

# The History and Business of Contraction in Major League Baseball

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## I. Introduction

The collective bargaining agreement reached between Major League Baseball players and owners hours before the strike deadline on August 30, 2002 allowed a baseball season encapsulating a labor-management negotiation to continue without a work stoppage for the first time since 1970.<sup>1</sup> The agreement includes provisions for a luxury tax to be placed on player payrolls exceeding proscribed thresholds, increased revenue sharing among the thirty teams, drug testing for illegal steroids, increased minimum player salaries, and new limitations on team debt.<sup>2</sup> However, for the purpose of this article, the most important aspect of the agreement is the provision that prohibits the contraction of any Major League clubs through the expiration of the Basic Agreement in 2006.<sup>3</sup> The clubs may eliminate two teams for the 2007 season provided that they notify the players of their intent to do so by July 1, 2006.<sup>4</sup> If the clubs choose to contract at that point in time, the union cannot challenge their ability to do so.<sup>5</sup> The agreement renders moot a grievance filed by the Major League Baseball Players Association with arbitrator Shyam Das that challenged the owners' ability to unilaterally contract two clubs based

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<sup>1</sup> See *Four Year Deal Includes Luxury Tax, No Contraction*, Aug. 30, 2002 at <http://espn.go.com/mlb/news/2002/0830/1425253.html> (last visited on Sept. 4, 2002).

<sup>2</sup> Id.

<sup>3</sup> Id.

<sup>4</sup> Id.

<sup>5</sup> Id.

upon the union's claim that contraction must be collectively bargained with the union.<sup>6</sup> While the dispute surrounding contraction has been temporarily resolved, it is likely that the issue will reemerge in 2006 because Major League Baseball will continue to have strong incentives to eliminate clubs.<sup>7</sup> Thus, the issue of contraction in baseball remains relevant despite its temporary resolution. In addition, the economic condition of professional sports leagues may result in contraction occurring in other sports, as well. The goal of this article is twofold: to review the history of contraction in both professional baseball and other sports and to analyze the business justifications for contraction by reviewing the relevant financial data to determine whether or not it is financially prudent for the Major League Baseball clubs to choose to eliminate some of its clubs.<sup>8</sup>

## II. History of Contraction in Major League Baseball

When discussing the history of contraction in Major League Baseball, it becomes clear that, contrary to popular belief, this is not an unprecedented topic in professional sports – contraction occurred frequently in the early era of baseball. During the nascent stages of the National League between 1876 and 1899, there were numerous teams that folded, usually because they declared bankruptcy.<sup>9</sup> However, other clubs were cancelled

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<sup>6</sup> Murray Chass, *The Union Puts Up a Stop Sign As the Owners Plan Contraction*, N.Y. Times, Nov. 9, 2001, at S3.

<sup>7</sup> These incentives are discussed in Section V.

<sup>8</sup> The one caveat that must be heeded is that the data that is used is based on the numbers that were presented by Major League Baseball to Congress in December, 2001. See 2001 club-by-club breakdown (available at <http://www.mlb.com/mlb/hearings/downloads/overview.pdf> (last visited on July 12, 2002)). Thus, the data must be taken with the requisite grain of salt, as the Major League Baseball Players Association has vigorously debated its validity. See Donald Fehr, House Judiciary Committee hearing, Dec. 6, 2001, available at <http://bigleaguers.yahoo.com/mlbpa/pr/20020213/mlbpa-donaldmfehrshousejudicia.html> (last visited on Jul. 15, 2002). However selective and incomplete the data may be, it is likely to be reliable enough to support the assertions contained herein. See Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 1, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>9</sup> GERALD W. SCULLY, *THE MARKET STRUCTURE OF SPORTS* 9 (1995).

by the National League for disciplinary reasons.<sup>10</sup> The original Louisville Grays team was cancelled after its second season in 1877, when four of its players were caught fixing games.<sup>11</sup> Shortly thereafter, the Saint Louis Brown Stockings were forced to leave the league in the 1877 after they signed those four expelled Grays players.<sup>12</sup> The Cincinnati Red Stockings were dropped from the league in 1880 after they refused to ban both beer sales and Sunday games.<sup>13</sup> Finally, the original New York Mutuals and Philadelphia Athletics franchises were cancelled after the National League's first season in 1876 when both teams refused to travel to western cities to complete their playing schedules.<sup>14</sup>

Other teams were purchased by their competitor franchises and then folded, as the purchasing team sought to obtain the selling team's marquee players. The Detroit Wolverines franchise bought the Buffalo franchise for \$7,000 in 1886 in order to acquire the team's four top players.<sup>15</sup> Having accomplished its goal, Detroit then folded the Buffalo team.<sup>16</sup> Similarly, the Boston Nationals purchased the Providence franchise for \$6,600 in order to obtain its two star players and then folded the club.<sup>17</sup>

The National League itself eliminated two teams in 1887. The Kansas City Cowboys played only the 1886 season before the National League purchased its franchise and players for \$6,000 and then cancelled the franchise and disbursed the players to the other teams.<sup>18</sup> After relocating from Cleveland in 1885, the Saint Louis Maroons played only the 1885 and 1886 seasons before the National League acquired the franchise and its

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<sup>10</sup> Id.

<sup>11</sup> Id.

<sup>12</sup> JAMES QUIRK & RODNEY FORT, PAY DIRT: THE BUSINESS OF PROFESSIONAL TEAM SPORTS

<sup>13</sup> SCULLY, *supra* note \_\_, at 9.

<sup>14</sup> JAMES QUIRK & RODNEY FORT, *supra* note \_\_, at 381.

<sup>15</sup> Id. at 379.

<sup>16</sup> Id.

<sup>17</sup> Id. at 308, 381.

<sup>18</sup> Id. at 380.

players for \$12,000 and - again - cancelled the franchise and disbursed the players.<sup>19</sup> The National League expanded from eight to twelve teams for the 1892 season, when it merged with the American Association and added franchises in Baltimore, Louisville, St. Louis, and Washington.<sup>20</sup> Eight years later, after the 1899 season, the National League eliminated the four weakest teams in the league: the Washington Senators, Baltimore Orioles, Cleveland Spiders and Louisville Colonels.<sup>21</sup> The Washington Senators owner, Earl Wagner, received \$46,500 from the National League for its franchise and players, less the \$7,500 that he had received from a prior sale of some of his star players to the Boston Nationals franchise.<sup>22</sup> The owners of Baltimore Orioles received \$30,000 from the National League for their franchise and players, and the National League also gave the club the power to sell its players to the other teams in the league.<sup>23</sup> The owners of that team also owned the Brooklyn Superbas franchise<sup>24</sup> and had already transferred most of the Orioles' good players from his Baltimore team to their Brooklyn team prior to the start of the season, so the Baltimore franchise was a shell of its former self even prior to its elimination.<sup>25</sup> The Louisville Colonels owner was a fellow by the name of Barney Dreyfuss, who also co-owned the Pittsburgh franchise.<sup>26</sup> Dreyfuss received \$10,000 from the National League for his Colonels franchise and players, although he had already transferred most of the good Louisville players to his Pittsburgh franchise prior to the

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<sup>19</sup> Id. at 379, 382.

<sup>20</sup> SCULLY, supra note \_\_, at 14.

<sup>21</sup> ROGER ABRAMS, THE MONEY PITCH: BASEBALL FREE AGENCY AND SALARY ARBITRATION 17 (2000).

<sup>22</sup> QUIRK & FORT, supra note \_\_, at 382-3.

<sup>23</sup> Id. at 378.

<sup>24</sup> The Brooklyn Superbas later became the Brooklyn Dodgers and today are known as the Los Angeles Dodgers.

<sup>25</sup> QUIRK & FORT, supra note \_\_, at 378.

