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# From Sports Stadiums to the Stock Exchange: The Economic Agency Costs of Fantex's Income- Share Agreements with Professional Athletes

By Nicole Medeiros<sup>1</sup>

## I. Introduction

It's Monday night – are you ready for some football?<sup>2</sup> Football, baseball, and basketball are among Americans' favorite pastimes.<sup>3</sup> In the United States, sports enthusiasts spend billions of dollars on games, merchandise, and memorabilia.<sup>4</sup> Over the past decade, companies have found new ways to whet Americans' appetites for their favorite pastimes. With Yahoo! Fantasy Sports and ESPN Fantasy Games, football aficionados can not only tune into the game on Monday night, but they can also draft a team of NFL players and regularly track their players' performances with detailed statistics.<sup>5</sup> Likewise, with FanDuel and DraftKing, sports fans can place friendly wagers on their game day predictions.<sup>6</sup> Now, thanks to Fantex, football fans

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1. Nicole Medeiros, J.D. Candidate at University of California - Hastings College of the Law. I wish to acknowledge *Hastings Business Law Journal's* Faculty Advisors for their guidance during the early stages of my writing process, particularly Professor Ellias who inspired me to explore agency costs. I would like to thank the *Hastings Business Law Journal's* Editorial Board for their hard work in editing this Note. Finally, I express sincere gratitude to my parents, Joe and Maria, and my brother, Keegan, for their love, humor, and ongoing cheers. Força!

2. Since 1991, Hank William Jr.'s song, "My Rowdy Friends Are Here on Monday Night," served as the Monday Night Football theme song on ABC and ESPN. ESPN has since parted ways with William Jr.'s song after his controversial remarks about President Obama. James Lipshutz, *ESPN Drops Hank William Jr.'s Monday Night Football Song*, BILLBOARD (Oct. 6, 2011), <http://www.billboard.com/articles/news/466603/espn-drops-hank-williams-jrs-monday-night-football-theme>.

3. See Darren Rovell, *NFL most popular for 30th year in row*, ESPN (Jan. 16, 2014), [http://espn.go.com/nfl/story/\\_/id/10354114/harris-poll-nfl-most-popular-mlb-2nd](http://espn.go.com/nfl/story/_/id/10354114/harris-poll-nfl-most-popular-mlb-2nd).

4. See Darren Heitner, *Sports Industry to Reach \$73.5 Billion By 2019*, FORBES (Oct. 19, 2015), <http://www.forbes.com/sites/darrenheitner/2015/10/19/sports-industry-to-reach-73-5-billion-by-2019/#495ac3615854>.

5. See YAHOO! FANTASY SPORTS, <http://fantasysports.yahoo.com/moregames>; ESPN FANTASY, <http://espn.go.com/fantasy/>.

6. The advent of FanDuel and DraftKings has also raised a plethora of important legal questions, including the legality of online fantasy sports wagers. See Jacob Pramuk, *DraftKings, FanDuel lobby Congress amid legal challenges*, CNBC (Jan. 21, 2016), <http://www.cnbc.com/2016/01/21/draftkings-fanduel-lobby-congress-amid-legal-challenges.html>.

can put their money where their mouths are by investing in stock linked to their favorite athletes' earnings.<sup>7</sup>

Formed in 2012, Fantex, a brand marketing and acquisition company, has taken fan engagement to an entirely new platform for sports enthusiasts—the stock exchange.<sup>8</sup> Headquartered in San Francisco, California, Fantex was incorporated in September 2012.<sup>9</sup> Led by Chief Executive Officer, Cornell “Buck” French, Fantex’s primary objective is “acquiring minority interests in the future income of professional athletes and assisting such individuals in growing these income streams.”<sup>10</sup> Since 2012, Fantex has secured minority interests in the future income of eleven professional athletes and launched public offerings of stocks tied to each of those brand contracts.<sup>11</sup>

In many respects, Fantex is a part of the wave of innovative online sports platforms for fans but it is also an example of the recent proliferation of income-share agreements that have emerged over the past decade.<sup>12</sup> Like Fantex, companies such as Pave, Lumni, and Upstart, enable students and entrepreneurs to receive money upfront in exchange for a minority interest in their future financial earnings.<sup>13</sup> In fact, the rise of these unique financial arrangements has garnered the attention of congressional leaders, who are exploring income-share agreements as a possible solution to the student debt crisis and attempting to develop a proper regulatory framework for income-share agreements.<sup>14</sup>

In light of recent legislative proposals, most scholarship about income-share agreements has focused on the complex financial characterization of the arrangements, and by implication, the regulatory and policy issues they raise if characterized as debt or equity.<sup>15</sup> While legal scholars have discussed income-share

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7. William Alden, *I.P.O Linked to Football Player Opens for Trading*, N.Y. TIMES (Apr. 28, 2014), <http://dealbook.nytimes.com/2014/04/28/i-p-o-linked-to-football-player-opens-for-trading/>.

