used to defer compensation to later years in order to keep Actual Club Payroll numbers down and avoid the luxury tax, the rules are specific as to how these monies are to be allocated in Actual Club Payroll calculations. If the contract specifies which year(s) the deferred compensation is attributable to, then those amounts are includible in the Actual Club Payroll for that year.[94] If, however, the deferred compensation is not attributable to any given year, the amount is prorated over the guaranteed years of the contract.[95] Included as deferred compensation is any annuity compensation arrangement, which is an agreement by the club to purchase an annuity to pay the player after his services as a player are over.[96] The cost to the club of purchasing the annuity is includible, but not the proceeds the player is scheduled to receive after his service as a player is over.[97]

For any player who is assigned to another MLB club, his salary for that contract year will be prorated with the assignor club being attributed the portion through the date of assignment

[93] *Id.*

[94] *Id.* art. XXIII(E)(6)(b).

[95] *Id.*

[96] *Id.* art. XXIII(E)(6)(c).

[97] *Id.*

and the assignee club being attributed the portion beginning on the day after assignment.[98]

To make matters more complicated, some player contracts specify that the player is entitled to additional monies should he be assigned. If the monies are due in the year they are assigned, then those monies are includible in the player's salary for that year and are part of the proportioning described above for assignments.[99] If, however, the additional monies are not payable until a future contract year, the assignee club is responsible for paying those monies and they are includible salary for the year in which they are paid.[100]

Another situation that arises is that in which a player signs a Uniform Player Contract with a club after opening day of the current season. If the contract is worded in such a way that the player's salary is payable over a full season, then the club is only attributed a prorated portion for the number of days out of the full season he was on the club's active list.[101] However, if the player's entire salary is expressly payable for only the portion of the season he is with the club, then the club is responsible for the full amount.[102]

More complicated matters come into play when a player's contract is terminated, especially if it is a multi-year contract. If a player contract for a single season is terminated, the club is attributed that portion of the player's salary actually paid during that contract year.[103] If,

[98] *Id.* This is true regardless of the player's actual reporting date.

[99] 1996 CBA, *supra* note 15, art. XXIII(C)(2)(c).

[100] *Id.*

[101] *Id.* art. XXIII(C)(2)(d).

[102] *Id.*

[103] *Id.* art. XXIII(C)(2)(e).

instead, a multi-year player contract is terminated, the same result occurs unless there is a covenant in the contract that obligates the club to continue paying salary to the player. In that instance, the club is attributed with the amount it is obligated to pay, in the contract year it is obligated to pay such sum, even if all monies are paid up-front.[104] Instead of termination, a player may be assigned to a Minor League club. In such an instance, the club will exclude the pro rata portion of the player's salary for the number of days the player was absent from the club's 40-man roster.[105]

Distribution of Information - The above covers the substance of how Actual Club Payroll is calculated under the luxury tax regulations of the 1996 CBA. These calculations are provided by the MLB Player Relations Committee to the MLBPA twice a year during those years that the tax is operative.[106] In addition, the MLBPA may request additional projected compilations throughout the season, as long as there are not an unreasonable number of requests.[107] Also, the MLB or the MLBPA, may request projections on how a club's acquisition of a player will affect that club's Actual Club Payroll.[108] This was no doubt a provision created in the hopes of making

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[104] *Id.*

[105] 1996 CBA, *supra* note 15, art. XXIII(c)(2)(g).

[106] *Id.* art. XXIII(F)(1). Calculations are provided within 15 days after the season opens and again 15 days after the All-Star Game (which is around the midpoint of the season). *Id.* The Actual Club Payroll in these compilations is broken down by player and includes an estimate of the club's 1/28th share of player benefit costs. *Id.*

[107] *Id.*

[108] *Id.* art. XXIII(F)(1)(c).

the luxury tax a potential factor in a club's decision to acquire a player.