<sup>26</sup> Id. at 380.

season.<sup>27</sup> The final team that was engaged in the contraction was the Cleveland Spiders. The owner of Cleveland Spiders, the Robison family, received \$25,000 from the National League for its franchise and players despite the fact that they also owned the St. Louis Perfectos franchise and had already transferred nearly all of the good Spiders players to the St. Louis franchise prior to the 1899 season, including star pitcher Cy Young.<sup>28</sup> That Spiders franchise went on to finish that season with 20 wins and 134 losses, the worst single season record in baseball history.<sup>29</sup> When the dust settled after the contraction, the National League had shrunk from twelve back to eight teams, with the remaining franchises consisting of the Boston Nationals,<sup>30</sup> Brooklyn Superbas, Chicago Cubs, Cincinnati Reds, New York Giants,<sup>31</sup> Philadelphia Phillies, Pittsburgh Pirates and St. Louis Cardinals.<sup>32</sup> Interestingly, the Washington Senators,<sup>33</sup> Baltimore Orioles<sup>34</sup> and Cleveland Blues<sup>35</sup> became original franchises, albeit with different ownership, in the newly created American League in 1901, joining the Boston Puritans,<sup>36</sup> Chicago White Sox, Detroit Tigers, Milwaukee Brewers<sup>37</sup> and Philadelphia Athletics.<sup>38</sup> That is an important lesson that remains relevant for Major League Baseball over one hundred years later – that contracted clubs can form the nucleus of an upstart rival league.

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<sup>27</sup> *Id.*

<sup>28</sup> ROGER ABRAMS, *THE MONEY PITCH: BASEBALL FREE AGENCY AND SALARY ARBITRATION* 16 (2000). *See also* QUIRK & FORT, *supra* note \_\_, at 379.

<sup>29</sup> *Id.*

<sup>30</sup> The Boston Nationals later became the Boston Braves, relocated to Milwaukee in 1953 and have played in Atlanta since 1966.

<sup>31</sup> The Giants moved to San Francisco in 1958.

<sup>32</sup> The St. Louis Perfectos were renamed the Cardinals.

<sup>33</sup> These Washington Senators were also known as the Nationals and became the Minnesota Twins in 1961.

<sup>34</sup> The Orioles became the New York Highlanders in 1903 and were renamed the Yankees in 1913.

<sup>35</sup> The Blues were renamed the Bronchos in 1901, became the Naps in 1903, and ultimately settled on the Indians in 1910. Quirk and Fort, *supra* note \_\_, at 402.

<sup>36</sup> The Boston Puritans became the Boston Red Sox in 1907.

<sup>37</sup> This version of the Milwaukee Brewers became the St. Louis Browns in 1902 and ultimately became the Baltimore Orioles in 1953.

<sup>38</sup> The Athletics moved to Kansas City in 1954 and relocated to Oakland prior to the 1968 season.

### III. History of Contraction in Other Professional Sports

Contraction in professional sports leagues was not limited to Major League Baseball. In the National Football League, 38 franchises were cancelled for financial reasons during the league's formative period between 1920 and 1952, though no franchise has been folded since the first incarnation of the Dallas Texans in 1952.<sup>39</sup> In the National Basketball Association (NBA), there have been ten teams that have folded since the league was formed from the merger between the Basketball Association of America and National Basketball League in 1949-50.<sup>40</sup> The first team to cease operations was the Providence Steamrollers in 1949, which was followed by the folding of six franchises in 1950 - the Anderson Packers, Chicago Stags, the original Denver Nuggets, St. Louis Bombers, Sheboygan Redskins, and Waterloo Hawks – and the Washington Capitols in 1951.<sup>41</sup> In 1954, the contraction was of the Indianapolis Olympians, who were removed from the league after its owners – former University of Kentucky basketball players Alex Groza, Ralph Beard, Wallace Jones and Cliff Barker - were involved in a point shaving scandal dating back to their college days.<sup>42</sup> The franchise went bankrupt due in part to its ownership's legal problems and was cancelled before the 1954 season.<sup>43</sup> There has not been a contraction in the NBA since the elimination of the first version of the Baltimore Bullets franchise during the 1954-55 season,<sup>44</sup> though the Minneapolis Lakers were put on financial probation by the league in 1958, and told that they must average \$6,600 in gate receipts per game in the next season or the NBA could exercise an option to buy the

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<sup>39</sup> QUIRK & FORT, *supra* note \_\_\_, at 32-5.

<sup>40</sup> *Id.* at 31.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 452.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at 447.

club for \$150,000 and move it to another city.<sup>45</sup> Shortly thereafter, the owner of the club made a preemptive strike against the NBA and moved the Lakers to Los Angeles for the 1960 season.<sup>46</sup>

Finally among the four major North American sports leagues, there were several clubs that folded for financial reasons during the National Hockey League's formative years. The Montreal Wanderers had to fold after their facility burned down in 1918.<sup>47</sup> The Philadelphia Quakers<sup>48</sup> went under in 1932, as did the St. Louis Eagles in 1935.<sup>49</sup> The St. Louis franchise was bought out by the NHL for an undisclosed price and its players were dispersed to the other NHL teams.<sup>50</sup> The Montreal Maroons folded in 1939, while the Brooklyn Americans did so in 1942.<sup>51</sup> Most recently in the NHL was the saga of the California Seals and the Cleveland Barons. The California Golden Seals were a long-troubled franchise that played in Oakland from 1967 to 1975, went broke in 1970, and was sold four times before relocating to Cleveland in 1976.<sup>52</sup> Faced with \$5.3 million of debts, the Cleveland Barons went broke again in 1977, was subsequently sold to George and Gordon Gund and promptly lost \$3 million in 1977-78 season.<sup>53</sup> Prior to the 1978-79 season, the Gund brothers merged the club with the Minnesota North Stars, another club they owned that had lost \$3 million from 1973 to 1978.<sup>54</sup> The Gunds maintained ownership of the club, with Minnesota assuming all of the debt of the

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<sup>45</sup> Id. at 453.

<sup>46</sup> Id. at 454.

<sup>47</sup> Id. at 469.

<sup>48</sup> The franchise was known as the Pittsburgh Pirates until relocating to Philadelphia in 1930. Id. at 470-71.

<sup>49</sup> The franchise played as the Ottawa Senators until relocating to St. Louis in 1934. Id. at 472.

<sup>50</sup> Id.

<sup>51</sup> The Americans franchise began as the Quebec Bulldogs in 1917, became the Hamilton Tigers in 1920, had a stint as the New York Americans from 1925 to 1941 and finally renamed itself 'Brooklyn' in 1941. Id. at 463-4.

<sup>52</sup> Id. at 465.

<sup>53</sup> Id.

<sup>54</sup> Id. at 465, 468.

Cleveland Barons.<sup>55</sup> Cleveland went out of business. Perhaps most importantly, the North Stars assumed some of the Cleveland team's best players and were able to keep many of their own best players as well, and it became one stronger Minnesota North Stars franchise that played in the Stanley Cup finals in the 1980-81 season.<sup>56</sup>

Most recently, and perhaps not as visible on the major league scope in this country, is Major League Soccer (MLS). MLS began play with ten teams in its inaugural 1996 season and eventually expanded to Chicago and Miami for the 1998 season.<sup>57</sup> On January 8, 2002, the league eliminated both the Miami Fusion and Tampa Bay Mutiny.<sup>58</sup> Interestingly, Miami was the best team in MLS in the 2001 season, finishing first in the league standings during the regular season.<sup>59</sup> However, the club was ninth in the league in attendance at 11,117 per game, accomplishing that in one of the few soccer-only facilities in Major League Soccer.<sup>60</sup> Conversely, Tampa Bay finished last in the regular season league standings and was eleventh out of the twelve teams in attendance last season at 10,479 per game.<sup>61</sup> Tampa Bay was operated and funded by the league itself since its inception, as MLS was never able to secure an investor-operator for the club, as per the league's unique ownership structure.<sup>62</sup> Miami's investor-operator, Ken Horowitz,

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<sup>55</sup> Id.

