UK court's soccer sponsorship ruling offers contract tips

03 JANUARY 2020

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CATEGORY:
ARTICLE

This article originally appeared in Law360 on January 2, 2020

Sports business lawyers should take note of the judgement rendered on Oct. 25, 2019, by the High Court of Justice in the dispute between New Balance Athletics Inc. and the Liverpool Football Club.[1] Not only lawyers, of course: CEOs and marketing directors alike should be aware of old and new ways to work their way around so-called matching right clauses, whether to strengthen them or take advantage of loopholes.

In essence, a matching right clause in a sponsorship agreement is crafted to allow the current sponsor to retain its sponsoring and commercial partnership with its key sports property, be it an individual, club, governing body, event or facility. Long-term partnerships are usually not only needed for building a robust and enduring return from the investment made in the sports property, mostly in terms of brand equity, but may also be needed to adequately execute a long-term commercial and marketing strategy. On the other side, while a club must reckon with such business reality, it must also ensure that the sponsorship contract reflects the actual market value of its shirt at the time it is up for renewal.

So what happened between Liverpool FC and New Balance, after some eight years of happy marriage, which broadly coincided with the athletic shoe brand's global rise in soccer? Typically, Nike Inc. put its eyes on Liverpool FC, a legendary club now back to past glories under Jürgen Klopp's stewardship. Most probably, New Balance's attempts to convince the club it would still be the best partner going forward fell short of Liverpool's expectations (and Nike's offer), which meant that the Boston sports manufacturer's only option left to hold on to its property would be that of triggering its matching right.

In a typical kit supply and sponsorship deal, the residing sponsor's castle is usually protected by a double defense system: the right of first negotiation (the moat) and the right of first refusal or matching right (the curtain wall). In this case, Nike's battering rams and missiles put the strength of this ultimate bastion to severe and fatal test.

According to the decision rendered by Justice Nigel Teare, the New Balance sponsorship agreement included a right of first negotiation, a period during which the parties were required to negotiate in good faith the renewal of the agreement and also throughout which the club was prevented from commencing negotiations with third parties. Once this first dealing period had expired and no renewal agreement was reached, Liverpool FC was entitled to enter into negotiations with a competitor of New Balance.

However, the clause provided that New Balance would then have "thirty (30) business days from the date of receipt of such third-party offer to Notify the Club in writing if it will enter into a new agreement with the Club on terms no less favourable to the Club than (i) the terms of this Agreement and/or (ii) the material, measurable and matchable terms of such third-party offer." Upon receipt of such notice Liverpool FC would have been "obliged to enter into a new agreement containing such terms with the Sponsor."

Nike, the prospective new sponsor, came up with something that fell a little short of an unmatchable offer.

Clubs' kit deals are typically built on a minimum guaranteed and incremental royalty-based income. The size of the base fee is certainly important, but so is the expected royalties stream. Nike didn't offer an above-market minimum guarantee for this type of deal: at £30 million per year, it is well below the £75 million Manchester United receives from Adidas AG for example.

However Nike did offer what it probably thought would be the killer blow to any offer New Balance could realistically make — i.e. to "sell Licensed Products throughout the Term […] as follows: (i) in no less than 6000 stores worldwide, 500 of which shall be Nike owned or controlled with the potential for sale of Licensed Product in as many as 13000 stores worldwide, and (ii) within not less than 51 countries online through NIKE.com."

In addition, Nike offered to sustain such sales "through marketing initiatives featuring no less than three (3) non-football global superstar athletes and influencers of the calibre of Lebron James, Serena Williams, Drake, etc." Somehow contrary to what would be expected, it was this second

proposition that actually proved fatal to New Balance.

New Balance responded to Liverpool's notification of Nike's offer within the following 30 days as follows: "New Balance Athletics, Inc is happy to notify the Club that it will enter into a new agreement with the Club as enclosed herewith on terms no less favourable to the Club than the material, measurable and matchable terms of the Nike Offer." It then went on listing the (almost) exact relevant terms as offered by Nike. However, the Liverpool FC did not think those terms did in fact meet Nike's terms.

One step back.

As emerges from the High Court decision, during the 30 days following notification of Nike's offer, it seems that New Balance went through frantic consultations among top management, regional managers and distributors to come up with sales estimates that could compete with Nike's distribution commitment.