Use of Collected Taxes - If the luxury tax was meant as a compromise to a full-blown salary cap, then MLB surely hopes that clubs factor the tax into their player acquisition decisions. A look at how luxury tax money is used makes it understandable that some teams feel targeted and punished by the luxury tax.[109] Under the 1996 CBA, luxury tax funds were distributed as follows: (a) the first $10 million collected was used to compensate for any shortage of funds created by using the Hybrid Plan for revenue sharing in the 1997 season; (b) the next $7 million was to be used to fund payments to the five American League teams and the five National League teams with the lowest local revenue for 1996, as specified in the revenue sharing plan; (c) the next $3 million was to be used to refund teams for payments into the Industry Growth Fund,[110] with any balance remaining to be put directly into the Industry Growth Fund; (d) the next $2.5 million was to be held in reserve to be used to refund teams for any overpayment in luxury tax created because of non-occurring option buyouts and the like; and (e) any remaining balance was to be placed in the Industry Growth Fund.[111]

Results and Reactions - A total of $30.9 million was collected in luxury taxes under the 1996 CBA and most owners found it ineffectual.[112] Part of the criticism over the luxury tax's

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[109] Bodley, *supra* note 14. Namely, the New York Yankees whose owner, George Steinbrenner, often speaks out against the luxury tax.

[110] The Industry Growth Fund was created to promote growth of the game in the US, Canada and around the world. *See* 1996 CBA, *supra* note 15, art. XXVI.

[111] *Id.* art. XXIII(H).

[112] ESPN, *Selig Outlines Baseball's Economic Proposals* (Jan. 9, 2002)

inaugural structure under the 1996 CBA was the "floating threshold" aspect,[113] where essentially the teams with the five highest payrolls paid the tax. If the goal was to keep down player salaries, it failed to work under this system. For example, the threshold for the 1997 season was $51 million or the median between the fifth and sixth highest payrolls, whichever was higher.[114] The median ended up being higher at $55.4 million and, in fact, the thirteen highest payrolls were *all* over the $51 million threshold that had been indicated in the 1996 CBA.[115] This ineffectual outcome left owners unsatisfied and led to a very different tax in the subsequent 2002 CBA.[116]

III. 2002 Collective Bargaining Agreement

A. Revenue Sharing

The Basics - The 2002 CBA's incarnation of revenue sharing was not that different from the Straight Pool Plan of the 1996 CBA's plan.[117] The base plan called for 34 percent of all Net

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http://espn.go.com/mlb/news/2002/0109/1308667.html.

[113] S*upra* note 80 and accompanying text.

[114] S*upra* note 78 and accompanying text. Presumably, MLB hoped that no club would go over $51 million. However, they obviously realized that it was likely to happen and thus built in the "floating threshold" aspect.

[115] Doug Pappas, *News Briefs: Winter 1998*, OUTSIDE THE LINES NEWSLETTER, Winter 1998. Another interesting thing to note is that the $54.1 million median was higher than the threshold set for the next season.

[116] S*upra* Part III(B).

[117] 2002 CBA, *supra* note 9, art. XXIV(A)(7).

Local Revenues to be equally divided among all 30 clubs under a straight pool plan.[118] The first new aspect of this version of the revenue sharing plan was the Central Fund Component, which reallocates additional sums from the Central Fund to payee clubs. The Central Fund is funded each year by national revenue derived from national television contracts and merchandising rights and is sometimes referred to as baseball's war chest.[119] The Central Fund Component of the revenue sharing plan begins with the net transfer value under the base plan, which is the total amount transferred from payor clubs to payee clubs under the base plan for revenue sharing.[120] This component calls for 41.066 percent of the net transfer value to be pulled from MLB's Central Fund and reallocated to payee clubs, effectuating a greater distribution to payee clubs.[121] Under this section, payee clubs are not all clubs which receive more from the revenue sharing distribution than they pay in, but only those that have their average Net Local Revenue over the previous three years fall below the average Net Local Revenue for all 30 clubs over the same period.[122] Allocations to each of the payee clubs is determined by mathematical formula. The money is drawn from the Central Fund and it is deducted according to mathematical formula from distributions that would have been made to payor clubs from the Central Fund at the end of

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[118] *Id.*

[119] Chris Isidore, *Cries of Poverty are Undercut by Hundreds of Millions in Central Fund* (Dec. 21, 2001) http://money.cnn.com/2001/12/21/news/column_sportsbiz.

[120] 2002 CBA, *supra* note 9, art. XXIV(A)(9)(a).

[121] *Id.*

[122] *Id.*

the season.[123] The Central Fund Component is one of two ways the 2002 CBA provides for additional compensation to be made to low revenue clubs despite a straight pool revenue sharing plan being in place.