<sup>56</sup> Id. See also Stanley Cup Champions and Finalists, available at <http://www.nhl.com/hockeyu/history/cup/champs.html> (last visited on Jul. 12, 2002).

<sup>57</sup> *MLS Year-by-Year Season Overview*, available at <http://www.mlsnet.com/archive/year-by-year.html> (last visited on Jul. 12, 2002).

<sup>58</sup> *MLS Eliminates Fusion, Mutiny*, available at <http://www.mlsnet.com/content/02/mls0108miatb.html> (last visited on Jul. 12, 2002).

<sup>59</sup> *MLS Regular Season Statistics*, available at [http://www.mlsnet.com/statistics/archive/2001\\_league.html](http://www.mlsnet.com/statistics/archive/2001_league.html) (last visited on Jul. 12, 2002).

<sup>60</sup> This should tell the reader a little about the importance of soccer-only facilities in drawing fans, despite some of the claims of MLS. The league has been focused on getting soccer specific facilities built for various league teams, believing that these edifices will help boost league attendance.

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<sup>62</sup> *MLS Teleconference: Jan. 8, 2002* (comments of Don Garber, MLS Commissioner) available at <http://www.mlsnet.com/content/02/mls0108teleconference.html> (last visited on Jul. 12, 2002).

reportedly lost \$50 million over the four seasons that he was involved with the club.<sup>63</sup>

Upon contracting the Miami Fusion, MLS officials stated that Miami is “not capable at this time of providing the support necessary to effectively sustain a Major League Soccer team.”<sup>64</sup> That was a reference to the team’s poor corporate support, as it enjoyed very little in terms of corporate sponsorship, as well as the notoriously difficult fan base in south Florida. Finally, the Dallas Burn and Colorado Rapids franchises were also considered for contraction but ultimately survived.<sup>65</sup>

#### IV. The Controversy Over Contraction in Major League Baseball

The most recent issue of contraction in Major League Baseball was first broached by Commissioner Bud Selig prior to game 2 of the World Series on October 29, 2001, when he stated, “As the problems become exacerbated, it has become clearer to me that everything should be on the table, including contraction.”<sup>66</sup> On November 6, league owners voted 28-2 to eliminate two teams.<sup>67</sup> Though the identity of those teams was not identified at the time, they were widely assumed to be the Montreal Expos and Minnesota Twins.<sup>68</sup> The next day, the MLBPA filed a grievance claiming that a unilateral contraction violated the terms of the expired Basic Agreement<sup>69</sup> that the union and management were still operating under. On November 9, Twins executive Jim Pohlad sent a startling letter to Twins employees writing, "Our willingness to go along with contraction, if the commissioner so decides, has come from a feeling of hopelessness.

Within the context of baseball's commitment, when we are posed the question, 'Why

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<sup>63</sup> *MLS Teleconference: Jan. 8, 2002* (comments of Ken Horowitz), supra note \_\_\_\_.

<sup>64</sup> *MLS Teleconference: Jan. 8, 2002*, supra note \_\_\_\_.

<sup>65</sup> Id.

<sup>66</sup> David Schoenfield, *Still 30 Teams: Contraction Timeline*, Feb. 5, 2002, available at <http://espn.go.com/mlb/s/2002/0205/1323230.html> (last visited on Feb. 6, 2002).

<sup>67</sup> Id.

<sup>68</sup> Id.

<sup>69</sup> The collective bargaining agreement in Major League Baseball is referred to as the Basic Agreement.

should the Minnesota Twins not be contracted?' we are unable to find a plausible answer."<sup>70</sup> On November 15, Bud Selig defended the possible contraction of the Minnesota Twins, stating "[A]t some point in the past decade, despite 26 or so stadium proposals, there were chances to do something, and nothing got done. So there are a lot of people up there who have to look themselves in the mirror."<sup>71</sup> The next day, Hennepin County (MN) District Judge Harry Seymour Crump granted an injunction requested by the Twins landlord, the Metropolitan Sports Facilities Commission, to force the Twins to play their 2002 home schedule in the Metrodome.<sup>72</sup> The Twins and MLB appealed the decision, which was upheld by the Minnesota Court of Appeals<sup>73</sup> and the Minnesota Supreme Court refused to consider the case on February 4, 2002.<sup>74</sup> The next day, contraction was called off for the 2002 season, with Selig remarking:

"While the clubs would have preferred to contract for 2002 and begin addressing the economic issues immediately, events outside of our direct control, including yesterday's court decision in Minnesota, have required us to move the date of contraction to 2003. Contraction was an initiative of the thirty clubs and continues to be wholly supported by that group. The clubs recognize that our current economic circumstance make contraction absolutely inevitable, as certain franchises simply cannot compete and cannot generate enough revenues to survive. Quite a few of our clubs advocate contraction by as many as four clubs, and our ultimate implementation of contraction obviously may well be affected by the economics of the industry in 2002."<sup>75</sup>

The Metropolitan Sports Facilities Commission settled its lawsuit with Major League Baseball and the Twins on June 6, 2002, with the team agreeing to play at its Metrodome home and the league agreeing not to contract or relocate the Twins through the 2003

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<sup>70</sup> See *Pohlad Writes Letter to Employees*, Nov. 10, 2001, available at <http://espn.go.com/mlb/news/2001/1110/1276291.html> (last visited on Nov. 12, 2001).

<sup>71</sup> See Schoenfeld, *supra* note \_\_.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> MLB contraction reset for 2003, MLB Press Release, Feb. 5, 2002, available at [http://mlb.mlb.com/NASApp/mlb/mlb/news/mlb\\_news\\_story.jsp?article\\_id=mon\\_20020205\\_contraction\\_news&team\\_id=mon](http://mlb.mlb.com/NASApp/mlb/mlb/news/mlb_news_story.jsp?article_id=mon_20020205_contraction_news&team_id=mon) (last visited on July 11, 2002).

season.<sup>76</sup> Thus, the proposed contraction of the Twins was resolved at least temporarily; an analysis of the financial justifications for contracting the team will occur nonetheless. However, the situation surrounding the Montreal Expos is far from resolved. In a complicated and extraordinary transaction, the Major League Baseball owners approved the sales of Expos to MLB for \$120 million and the Marlins to Expos owner Jeffrey Loria for \$158.5 million on February 1, 2002.<sup>77</sup> The \$38.5 million difference will be loaned to him by MLB, and if the Marlins are unable to secure a new ballpark within five years, Loria will pay back only \$23.5 million, interest-free.<sup>78</sup> If the team gets a new ballpark, MLB will receive 20 percent of the team's operating profit in its first five years at the new stadium.<sup>79</sup> The Expos are now operated by a newly formed partnership of the other 29 Major League clubs,<sup>80</sup> a unique arrangement that presumably will end when the Expos franchise is sold to an ownership group that will likely relocate the team to another city. This option is a distinct possibility given Bud Selig's statement on January 17, 2002. "There's no doubt in my mind that relocation is coming. It's just a question of when. I've always said that we need to solve the basic problems, and when we solve the basic problems we can then turn our attention to relocation."<sup>81</sup> Selig also said that Washington, D.C., is a "prime candidate" for relocation.<sup>82</sup>

## V. The Goals of Contraction for Major League Baseball

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<sup>76</sup> MSFC agrees to settle lawsuit against Major League Baseball and Minnesota Twins, June 6, 2002, available at [http://www.msfc.com/commissionnews\\_detail.cfm?releaseID=57](http://www.msfc.com/commissionnews_detail.cfm?releaseID=57) (last visited on July 11, 2002).

<sup>77</sup> See Schoenfield, supra note \_\_.

<sup>78</sup> Id.

<sup>79</sup> Id.

<sup>80</sup> Murray Chass, *Twins Avoid Contraction for 2003 Season*, N.Y. TIMES, May 30, 2002, at D5.