According to Liverpool's counsel, this exercise was fraught with inaccuracy and bad faith, since there were five "serious errors" concerning the feedback provided by regional managers, "which were known to someone in senior management at New Balance" and that any one of those errors would take the number of stores (doors) below 6,000.

English courts have traditionally been skeptical of the concept of good faith in commercial contracts, as it does not generally have an established, agreed meaning under English contract law. Applying a restrictive notion of the (implied, in this case) obligation of good faith, as emerging from a number of decisions, however, Justice Teare considered the question to be "whether reasonable and honest people would regard the challenged conduct as commercially unacceptable."

In the case at hand, it seemed plausible that New Balance's top management was not aware of the errors and given it had taken a sensible approach by conducting a due diligence exercise, there appeared to be "a cogent case that when the Senior Leadership Team … took the decision to match the Nike offer … it acted in good faith."

Justice Tear went even further by adding that "if New Balance honestly believed that it could meet the distribution obligation but its grounds for so believing were unreasonable then I do not consider that it would be acting in breach of the implied duty of good faith. Its conduct would be innocent, albeit careless or unwise."

At this point Liverpool's case would have appeared doomed, since, according to the High Court, the distribution term was matched by New Balance. Instead, the court went on to say that, however, the "marketing term was not [matched because] no reference was made to Lebron James, Serena Williams or Drake."

In fact, it now seems with hindsight that New Balance underestimated such reference and, rather than repeating Nike's words and names, offered to "market LFC and/or Licensed Products through marketing initiatives featuring no less than three (3) non-football global superstar athletes and influencers", though omitting "of the calibre of Lebron James, Serena Williams, Drake, etc."

Possibly New Balance thought Nike meant to effectively offer use of those people (as it could have, being them all Nike's brand ambassadors) and that it added "of the calibre of" to emphasize their value. Instead, the court read such reference as an objective measure of the kind of celebrities that would have been employed in marketing initiatives supporting the club's kit sales. As such, its omission had the effect that New Balance could not be found to have matched the offer.

In the words of Justice Teare:
[I]t can be argued that an offer to use 'global superstar' athletes and influencers is an offer to use athletes and influencers of the highest calibre and that therefore the New Balance offer is 'no less favourable' to Liverpool FC. However, the missing words must have been agreed for a purpose.

Since "the evidence is clear that the calibre of [Lebron James, Serena Williams and Drake] can be measured in a variety of ways" (one being their social media exposure, another being their sporting achievements), the court concluded "that the New Balance offer on marketing was less favourable to Liverpool FC than the Nike offer because Liverpool FC cannot require New Balance, on the terms of its offer, to use global superstar athletes 'of the calibre of Lebron James, Serena Williams, Drake, etc.'"

What can be learned from this case, apart from the importance of mirroring the matched offer word by word?

From the sponsor's point of view, it is certainly not all that easy to make these clauses completely watertight when it comes to renewal time, and one can expect them to be put on a severe test by creative and canny packages from commercially powerful rivals, crafted precisely to be as hard to match as possible. Other than specifying that the terms to be matched are those that are material and measurable, it is also important, where possible, to clearly identify both the elements to be matched and the method of measurement.

Ideally, marketing tools and strategies should be excluded altogether whereas, on kits' production and especially distribution, a commercially weaker sponsor will be certainly helped by a clause requiring that the offer specify the expected return on incremental royalties, rather than the number of doors or selling points, which in fact could be unmatchable if a large rival comes along.

Nike and Adidas are no doubt dominant forces in the current football kit market. It will be always difficult, if not impossible, for smaller competitors to repel their assaults in purely financial terms. But it's not just a matter of money. An enormous monetary offer could still be matched through other mechanisms. The arsenal of resources deployable by the two market leaders is such that matching their offer in purely commercial terms incredibly challenging for many other brands.

Unless the relevant provision is carefully drafted to exclude from the "material, measurable and matchable" terms, items such as the sheer number of outlets available to carry the club kits, the number of countries where such kits may be distributed, the (however measured) popularity of key brand ambassadors or influencers or other co-marketing opportunities offered by a global superpower brand that would be simply impossible to match on the basis of dimension (or alternatively downgrades the same from "objectively and measurably matched" to "reasonably

pursued in keeping with the commercial and marketing dimensions of the current sponsor"), it seems clear that virtually no kit sponsorship agreement can resist the fire power of these sports superpowers.

FOOTNOTES

[1] ([2019] EWHC 2837 (Comm)).

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