The second new aspect of the 2002 CBA that allows for lower revenue clubs to receive additional distributions is the Commissioner's Discretionary Fund. Under this provision, $10 million in Central Fund money is used in each revenue sharing year to form the Commissioner's Discretionary Fund from which distributions may be made to any club at the discretion of the Commissioner.[124] In order to receive funds, clubs must make a request in writing detailing how the funds will be spent and how such spending will improve the club's performance on the

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[123] *Id.* To determine the amount a payee club will receive, "multiply the net transfer value of the Central Fund Component in that revenue sharing year by a fraction, the numerator of which is the difference between the industry's mean Net Local Revenue for the preceding three revenue sharing years and the Recipient's mean Net Local Revenue for that period, and the denominator of which is the sum of all differences for each of the Recipients." *Id.* To determine the amount a contributor club will have deducted from its share of Central Fund money, "multiply the Contributor's Net Local Revenue for the preceding three revenue sharing years by a fraction, the numerator of which is the net transfer value of the Central Fund Component in that revenue sharing year and the denominator of which is the sum of the means of each Contributor's Net Local Revenue for the preceding three revenue sharing years." 2002 CBA, supra note 10, art. XXIV(A)(9)(a).

[124] 2002 CBA, *supra* note 9, art. XXIV(A)(10).

field.[125] Although a distribution is at the discretion of the Commissioner, the rules require him to notify and consult with the MLBPA about his decision to grant or not grant such distribution.[126] Any amount not distributed under this mechanism is distributed on a pro rata basis to all clubs at the end of the revenue sharing year.[127]

Results and Reactions - By far, the biggest complaint about revenue sharing under this plan has been the disincentive for lower revenue clubs to improve. The supposed rationale behind a lower revenue club doing this is that if they improve on the field, more fans will come to games, their revenue will increase, and they will lose the hefty sum they would otherwise receive from revenue sharing.[128] A related problem is that higher revenue teams will have disincentives to spend their money on baseball, with owners choosing instead to spend their money on other business pursuits.[129] Red Sox owner, John Henry, whose team had one of the highest payrolls during the operation of the 2002 CBA, is one of the owners who has addressed the problems with the revenue sharing plan.[130] While he applauds the overall improvement in baseball, he notes that as with all taxes, there is a limit at which effort and investment is

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[125] *Id.*

[126] *Id.*

[127] *Id.*

[128] Jayson Stark, *Either Spend on Payroll, or Give it Back* (April 28, 2006) http://insider.espn.go.com/mlb/insider/columns/story?columnist=stark_jayson&id=2424797&univLogin02=stateChanged.

[129] See Brown, *supra* note 50.

[130] *Id.*

discouraged.[131]

Another often heard complaint is that some clubs receive more from revenue sharing than they spend on payroll. For example, in 2005, the Florida Marlins cut their payroll by more than 75% to a league-leading low of $14,998,500, more than $20 million below the next highest payroll.[132] Their cut of revenue sharing amounted to approximately $31 million, leaving them with a surplus of roughly $16 million.[133] Such numbers make it less than surprising that owners of high revenue teams are calling for stricter controls and accounting for the way revenue sharing money is spent.

The 2002 CBA added a provision that stated that any revenue sharing receipts should be used by a club to "improve its performance on the field."[134] There was also a requirement that spending reports be submitted, and authority was given to the Commissioner to penalize clubs misusing funds.[135] Unfortunately, many believe this section is without force because there is no requirement as to how detailed the spending reports must be and no team has ever faced penalties under this section for misuse of funds.[136] The real loophole is touted to be that funds

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[131] *Id.*

[132] Maury Brown, *The Upcoming CBA and the Battles Within It (Part 2) – Revenue Sharing*, May 1, 2006, http://www.hardballtimes.com/main/article/the-upcoming-cba-and-the-battles-within-it-part-2-revenue-sharing (hereinafter referred to as "Brown 2").

[133] *Id.*

[134] 2002 CBA, *supra* note 9 art. XXIV(B)(5).