<sup>81</sup> See Schoenfield, supra note \_\_.

<sup>82</sup> Id.

When discussing the Major League Baseball owners' claims before and during the 2002 collective bargaining negotiations that contraction was a business necessity, it must be remembered that owners have long complained about the future of Major League Baseball. In 1881, Chicago White Stockings owner Albert Spalding remarked, "Professional baseball is on the wane. Salaries must come down or the interest of the public must be increased in some way. If one or the other does not happen, bankruptcy stares every team in the face."<sup>83</sup> One hundred and twenty years later, Major League Baseball commissioner Bud Selig made a remarkably similar claim that "[I]t makes no sense for Major League Baseball to be in markets that generate insufficient local revenues to justify the investment in the franchise."<sup>84</sup>

This begs the question – what were the goals of contraction for Major League Baseball? First, the league would have liked to increase the overall revenues for each remaining team by increasing the amount of money that each team receives from league-wide sharing of both local and national revenues.<sup>85</sup> Since local revenues comprised approximately 79 percent of league-wide revenues from 1995 to 1999,<sup>86</sup> Major League Baseball's revenue sharing plan is based heavily on local operating revenues.<sup>87</sup> It is not based on attendance, wins or losses, or the profitability of the franchise.<sup>88</sup> The system is intended to transfer funds from the big revenue clubs that generate a great deal of local

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<sup>83</sup> *Selig to Present Losses to Congress Today*, Dec. 6, 2001, available at <http://msn.espn.go.com/mlb/news/2001/1205/1290564.html> (last visited on July 12, 2002).

<sup>84</sup> See Schoenfield, *supra* note \_\_\_\_.

<sup>85</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 6, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>86</sup> See *The Report of the Independent Members of the Commissioner's Blue Ribbon Panel on Baseball Economics 17*, available at [http://www.mlb.com/mlb/downloads/blue\\_ribbon.pdf](http://www.mlb.com/mlb/downloads/blue_ribbon.pdf) (last visited on July 12, 2002).

<sup>87</sup> See Mychael Urban, *Revenue sharing: How it works, is it working?*, Dec. 6, 2001, available at [http://www.mlb.com/NASApp/mlb/mlb/news/mlb\\_news\\_story.jsp?article\\_id=mlb\\_20011206\\_urban2\\_news&team\\_id=mlb](http://www.mlb.com/NASApp/mlb/mlb/news/mlb_news_story.jsp?article_id=mlb_20011206_urban2_news&team_id=mlb) (last visited on July 12, 2002).

<sup>88</sup> *Id.*

income to the small revenue clubs that do not.<sup>89</sup> In addition to this sharing of local revenues, each club receives an even share of all national revenues, which was \$24.401 million per club in 2001.<sup>90</sup> From 1997 to 2002, baseball's formula for sharing local operating revenue was as follows. Every team put twenty percent of their local operating revenues into a pool.<sup>91</sup> Seventy-five percent of that money was redistributed evenly amongst the thirty teams in Major League Baseball.<sup>92</sup> The remaining twenty-five percent was divided on a sliding scale amongst the teams that produced less than the league-wide average in local operating revenues, which was \$94.3 million in 2001.<sup>93</sup> The New York Yankees generated the greatest amount of local operating revenue in 2001 with \$217.807 million, while the Philadelphia Phillies had \$57.114 million in local operating revenue.<sup>94</sup> Overall, \$166.949 million – or 5.9 percent of league-wide local operating revenue – was transferred from high revenue clubs to low revenue clubs in 2001.<sup>95</sup> The Yankees contributed \$26.540 million and the Phillies were awarded \$11.752 million of that total.<sup>96</sup>

The new revenue sharing system has three components – the base plan, the central fund aspect, and the commissioner's discretionary fund.<sup>97</sup> It is intended to aid the middle-revenue clubs by giving them a larger portion of shared revenues, thus providing them with the financial resources that will allow them to become more competitive with

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<sup>89</sup> Id.

<sup>90</sup> Id. There were two teams that did not receive the full amount of money from national revenue sharing. As part of their expansion agreements, Arizona and Tampa Bay received \$18.479 million each in 2001 (approximately 3/4 of the money received by the other teams), though each will receive a full amount beginning with the 2003 season.

<sup>91</sup> Id.

<sup>92</sup> Id.

<sup>93</sup> Id.

<sup>94</sup> See 2001 club-by-club breakdown, *supra* note 1.

<sup>95</sup> See Urban, *supra* note \_\_.

<sup>96</sup> See 2001 club-by-club breakdown, *supra* note 1.

<sup>97</sup> See *Four Year Deal Includes Luxury Tax, No Contraction*, Aug. 30, 2002 at <http://espn.go.com/mlb/news/2002/0830/1425253.html> (last visited on Sept. 4, 2002).

the large revenue clubs.<sup>98</sup> Under the base plan, every team will contribute 34 percent of its net local revenue, after deductions for ballpark expenses, to a pool that will be redistributed equally to all 30 teams.<sup>99</sup> The central fund component involves monies that will be taken from those teams that are net contributors to the base plan and redistributed to teams that are net recipients from the base plan.<sup>100</sup> The central fund component begins at 60 percent in 2003, and increases to 80 percent in 2004 and 100 percent in 2005 and 2006.<sup>101</sup> It is determined by taking a figure in which the numerator is \$72.2 million and the denominator is total net local revenue (after ballpark expenses) of all contributing clubs, and then multiplying this figure by a contributing club's total net local revenue (after ballpark expenses).<sup>102</sup> The monies will be redistributed to the clubs that are below the league average in revenues based on each team's distance from the average. It is estimated that the central fund component will total \$72.2 million per year. The third aspect of the new revenue sharing system is the commissioner's discretionary fund, under which a total of \$10 million, or \$333,333 from each team, will be taken from the central fund and may be redistributed by the commissioner.<sup>103</sup> Based on 2001 revenues, it is estimated that the Yankees will contribute \$45 million and the Phillies will be awarded \$14.2 million in 2003.<sup>104</sup> Overall, based on 2001 revenues it can be estimated that

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<sup>98</sup> Jayson Stark, *Brewers, Pirates Gain Most Under Revenue-sharing Plan*, Sept. 9, 2002, available at <http://espn.go.com/mlb/news/2002/0906/1428242.html> (last visited on Sept. 9, 2002).

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *See* 2001 club-by-club breakdown, *supra* note 1.

approximately \$214.6 million will be transferred from high revenue clubs to low revenue clubs in 2003.<sup>105</sup>

A second goal of contraction would have been to enhance and re-establish the league's monopoly power. An explanation of the reasons that professional sports leagues restrict and expand their memberships is required in order to fully understand this goal. Professional sports leagues restrict entry to increase league-wide profits and increase the franchise values of any one particular club, as the scarcity of a team drives up its value.<sup>106</sup> Scarcity also allows the clubs to exercise leverage over local governments and taxpayers when seeking new stadia because they can use the threat of relocation.<sup>107</sup> However, unlike the NFL, NHL, and NBA, Major League Baseball has been hesitant to allow its clubs to do so, and there has not been a franchise relocation in the league since 1972 when the Washington Senators became the Texas Rangers.<sup>108</sup> Leagues expand to increase their revenues, as expansion provides them with the ability to offer enhanced television packages to networks, tap into new fan bases, and deter the entry and/or the threat of entry of any rival leagues.<sup>109</sup> Thus, a league must balance its restrictions on the number of teams with its expansion goals. The goal for a professional sports league is to retain a sufficient number of viable open markets to maximize any of its teams' leverage over local governments and taxpayers by yielding competitive bidding amongst potential relocation cities, yet maintaining an insufficient number of available cities to sustain a

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<sup>105</sup> Jayson Stark, *Brewers, Pirates Gain Most Under Revenue-sharing Plan*, Sept. 9, 2002, available at <http://espn.go.com/mlb/news/2002/0906/1428242.html> (last visited on Sept. 9, 2002).

<sup>106</sup> QUIRK & FORT, PAY DIRT, AT 298-302.

<sup>107</sup> QUIRK & FORT, PAY DIRT, AT 298-302.

<sup>108</sup> *Owners Vote to Eliminate Two MLB Teams*, Nov. 7, 2001, available at <http://espn.go.com/mlb/news/2001/1106/1274159.html> (last visited on July 12, 2002).

<sup>109</sup> QUIRK & FORT, PAY DIRT, AT 298-302.

rival league.<sup>110</sup> While the professional leagues historically have maintained two or three cities to exist as potential relocation threats, Major League Baseball and the NBA seem to have over-expanded in the late 1980's and 1990's, adding too many teams too rapidly. With the addition of teams in Miami and Denver in 1993 and Phoenix and Tampa Bay in 1998, Major League Baseball grew from 26 to 30 teams in a short period of time. The growth of the NBA from 23 to 29 teams with the addition of franchises in Charlotte and Miami in 1988, Orlando and Minneapolis in 1989, and Toronto and Vancouver in 1995 has made it difficult for teams to find desirable markets to which to relocate. This is best evidenced by the recent relocations of the NBA's Vancouver Grizzlies and Charlotte Hornets to smaller, less attractive cities in Memphis and New Orleans, respectively. Memphis is the 42<sup>nd</sup> largest market in the country and a market that has traditionally shunned all of its professional sports franchises. Every big league professional sports franchise that has ever played in Memphis has folded. New Orleans failed to support its first NBA franchise, the Jazz, and saw the team relocate to Utah in 1979.<sup>111</sup> The fact that it has become difficult for teams and leagues to find viable open markets is evidence that both leagues have misused their monopoly power.

Major League Baseball is faced with a similar dilemma, as all of the currently unoccupied markets are flawed in various degrees. Potential Major League Baseball cities include the Washington, DC/Northern Virginia area, which is fraught the problems not because of the population but because it is located in the Baltimore Orioles territory and its owner, Peter Angelos, has thus far refused to allow a team to invade his area out of a fear of diluting his fan base and surrendering significant revenues. Angelos would

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<sup>110</sup> JAMES QUIRK & RODNEY FORT, *HARD BALL: THE ABUSE OF POWER IN PRO TEAM SPORTS* 135-6 (1999).

<sup>111</sup> *Jazz History*, available at <http://www.nba.com/jazz/history/00400490.html#6> (last visited on Jul. 12, 2002).

demand a significant windfall payment to allow a team to relocate to this area. Another potential market is Las Vegas, yet its relationship with the gambling industry raises a whole set of problems that leagues are very reluctant to address. Other potential suitors include New Orleans, Charlotte, Portland, Nashville, Louisville, and Norfolk, all of which would be hard pressed to support a Major League Baseball franchise. Contraction would have allowed the teams to make greater use of the league's monopoly power and increase the political capital for the existing teams.<sup>112</sup> Alternatively, Major League Baseball could have either relocated existing teams or awarded expansion franchises to the contracted markets in future years to get a significant financial windfall expansion fee.<sup>113</sup> This scenario is not as preposterous as it sounds and has been played out in the NFL in Cleveland, Houston, and perhaps Los Angeles in the future, as well as in the NHL in Minnesota and Atlanta. In each instance, existing teams relocated to another city, and expansion teams were later awarded to the vacated city with a significant financial gain resulting for both leagues.

A third goal of contraction would have been to improve both competitive balance and the caliber of play in Major league Baseball by eliminating some weaker clubs and distributing players to the existing clubs. This may have been an unrealistic goal. Major League Baseball would have liked to improve its competitive balance - its relative quality of play – through contraction. The apparent belief was that eliminating some of its weaker clubs would allow the remaining teams to become more competitive with each

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<sup>112</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 10, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>113</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 10, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

other. However, a large number of teams at the bottom of the league were still going to be without, as Bud Selig likes to say, ‘hope and faith.’<sup>114</sup> The eliminated teams would simply have been replaced at the bottom of the league standings by other weak clubs. In addition, the elimination of teams merely because they are poor performers would have ignored the cyclical nature of professional sports. This year’s cellar-dwellers become contenders in future years. In 1990, contraction based solely on poor on-field performance likely would have resulted in the elimination of the Atlanta Braves and Cleveland Indians, two historically weak clubs that became dominant teams throughout that decade.<sup>115</sup> Contraction should be based on market conditions and not the club’s on-field performance. In addition, eliminating a small number of clubs would do very little to narrow the gap between the league’s ‘haves’ and its ‘have-nots.’ Even with the new collective bargaining agreement, baseball’s economic system itself will remain flawed, as it will still heavily favor the league’s large revenue generating clubs. The league would have also liked to improve the caliber of play in the league - the absolute quality of play – through contraction. In terms of the absolute quality of play, removing the fifty worst players from Major League Baseball was going to do very little to improve the overall quality of play in the league. This is the equivalent of only taking the two worst players off of each team – a little-used relief pitcher and last bench player, for example - which was very unlikely to have a significant effect on the absolute quality of play in Major League Baseball.

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<sup>114</sup> Testimony of Allan H. (Bud) Selig, Commissioner of Baseball Before the Committee on the Judiciary United States House of Representatives, December 6, 2001, available at [http://www.mlb.com/NASApp/mlb/mlb/news/mlb\\_news\\_story.jsp?article\\_id=mlb\\_20011206\\_seligtestimony\\_news&team\\_id=mlb](http://www.mlb.com/NASApp/mlb/mlb/news/mlb_news_story.jsp?article_id=mlb_20011206_seligtestimony_news&team_id=mlb) (last visited on July 12, 2002).

<sup>115</sup> From 1991-2000, the Atlanta Braves won every division title, reached the World Series in 1991, 1992, 1995, 1996 and 1999, won the 1995 World Series, and compiled an overall record of \_\_ wins and \_\_ losses. From 1994 to 1999, the Cleveland Indians won \_\_ division titles and reached the World Series in 1995 and 1997, compiling an overall record of \_\_ wins and \_\_ losses.

A fourth goal of contraction was to give the owners increased leverage in the recently completed collective bargaining negotiations.<sup>116</sup> The Major League Baseball Players Association filed a grievance with arbitrator Shyam Das challenging the owners' ability to unilaterally contract two clubs; the union claimed that contraction must be collectively bargained with the union.<sup>117</sup> The outcome of this arbitration could have had a significant impact on the collective bargaining process.<sup>118</sup> If management was allowed to contract clubs without the consent of the union, it would have gained significant collective bargaining leverage, as the union could have been forced to make valuable concessions to stave off the potential loss of at least fifty jobs. Conversely, a decision in favor of the union would likely have doomed contraction, as it was highly improbable that the union would have allowed a decrease in the total number of players on Major League Baseball rosters. Management's agreement to forsake contraction until at least 2007 rendered the arbitration moot before a decision could be reached. This agreement likely allowed the clubs to gain additional concessions from the union, as it could exchange the preservation of 50 jobs for gains in other areas that may have been otherwise unavailable. Nonetheless, it can be assumed that the introduction of the issue of contraction into the bargaining process delayed lead to increased fan antipathy in Montreal, Minnesota, Florida, Kansas City, and Tampa Bay. This delay may have contributed to the decreased attendance in Montreal, Minnesota, Florida, Kansas City, and Tampa Bay in 2002.<sup>119</sup>

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<sup>116</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 9, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>117</sup> Murray Chass, *The Union Puts Up a Stop Sign As the Owners Plan Contraction*, N.Y. Times, Nov. 9, 2001, at S3.

<sup>118</sup> Id.

<sup>119</sup> See Pro Sports Tracker – MLB Attendance, available at [www.sportsbusinessjournal.com](http://www.sportsbusinessjournal.com) (**insert data at end of 2002 season**).