[135] *Id.*

[136] Murray Chass, *These Teams are Poor? That's Rich*, N.Y. TIMES, April 30, 2006,

can be used for any number of things deemed to directly or indirectly relate to on-field performance, including spending on a club's farm system or scouting.[137] Some even speculate that teams like the Marlins use revenue sharing funds to compensate for past overspending.[138] It comes as no surprise that George Steinbrenner, the owner of the high revenue Yankees, is frequently cited with quotations such as, "I'd like to see everybody competing, but we're not a socialist state."[139]

B. Competitive Balance Tax

George Steinbrenner also feels his Yankees are targeted by the luxury tax, renamed the competitive balance tax in the 2002 CBA. The club owners ratified the 2002 CBA with a vote of 29 to 1; the one holdout was, of course, Steinbrenner.[140] More than just a simple name change, the competitive balance tax of the 2002 CBA packs a much more powerful punch than its predecessor. Not only are there firm thresholds in place for each year the tax is active, but the tax percentage increases for second and third time violators.[141] Because the methods of Actual Club Payroll calculation remain largely unchanged, this discussion will focus on only aspects of

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http://www.nytimes.com/2006/04/30/sports/baseball/30revenue.ready.html?ex=1304049600&en=ce1360b237adcd78&ei=5088.

[137] Brown 2, *supra* note 131.

[138] Chass, *supra* note 135.

[139] Brown 2, *supra* note 131.

[140] David Locke, *Plan to Curtail Yankees, Steinbrenner Backfires*, SEATTLE POST-INTELLIGENCER, April 30, 2003.

[141] See generally 2002 CBA, *supra* note 9, art. XXIII.

the 2002 CBA that differ from the luxury tax arrangements in the 1996 CBA.

The Basics - The first major change is the establishment of firm thresholds for each year the competitive balance tax is in place. The thresholds are as follows: $117 million in 2003; $120.5 million in 2004; $128 million in 2005; and $136.5 million in 2006.[142] So far, these thresholds have been breached by only three teams: the Yankees, Red Sox and Angels.[143] To discourage spending, and give the tax more bite, the tax percentage increases for second and third time violators.[144] For 2003, first time violators under the new 2002 CBA were taxed at 17.5 percent.[145] After 2003, first time violators were taxed at 22.5 percent, second time violators were taxed at 30 percent, and third time violators were taxed at 40 percent.[146]

It comes as no surprise that the Yankees were the only third time offenders by 2005.[147] The Yankees paid a tax of approximately $11.8 million in 2003[148], $25 million in 2004[149] and $34

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142 *Id.* art. XXIII(B)(2).

143 Barry Bloom, *Yanks, Red Sox Hit with Luxury Tax Bills* (Dec. 21, 2005) http://newyork.yankees.mlb.com/NASApp/mlb/news/article.jsp?ymd=20051221&content_id=1286225&vkey=news_nyy&fext=.jsp&c_id=nyy.

144 2002 CBA, *supra* note 9, art. XXIII(B)(3).

145 *Id.*

146 *Id.*

147 Bloom, *supra* note 142.

148 Sports Illustrated, *Yankees Receive $11.8 Million Luxury Tax Bill*, Dec. 24, 2003, http://sportsillustrated.cnn.com/2003/baseball/mlb/12/24/luxury.tax.ap/index.html.

149 USA Today, *Yankees, Red Sox, Angels to Pay Luxury Tax*, Dec. 27, 2004,

million in 2005.[150] Despite all this spending, the Yankees lost the World Series to the Marlins in 2003, lost the American League Championship to the Red Sox in 2004, and lost in the American League Division Series to the Angels in 2005.[151] Most interesting about this is that the Angels were taxed just under $1 million in 2004 and the Red Sox were taxed approximately $3.1 million and $4 million in 2004 and 2005 respectively.[152] It is also of interest to note that the Red Sox won the World Series in 2004 for the first time since 1918.[153]

The only other major change in the 2002 CBA is use of the proceeds. The first $5 million is to be held in reserve for potential tax refunds resulting from a club's inclusion of an

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http://www.usatoday.com/sports/baseball/2004-12-27-luxury-tax_x.htm.

[150] Bloom, *supra* note 142.

[151] Yankees Postseason Results, http://newyork.yankees.mlb.com/NASApp/mlb/nyy/history/postseason_results.jsp (last visited October 4, 2006). The first level of postseason play is the League Division Series, of which there are two: the American League Division Series and the National League Division Series. At this level, 8 teams compete. The second level of postseason play is the League Championship Series, of which there are again two: the American League Championship Series and the National League Championship Series. At this level, 4 teams compete. The third and final level of postseason play is the World Series, at which the final two teams compete.

[152] Bloom, *supra* note 142.