Thus, contraction had a substantial financial impact on Major League Baseball even prior to its resolution.<sup>120</sup>

Finally, the effect of contraction on player salaries must be considered. Though the contraction of two teams would have led to fifty less roster positions on Major League Baseball clubs, the supply of and demand for players would have been impacted equally.<sup>121</sup> The weakest players were going to be demoted to the minor leagues, and those were generally going to be the lowest paid players as well.<sup>122</sup> Thus, contraction would have had little long-term effect on Major League Baseball player salaries.<sup>123</sup>

## VI. The Business of Contraction

With this background information, an analysis of the issue of whether contraction would have made financial sense may be undertaken by first considering its various costs and benefits. It should be noted that MLB cannot force a team to fold involuntarily unless it is in blatant violation of league rules.<sup>124</sup> Thus, in order for contraction to occur, it is widely assumed that Major League Baseball would have purchased the targeted clubs from their current owners and then folded them, with players dispersed among the remaining league teams. This would have been quite similar to the contraction processes engaged in throughout the early history of professional sports leagues, with the exception that the buyout prices for the contracted clubs would have been significantly higher. Indeed, the largest cost of contraction was going to be the buyout payments to the teams

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<sup>120</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 10, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>121</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 7-8, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>122</sup> *Id.* at 8.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.* at 4.

that volunteer for contraction.<sup>125</sup> Each club would have fetched a premium that was expected to be much higher than its book value, despite the likelihood that the team suffered operating losses. Presumably, this premium would have compensated the owners of the contracted teams for their lost capital gains that would have been realized upon the future sale of the club and for the loss of the intangible benefits associated with ownership of a Major League Baseball team. Major League Baseball has already taken this step with the Montreal Expos, who were purchased by the league prior to the 2002 season for \$120 million despite being valued at \$91 million in 2001.<sup>126</sup> The rumored acquisition cost of the Minnesota Twins was between \$150 and \$250 million, though the team was valued at \$98 million in 2001.<sup>127</sup> The acquisition cost for other clubs thought to be candidates for contraction – including Kansas City, Tampa Bay and Florida – was thought to be approximately \$200 million each, which would represent a significant increase over their recent purchase prices. Kansas City was bought for \$96 million in 2000.<sup>128</sup> Tampa Bay paid a \$130 million expansion fee to enter the league in 1995,<sup>129</sup> and Florida was purchased for \$158 million in 2002.<sup>130</sup>

A second cost of contraction would have involved the payment of any obligations remaining under each team's stadium lease agreement.<sup>131</sup> There would have been no payment involved for the Minnesota Twins, Montreal Expos, or Florida Marlins because

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<sup>125</sup> Id. at 5.

<sup>126</sup> [http://www.forbes.com/free\\_forbes/2002/0415/092tab2\\_2.html](http://www.forbes.com/free_forbes/2002/0415/092tab2_2.html)

<sup>127</sup> [http://www.forbes.com/free\\_forbes/2002/0415/092tab2\\_2.html](http://www.forbes.com/free_forbes/2002/0415/092tab2_2.html)

<sup>128</sup> Paul C. Smith, *Prestige or Profit: Why Franchises Have Buyers*, mlb.com, Dec. 6, 2001, *Available at* [http://www.mlb.com/NASApp/mlb/mlb/news/mlb\\_news\\_story.jsp?GXHC\\_gx\\_session\\_id\\_=d802d44ada61497e&article\\_id=mlb\\_20011206\\_franchisevalue\\_news&team\\_id=mlb](http://www.mlb.com/NASApp/mlb/mlb/news/mlb_news_story.jsp?GXHC_gx_session_id_=d802d44ada61497e&article_id=mlb_20011206_franchisevalue_news&team_id=mlb) (last visited on Jul. 15, 2002).

<sup>129</sup> Id.

<sup>130</sup> Id.

<sup>131</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 5, *available at* <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

their leases all expired after the 2002 season.<sup>132</sup> This cost was also negligible for the Tampa Bay Devil Rays. Although the team's stadium lease does not expire until 2027, the city of St. Petersburg is paying the team a management fee of \$4.2 million, less approximately \$300,000 that the team shares with the city from the naming rights deal for Tropicana Field.<sup>133</sup> Thus, there would have been no cost involved for the Devil Rays in terms of lease payments. Kansas City would have incurred approximately a \$10 million buyout cost for their lease with the city, under which the team's annual rent is \$450,000 plus an excess percentage of gate receipts; the lease runs through 2015.<sup>134</sup>

A third cost of contraction would have been the multi-year guaranteed contracts that existed for those players on the eliminated teams who did not make other Major League Baseball rosters and were 'left out of the game.'<sup>135</sup> As previously mentioned, this was most likely going to be less skilled players with shorter, less expensive contracts that were near the league minimum salary of \$200,000. However, there was the potential for some higher paid, longer-term contract players who were under producing to be shunned by the other teams.<sup>136</sup> These players would not have been picked up because the other clubs would not have wanted to incur their salary costs. A very high-end estimate of this cost is \$30 million.

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<sup>132</sup> See *Inside the Ownership of Professional Sports* 2001.

<sup>133</sup> Id.

<sup>134</sup> Id.

<sup>135</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 5, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>136</sup> Examples include: Florida's Charles Johnson, a .\_\_\_ (**insert at end of 2002 season**) hitter in 2002 whose five year, \$35 million contract expires at the end of 2005; Preston Wilson, who hit \_\_\_ in 2002 with \_\_\_ errors and is owed an additional \$27.5 million from 2003 – 2005; and Tampa Bay's Craig Vaughn, whose .\_\_\_ (**insert at end of 2002 season**) batting average does not justify his four year, \$34 million contract that expires after the 2003 season. In addition, approximately 40 percent of Vaughn's salary is deferred and would have to be paid by MLB. See Murray Chass, *Bankruptcy Fallout Would Prove Thorny*, N.Y. TIMES, Jul. 14, 2002, at D2. See also <http://sports.espn.go.com/mlb/players/profile?statsId=5228> (last visited on Jul. 15, 2002). See also <http://sports.espn.go.com/mlb/players/profile?statsId=5994> (last visited on Jul. 15, 2002). See also <http://sports.espn.go.com/mlb/salaries?team=fla> (last visited on Jul. 15, 2002).

A fourth cost of contraction could have been the potential need to purchase the eliminated Major League teams' affiliated minor league clubs.<sup>137</sup> Most Major League teams have six affiliated minor league clubs, including one at both the AAA and AA levels, at least two (and usually three) at the A level, and at least one (and sometimes two) at the Rookie level. While it is uncertain whether Major League Baseball would have been required to purchase these affiliated clubs,<sup>138</sup> a conservative approach necessitates that this cost be included in the overall cost of contraction. In the likelihood that the minor league teams that are affiliated with the contracted major league clubs would have needed to be folded, they would have needed to be purchased and eliminated similar to the contracted Major League clubs - or at least potentially some clubs would have needed to be eliminated.<sup>139</sup> The purchase price of those affiliated clubs is estimated to be somewhere between \$50-\$75 million plus the cost of any remaining stadium lease obligations.<sup>140</sup>

A final cost of contraction would have been the losses that Major League Baseball will incur from operating the Montreal Expos during the 2002 season. Even after collecting \$28.517 million in revenue sharing, the Expos still sustained before-interest operating losses of \$10.002 million in 2001.<sup>141</sup> Due to the team's tenuous status, this loss likely will be even greater in 2002 and will be passed along to the other Major League

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<sup>137</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 6, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>138</sup> Richard Sandomir, *Contraction Plans Put Minor League Affiliates in Limbo*, N.Y. TIMES, Dec. 4, 2001, at S4.

<sup>139</sup> Id.

<sup>140</sup> Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 6, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002).

<sup>141</sup> See MLB 2001 club-by-club breakdown (available at <http://www.mlb.com/mlb/hearings/downloads/overview.pdf> (last visited on July 12, 2002)).

clubs. Thus, looking at the total contraction costs of two clubs yielded a total sum of between \$460-485 million, which was between \$16,428,571 and \$17,321,429 for each of the remaining 28 MLB teams.<sup>142</sup>

There were considerable financial benefits associated with contraction that Major League Baseball will now forsake. First, there would have been substantially more central, i.e. national, revenues for each club. The additional money yielded from league-wide broadcasting, licensing and sponsorship fees would have been \$24.401 million per team in 2001.<sup>143</sup> In addition, there would have been a decrease in the amount of local revenues that are shared with the weaker clubs in the league. The Expos received \$28.517 million from the revenue sharing plan in 2001, while the Twins received \$19.089 million, the Marlins took in \$18.561 million, the Royals collected \$15.997 million, and \$12.384 million was shared with the Devil Rays.<sup>144</sup>

In analyzing the overall financial benefit of contraction, the key issue was obviously how much money the remaining teams were going to save by eliminating the various clubs. Eliminating the Expos was going to save Major League Baseball teams \$62.920 million per year, based on 2001 figures.<sup>145</sup> The elimination of the Twins would have

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<sup>142</sup> This figure assumes that two clubs will be eliminated and that the identity of the contracted clubs would be the Montreal Expos for \$120 million and one other club for a high-end purchase price of \$250 million, for a total purchase price of \$370 million. This figure also assumes that the cost associated with the minor league clubs is \$50 - \$75 million, operating losses of the Montreal Expos of \$10 million, player contract costs of \$30 million, and a lease cost of \$0, unless the second club is the Kansas City Royals, in which case this cost would be approximately \$10 million.

<sup>143</sup> See MLB 2001 club-by-club breakdown (available at <http://www.mlb.com/mlb/hearings/downloads/overview.pdf> (last visited on July 12, 2002)).

<sup>144</sup> Id.

<sup>145</sup> This figure is derived by summing the \$24.401 million in national revenues that was earmarked for the Expos and the \$28.517 million in local operating revenues that was shared with the Expos in 2001, as well as operating losses of at least \$10.002 million in the 2002 season. These monies will now be retained by the clubs, an average of \$2,247,143 million per club.

saved the clubs \$43.490 million each year,<sup>146</sup> while the contraction of the Marlins would have saved \$42.962 million,<sup>147</sup> the elimination of the Royals would have saved the other clubs \$40.398 million annually,<sup>148</sup> and a contraction of the Devil Rays would have aided the other clubs by \$30.642 million.<sup>149</sup> Thus, the elimination of both the Expos and the Twins would have saved the other Major League clubs \$96.408 million per year, or \$3,443,043 per team every year.

Pursuant to an understanding of the costs associated with the contraction of each club and assuming that there is a desired pre-tax rate of return of 14 percent,<sup>150</sup> there can be a determination of the net financial return to be gained from the elimination of each of the various clubs by comparing the targeted pre-tax returns with the net benefits. The net cost of contracting the Expos would have been \$170 - \$182.5 million.<sup>151</sup> Assuming a targeted return of 14 percent, Major League Baseball must have expected an annual return of at least \$23,800,000 for the contraction of the Expos to be worthwhile. Since the net benefit of contracting the Expos was projected to be \$62,920,000 per year, it is certainly fair to conclude that the Expos were worth folding from a financial perspective.

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<sup>146</sup> This figure is derived by summing the \$24.401 million in national revenues that was earmarked for the Twins and the \$19.089 million in local operating revenues that was shared with the Twins in 2001. These monies will now be retained by the clubs, an average of \$1,553,214 million per club.

<sup>147</sup> This figure is derived by summing the \$24.401 million in national revenues that was earmarked for the Marlins and the \$18.561 million in local operating revenues that was shared with the Marlins in 2001. These monies will now be retained by the clubs, an average of \$1,534,357 million per club.

<sup>148</sup> This figure is derived by summing the \$24.401 million in national revenues that was earmarked for the Royals and the \$15.997 million in local operating revenues that was shared with the Royals in 2001. These monies will now be retained by the clubs, an average of \$1,442,785 million per club.

<sup>149</sup> This figure is derived by summing the \$18.258 million in national revenues that was earmarked for the Devil Rays and the \$12.384 million in local operating revenues that was shared with the Devil Rays in 2001. These monies will now be retained by the clubs, an average of \$1,094,357 million per club.

<sup>150</sup> This is typical of most investors. Roger Noll, *The Economics of Baseball Contraction*, Stanford Institute for Economic Policy Research Discussion Paper 01-15, at 9, available at <http://siepr.stanford.edu/papers/pdf/01-15.pdf> (last visited on Jul. 15, 2002). However, the average rate of return for the thirteen Major League Baseball clubs that were sold between 1992 and 2000 was 7.9%. See The Report of the Independent Members of the Commissioner's Blue Ribbon Panel on Baseball Economics 51, available at [http://www.mlb.com/mlb/downloads/blue\\_ribbon.pdf](http://www.mlb.com/mlb/downloads/blue_ribbon.pdf) (last visited on July 12, 2002).

<sup>151</sup> This figure assumes a purchase price of \$120 million, player costs of \$15 million, minor league expenses of \$25-37.5 million, and operating losses of \$10 million.

One can perform a similar analysis with each of the other clubs that were considered to be potential contraction targets. The net cost of eliminating the Twins would have been \$290 - \$302,500,000.<sup>152</sup> Thus, Major League Baseball must have expected an annual return of \$40,600,000 - \$42,350,000 for the contraction of the Twins to be financially beneficial. The net benefit of folding the Twins was expected to be \$43,490,000. Thus, the financial benefit of eliminating the Twins was not as great as the contraction of the Expos but it was enough to conclude that the Twins were marginally worth folding from purely a financial perspective.

The net cost of eliminating the Marlins would have been \$240 - \$252 million.<sup>153</sup> Major League Baseball's expected annual return must have been \$33,600,000 - \$35,280,000 for the contraction of the Marlins to be worthwhile. Since there was an expected net benefit of \$42,962,000,<sup>154</sup> it can be concluded that the elimination of the Marlins was financially justifiable.

The net cost of eliminating the Royals would have been \$250 - \$262 million.<sup>155</sup> With a desired annual return of \$35,000,000 - \$36,680,000 and an expected net benefit to the other clubs of \$40,398,000 million annually,<sup>156</sup> the contraction of the Royals also would have been financially justified.

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<sup>152</sup> This figure assumes a purchase price of \$250 million, player costs of \$15 million, and minor league expenses of \$25-37.5 million.

<sup>153</sup> This figure assumes a purchase price of \$200 million, player costs of \$15 million, and minor league expenses of \$25-37.5 million.

<sup>154</sup> This figure is derived by summing the \$24.401 million in national revenues that was earmarked for the Marlins and the \$18.561 million in local operating revenues that was shared with the Marlins in 2001. These monies will now be retained by the clubs, an average of \$1,534,357 million per club.

<sup>155</sup> This figure assumes a purchase price of \$200 million, player costs of \$15 million, minor league expenses of \$25-37.5 million, and lease costs of \$10 million.

<sup>156</sup> This figure is derived by summing the \$24.401 million in national revenues that was earmarked for the Royals and the \$15.997 million in local operating revenues that was shared with the Royals in 2001. These monies will now be retained by the clubs, an average of \$1,442,785 million per club.

Finally, the net cost of eliminating the Devil Rays would have been \$240 - \$252 million,<sup>157</sup> with a desired return to Major League Baseball of \$33,600,000 - \$35,280,000. Since the contraction of the Devil Rays would have aided the other clubs by \$30,642,000, it can be concluded that the elimination of the Devil Rays was not financially justified. However, when the Devil Rays begin to receive a full share of national revenues in 2003, the other clubs will realize an additional savings of \$6,143,000 per year.<sup>158</sup> Thus, the net benefit to the other clubs will then rise to \$36,785,000, allowing the conclusion that the elimination of the Devil Rays would have been marginally justifiable at that time.