[153] Red Sox Postseason Results, http://boston.redsox.mlb.com/NASApp/mlb/bos/history/postseason_results.jsp (last visited October 4, 2006).

option buyout in its Actual Club Payroll and subsequent non-payment of the option buyout.[154] After allocating the first $5 million to the reserve, the rest is divided up as follows: 50 percent to player benefits, 25 percent to the Industry Growth Fund and 25 percent goes to developing players in countries with no organized baseball at the high school level.[155] In comparison to the 1996 CBA model, the 2002 CBA is more focused on the development of the overall sport, whereas the previous model involved more of a transition into the tax.

Results and Reactions - Those who think that increased revenue sharing and the competitive balance tax have resulted in greater competitive balance most often point to the inclusion of a different mix of clubs in the playoffs each year. One sportswriter calls this "spreading the success" and notes that there's far more competitive balance in baseball than in other professional sports in the U.S.[156] For example, as of 2005, 10 different teams have filled 12 different World Series slots since 2000, with a different club winning in each of those 6 years.[157] Additionally, 14 different teams have filled 24 League Championship Series slots since 2000.[158] In comparison, the NFL has only had 4 different champions in the past 6 years, and the

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[154] 2002 CBA, *supra* note 9, art. XXIII(H)

[155] 2002 CBA, *supra* note 9, art. XXIII(H). The use of 25 percent of the funds to develop players in countries with no organized baseball at the high school level makes sense when you look to the influx of foreign players in recent years.

[156] Dan Wetzel, *Sharing the Wealth* (Oct. 21, 2005) http://sports.yahoo.com/mlb/news?slug=dw-worldseries102105&prov=yhoo&type=lgns.

[157] *Id.*

[158] *Id.*

NBA has only had 3 different champions in those 6 years.[159]

Instead of giving credit to increased revenue sharing and the competitive balance tax, some commentators give the credit to the introduction of the Wild Card in 1995, which allows one team from each league, which has the best record out of those clubs that did not win their division, to enter the first round of the postseason.[160] However, Commissioner Bud Selig is often cited as touting the parity resulting from revenue sharing and the competitive balance tax and it seems others are starting to get on board.[161]

There remains one club seemingly unaffected by the efforts to create greater parity through revenue sharing and the competitive balance tax: the New York Yankees. One sportswriter asserted that the owners' plan to curtail Steinbrenner's spending on the Yankees really backfired.[162] Instead of putting the brakes on his spending so other clubs could catch up, it has made many clubs fight to stay under the tax threshold to avoid the tax, while Steinbrenner has plowed forward with a payroll that was approximately 40 percent higher than the next

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[159] *Id.*

[160] Jacob Luft, *Wild Card Drains Passion from AL West Race*, Sept. 13, 2002, http://sportsillustrated.cnn.com/baseball/news/2002/09/12/the_beat. This article was written shortly after the 2002 CBA was executed but it shows the general sentiment.

[161] *See* Mike Bauman, *A Great Year for the Grand Old Game* (Dec. 26, 2005) http://stlouis.cardinals.mlb.com/NASApp/mlb/news/article_perspectives.jsp?ymd=20051221&content_id=1286183&vkey=perspectives&fext=.jsp.

[162] Locke, *supra* note 139.

highest club in 2003.[163] In 2005, the Yankees jumped to approximately 61 percent higher than the next highest club payroll.[164] His ability to do this year after year stems, at least partially, from the fact that he owns his own television network.[165] The result is that he can pay a star player far more because having that star on the team will make the Yankees better, which will make television ratings and advertising rates during games increase, which will increase Steinbrenner's own personal revenue.[166] As David Locke points out in his article on this topic, other teams start the season with a set stream of revenue, knowing their limitations for the year. Steinbrenner has an entirely different business model from which to work because he can increase his revenue stream by making the Yankees a better team, and he can afford to make the Yankees a better team by acquiring stars with the increased revenue.[167] This cycle is what allows the Yankees to function as they do and makes the competitive balance tax essentially ineffective against the Yankees.

IV. 2007 Collective Bargaining Agreement

A. Revenue Sharing

Although the 2007 CBA has yet to be released for the public's consumption on either the

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[163] *Id.*

[164] USA Today Salaries Database, http://asp.usatoday.com/sports/baseball/salaries/totalpayroll.aspx?year=2006 (last visited October 4, 2006).

[165] Locke, *supra* note 139.