## VII. Recommendations and Conclusion

One can conclude that Major League Baseball would have been financially justified in contracting the Expos, Marlins, and Royals and marginally justified in eliminating the Twins and Devil Rays, but this would not have adequately addressed all of the problems facing Major League Baseball. There are large and growing revenue disparities, an insufficient level of revenue sharing, and competitive imbalance.<sup>159</sup> While the new collective bargaining agreement addresses all of these issues, it does not go far enough. These issues are all intertwined, and to reiterate former Major League Baseball Commissioner Bowie Kuhn's recent thoughts about contraction, "It is not the only solution but not any one solution is going to fix the problems the industry is facing."<sup>160</sup> With the new collective bargaining agreement in place, contraction will not occur until at

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<sup>157</sup> This figure assumes a purchase price of \$200 million, player costs of \$15 million, and minor league expenses of \$25-37.5 million.

<sup>158</sup> This is based on 2001 figures.

<sup>159</sup> See The Report of the Independent Members of the Commissioner's Blue Ribbon Panel on Baseball Economics 1, available at [http://www.mlb.com/mlb/downloads/blue\\_ribbon.pdf](http://www.mlb.com/mlb/downloads/blue_ribbon.pdf) (last visited on July 12, 2002).

<sup>160</sup> Jim Street, *Kuhn: Contraction, additional steps make sense*, Nov. 29, 2001, available at [http://www.mlb.com/NASApp/mlb/mlb/news/mlb\\_news\\_story.jsp?article\\_id=mlb\\_20011129\\_bowiekuhn\\_news&team\\_id=mlb](http://www.mlb.com/NASApp/mlb/mlb/news/mlb_news_story.jsp?article_id=mlb_20011129_bowiekuhn_news&team_id=mlb) (last visited on July 12, 2002).

least 2007. The Expos' problems will likely be solved by relocation to an area such as Northern Virginia/Washington, D.C. and the woes of the Twins, Marlins, and Royals will be quelled temporarily by either the sale of the clubs and/or construction of new stadia.

In pondering what else Major League Baseball can do to maintain the future viability of all of its clubs in the absence of contraction, one can start by comparing some of the recommendations that the Commissioner's Blue Ribbon Panel on Baseball Economics put forward in 2000, which did not recommend contraction, with the terms of the new collective bargaining agreement.<sup>161</sup> The Blue Ribbon Panel's recommendations included the sharing of 40 – 50 percent of all local revenues,<sup>162</sup> instituting a 50% luxury tax on clubs with player payrolls of above \$84 million and a minimum payroll of \$40 million per club,<sup>163</sup> having an unequal distribution of any new Major League Baseball Central Fund revenues to low-revenue clubs meeting the \$40 million minimum payroll requirement,<sup>164</sup> reforming the Rule 4 (entry level) draft rules<sup>165</sup> and instituting a competitive balance draft,<sup>166</sup> and allowing the Major League clubs to exercise their monopoly power by permitting franchise relocations to occur.<sup>167</sup>

Most of these issues had to be negotiated with the Player Association and thus the solutions were not as clear-cut as they may have seemed to the Blue Ribbon Panel. The union's preference to see a much smaller increase in local revenue sharing resulted in a three-tiered system that involves a sharing of 34% of every team's net local revenues

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<sup>161</sup> See The Report of the Independent Members of the Commissioner's Blue Ribbon Panel on Baseball Economics 44, available at [http://www.mlb.com/mlb/downloads/blue\\_ribbon.pdf](http://www.mlb.com/mlb/downloads/blue_ribbon.pdf) (last visited on July 12, 2002).

<sup>162</sup> Id. at 8.

<sup>163</sup> Id. The clubs are instead seeking a higher payroll threshold of \$98 million before the 50% tax would be levied.

<sup>164</sup> Id. at 9.

<sup>165</sup> Id. at 9.

<sup>166</sup> Id. at 9.

<sup>167</sup> Id. at 10.

(after stadium operating expenses), the gradual redistribution of \$72.2 million annually from the larger revenue clubs to the smaller revenue clubs, and the redistribution of \$10 million by the commissioner at his discretion.<sup>168</sup> The union also opposed the imposition of any drag on player salaries such as a luxury tax.<sup>169</sup> However, the agreement includes provisions for a luxury tax to be placed on player payrolls exceeding proscribed thresholds of \$117 million in 2003, \$120.5 million in 2004, \$128 million in 2005, and \$136.5 million in 2006.<sup>170</sup> The applicable tax rate the first time that a team exceeds the threshold will be 17.5 percent in 2003, and 22.5 percent in 2004 and 2005; there will be no tax in 2006 for first time offenders.<sup>171</sup> The second time that a team is over the threshold, it will pay a 30 percent tax in 2004 and 2005 and a 40 percent tax in 2006.<sup>172</sup> A team that exceeds the threshold for a third and fourth time will pay a 40 percent tax.<sup>173</sup>

Not all of the Blue Ribbon Panel's recommendations were followed. There is neither a minimum player payroll nor a competitive balance draft in the new labor deal. In addition, proposed reforms of the entry-level draft rules will undergo further study by a labor-management committee. Finally, the new collective bargaining agreement includes provisions that were not addressed by the Blue Ribbon Panel. These additional terms include a potential revamping of the rules concerning the allowable debt limit for Major League clubs. The commissioner has the option of replacing the current 60-40 assets to debt ratio rule with one that prohibits a club from having more debt than ten times its

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<sup>168</sup> See *Four Year Deal Includes Luxury Tax, No Contraction*, Aug. 30, 2002 at <http://espn.go.com/mlb/news/2002/0830/1425253.html> (last visited on Sept. 4, 2002).

<sup>169</sup> Judiciary Committee hearing on antitrust begins, Feb. 13, 2002, available at [http://www.mlb.com/NASApp/mlb/mlb/news/mlb\\_news\\_story.jsp?article\\_id=mlb\\_20020213\\_antitrust\\_news&team\\_id=mon](http://www.mlb.com/NASApp/mlb/mlb/news/mlb_news_story.jsp?article_id=mlb_20020213_antitrust_news&team_id=mon) (last visited on July 12, 2002).

<sup>170</sup> See *Four Year Deal Includes Luxury Tax, No Contraction*, Aug. 30, 2002 at <http://espn.go.com/mlb/news/2002/0830/1425253.html> (last visited on Sept. 4, 2002).

<sup>171</sup> Id.

<sup>172</sup> Id.

<sup>173</sup> Id.

earnings before interest, depreciation, taxes and amortization (EBITDA), except for those clubs that began playing in a newly constructed stadium within the last decade.<sup>174</sup> In response to public criticism and allegations of rampant steroid use among Major League players, there will be random survey drug testing for illegal steroids in 2003 with the potential for mandatory random testing in future years if 5 percent or more of the players surveyed test positive.<sup>175</sup> Players at the lower end of the salary scale will recognize an immediate benefit. The minimum player salary will rise from \$200,000 to \$300,000 in 2003 and the clubs' contribution to the players' benefits plan will increase from \$70 million to approximately \$114.5 million per year. In a move that will likely have a deleterious effect on small and middle revenue franchises, clubs that lose marquee free agents will no longer be compensated with draft picks.<sup>176</sup>

It is unlikely that these provisions will have a profound effect on the landscape of professional baseball during the new collective bargaining agreement's 2002 – 2006 lifetime. However, they represent a good starting point for the reformation of Major League Baseball. The adoption of additional measures will only serve to enhance the future viability of Major League Baseball. Therefore, while the issue of contraction has been temporarily resolved, it is likely to resurface again.

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<sup>174</sup> Id. Those clubs will be allowed to carry a debt of fifteen times EBITDA. Id.

<sup>175</sup> Id.

<sup>176</sup> Id.