[166] *Id.*

[167] *Id.*

MLB or MLBPA websites, several sportswriters have summarized its contents. It appears that very little has changed since the 2002 CBA, with the exception of increased thresholds for revenue sharing and the luxury tax. The biggest change for revenue sharing seems to be the reduction in the tax rate from 34 percent under the 2002 CBA to 31 percent under the new 2007 CBA.[168] However, because baseball is generating more revenue, those clubs on the bottom in terms of revenue should receive more from the top clubs, despite the decreased rate.[169] The goal under the 2007 CBA is to move about $326 million from large revenue clubs to small revenue clubs, which is consistent with the amount being moved under the 2002 CBA.[170] This number will grow consistent to revenue and disparity changes.[171] These changes result in very little change to revenue sharing under the 2007 CBA.

B. Competitive Balance Tax

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[168] 2002 CBA, *see supra* note 9, art. XXIV(A)(7) (setting the rate at 34 percent); Tampa Bay Devil Rays, *MLB, Union Announce New Labor Deal* (Oct. 25, 2006) http://tampabay.devilrays.mlb.com/news/article.jsp?ymd=20061024&content_id=1722211&vkey=news_mlb&fext=.jsp&c_id=mlb (stating that the new rate is 31 percent).

[169] To show the dramatic increase in revenues over the last fifteen seasons, gross revenues in MLB were $5.2 billion in 2006, compared to $1.2 billion in 1992. Tampa Bay Devil Rays, *MLB, Union Announce New Labor Deal* (Oct. 25, 2006) http://tampabay.devilrays.mlb.com/news/article.jsp?ymd=20061024&content_id=1722211&vkey=news_mlb&fext=.jsp&c_id=mlb (stating that the new rate is 31 percent).

[170] *Id.*

[171] *Id.*

The 2007 CBA also brings very little change to the competitive balance tax, with the exception of increasing threshold levels. The thresholds have increased as follows: $148 million in 2007; $155 million in 2008; $162 million in 2009; $170 million in 2010; $178 million in 2011.[172] In addition, the rates at which clubs are taxed remains unchanged. First-time offenders are taxed at a rate of 22.5 percent, second-time offenders are taxed at 30 percent, and any club who has exceeded the threshold for three or greater times is taxed at 40 percent.[173] Those clubs that were taxed at 40 percent in 2006 will enter into the 2007 CBA at the same rate if they again exceed the threshold during the 2007 season.[174] These changes merely continue the status quo, with slight increases in the thresholds to account for rising player salaries.

V. Suggestions for Alternatives

For those fans and commentators who hoped that the new collective bargaining agreement would further resolve the disparity amongst MLB clubs, the 2007 CBA was probably a huge disappointment. For years, fans, coaches, players, sportswriters, scouts, agents and anyone else with a passion for the game have explored alternatives from compensating clubs for their homegrown players to introduction of a minimum salary cap. Part V will outline some of these options and weigh them against the current system.

Maximum Salary Cap - One of the most often touted ideas is that of a maximum salary cap for MLB. While this would be a solution that might please most owners and fans, most acknowledge it will never happen because of the strength of the MLBPA.

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[172] *Id.*

[173] *Id.*

[174] *Id.*

Minimum Salary Cap - A solution similar to having a maximum salary cap is having a minimum salary cap. Unfortunately, players believe that they cannot philosophically agree with a minimum salary cap if they do not believe in a maximum salary cap.[175] While requiring clubs to have a payroll of at least $50 or $60 million might well improve the parity on the field, the MLBPA obviously will not risk being put in the position where they can no longer defend their philosophy against a maximum salary cap.

Independent Auditing - As previously mentioned, low revenue teams receiving revenue sharing funds must report their spending by April 1st of the following year and the Commissioner has the authority to penalize clubs that misuse these funds.[176] Some would like to see an independent auditor reviewing these reports, as well as the introduction of penalties in the form of returning all monies not used to improve on-field performance. Commissioner Selig has routinely defended his oversight of this issue and insists that funds are used properly by receiving clubs and that no penalties have been necessary.[177]

Compensation for Homegrown Players - Scott Boras, the infamous player agent discussed previously, spoke out before the adoption of the 2002 CBA with some ideas of his own. One rather interesting idea involved compensating clubs for players that come through

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[175] Stark, *supra* note 127. Stark sums up the attitude of the players best: "They think you have to be consistent in life, even if it means teams are using their revenue-sharing monopoly money to pump up the value of their franchises instead of using it to pay the members of your own union." *Id.*

[176] *See supra* note 134 and accompanying text.

[177] Chass, *supra* note 135.

their farm system and later succeed in the major leagues.[178] Specifically his plan said that a club could be compensated $1 million for a homegrown player who has 500 at-bats in a season, increasing $1 million for each year he is in the majors until he becomes a free agent.[179] While this is only one model, one could come up with many different ways in which a club could be compensated for developing players.

Some clubs insist that the revenue sharing money they received is put directly into the farm system, on the theory that this is where you build a winning franchise.[180] The only problem with this is that, in order to generate more money for the club, many of these players must be traded to other clubs before they are able to produce for the club that "raised" them. The assumption is that eventually the club will have enough money to be able to afford the acquisition of better players and will, in turn, be more competitive on the field. Although this has not been the case for the Pirates, which finished the 2006 season 16.5 games behind the first place team in their division.[181] Whether their philosophy of spending their money in the minors will pay off is a question only time can tell.

However, the idea of rewarding clubs for the development of successful players makes some sense. A plan like this would allow lower revenue clubs that drafted young talent to realize

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[178] Nightengale, *supra* note 73.

[179] *Id.*

[180] *See, e.g.,* ESPN (May 17, 2004) http://sports.espn.go.com/mlb/news/story?id=1803537. The Pittsburgh Pirates have done this and had the largest winning percentage in the minors in 2003. *Id.*

[181] MLB, http://mlb.mlb.com/NASApp/mlb/mlb/standings/index.jsp (last visited Oct. 4, 2006).

some of the benefit, even if they are forced to trade the player before they can realize his full monetary value. While the administration for such a plan could be cumbersome, it could change baseball as we know it in a very meaningful way.

Incentive-based Rewards - Scott Boras also suggested doling out revenue sharing dollars based on the number of wins a team achieves.[182] His suggestion is to set benchmarks, such as $5 million received for 75 wins and $10 million received for 80 wins.[183] This would combat the previously discussed issue of low revenue teams relying on the revenue sharing monies and thus having disincentives to improve.[184]

Conclusion

Despite assertions by Commissioner Selig, and the vast improvements in the regulations between the 1996 and 2002 CBA, the system of taxation and revenue sharing contains disincentives for all clubs and is poorly monitored. Owners of high revenue teams have disincentives to spend their money on baseball because of their distaste of supporting lower revenue teams and their fear that funds are being misused. Understandably, these owners see

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[182] Nightengale, *supra* note 73.

[183] *Id.* Each team plays 162 games per year, with the general standard of a "good" season being a win percentage of .500, or 81 games.

[184] *See supra* Part III(A).

their club as a business that they are running in order to generate a profit. What they sometimes lose sight of is that MLB, as a whole, is a business and is only attempting to subsidize weaker departments (low revenue clubs) so that the business as a whole prospers.

Nevertheless, the current system provides disincentives for lower revenue teams to improve because winning games means higher revenue, which will eventually lead to less of their money coming from revenue sharing. Why would owners prefer to get their money from revenue sharing than from their own revenue? The simple answer is that it is easier. In addition, some owners are suspected of spending very little money on their club in order to pressure their city for a new stadium, or to convince MLB to move their team to a new city. If this is the case, it would seem to make the most sense to institute both a maximum and a minimum salary cap. This would force owners to live within an acceptable realm of operating expenses. Clubs with more money would be curbed from buying a championship club, and clubs with less money would be prevented from milking the revenue sharing system or strong-arming their way into a new city or stadium.

Without such a control, we are left to ponder the effectiveness of the luxury tax and revenue sharing. If MLB is correct, and the current systems of taxation and revenue sharing actually improve competitive balance in baseball, there are still issues of disparity and poor monitoring. Perhaps the disparities will continue to erode over time. However, without stricter monitoring and stiffer penalties, low revenue teams will exploit any loophole they can find and there is a risk of owners lining their own pockets to compensate for the debt they take on in order to purchase a MLB club. The spirit of the game should be about pride and competition, not about making owners rich. Unfortunately, the luxury tax and revenue sharing do not seem to have changed this climate in baseball.

At the time of the writing of this Note, a new collective bargaining agreement for the 2007-2011 seasons has recently been reached by the MLB and MLBPA, outlined *supra* in Part IV. Instead of moving towards greater restrictions favoring competitive balance, however, it merely raises the thresholds for both the revenue sharing plan and the luxury tax. Only time will tell, but it seems unlikely that this new agreement will produce any better results than its predecessors.