8. Fantex Holdings Inc. (“Fantex Holdings”) is the holding company for Fantex Brokerage Services LLC (“Fantex Brokerage”), an online brokerage firm, and Fantex, Inc. (“Fantex”), a brand marketing, acquisition and development company which issues securities. Throughout this Note, I refer primarily to Fantex because this is the entity that contracts with the athletes.

9. FANTEX, INC., AMENDMENT NO. 1 TO FORMS S-1, SPORTS PORTFOLIO 1 (2016 Prospectus) 123 (Jan. 13, 2016).

10. *Id.*

11. FANTEX, INC., *supra* note 9.

12. For consistency, I use the term “income-share agreement” to refer to contractual arrangements in which individuals receive money upfront in exchange for a stake in their future income.

13. *See Start me up: Helping youngsters to sell stakes in their future*, THE ECONOMIST (June 15, 2013), <http://www.economist.com/news/finance-and-economics/21579490-helping-youngsters-sell-stakes-their-future-start-me-up>.

14. *See* Shu-Yi Oei & Diane Ring, *Human Equity? Regulating the New Income Share Agreements*, 68 VAND. L. REV. 681, 686 (2015) (“In April 2014, Marco Rubio (R-FL) and former Representative Tom Petri (R-WI) introduced a bill, the ‘Investing in Student Success Act,’ seeking to clarify the legality of ISAs and their treatment under securities, tax, bankruptcy, and usury laws.”).

15. With the exception of several articles, there is scant literature addressing the legal and regulatory implications of “income share agreements.” *See* Shu-Yi Oei & Diane M. Ring, *The New “Human Equity” Transactions*, 5 CAL. L. REV. CIRCUIT 266, 268 (2014) (“This Essay constitutes the first

agreements in education, few have comprehensively analyzed Fantex's brand contracts with professional athletes.<sup>16</sup>

One of the issues not yet explored are the economic agency costs of these financial arrangements. Specifically, in the realm of professional sports, where injuries are common and careers sometimes fleeting, how does an income-share agreement influence a professional athlete's decision-making with respect to future personal, health, or financial decisions? What information asymmetries and moral hazards exist? And, in what ways can the income-share agreements be adjusted in order to more fully align both parties' interests and incentives?

This Note aims to explore the economic agency costs of Fantex's income-share agreements with professional athletes by assessing moral hazards and asymmetric information in Fantex's brand contracts. Part II provides a brief overview of the historical emergence of income-share agreements and Part III gives a summary of Fantex's business model. Part IV identifies and analyzes the asymmetric information and moral hazards in Fantex's brand contracts with professional athletes. Lastly, Part V offers recommendations on ways in which the contracting parties can mitigate those costs by incorporating earnout provisions in the brand contracts.

## II. The Proliferation of Income-Share Agreements

Reactions to Fantex have been widespread and mixed among sports commentators, financial analysts, and professional athletes. Investment analysts have expressed skepticism about the financial viability of the stock, claiming that Fantex "is an extraordinarily idiosyncratic, volatile investment."<sup>17</sup> Given the susceptibility of football players to injury, some analysts are hesitant to label Fantex an investment—instead, one analyst described Fantex as "a risky bet."<sup>18</sup>

Some claim that investing in an individual's "brand," is "[p]retty distasteful,"<sup>19</sup> with one former football player explaining: "[t]hey are merchandising human beings, let's be honest."<sup>20</sup> While others, including Fantex-affiliated Vernon Davis,

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serious attempt in the legal literature at proposing a framework for analyzing whether these new transactions are normatively acceptable and, if so, what regulatory issues they may raise.").

16. See Oei & Ring, *supra* note 14, at 686; Jeff Schwartz, *The Corporatization of Personhood*, 2015 U. ILL. L. REV. 1119, 1121 (2015); Ritika Kapadia, *A Solution to the Student Loan Crisis: Human Capital Contracts*, 9 BROOK. J. CORP. FIN. & COM. L. 591, 591 (2015).

17. *Fantex: Is Buying Shares in Athletes Risky Business?*, KNOWLEDGE AT WHARTON, U. PENN., <http://knowledge.wharton.upenn.edu/article/fantex-buying-shares-athletes-risky-business/> (quoting Wharton Operations and Information Management Practice Professor Cade Massey).

18. *Id.* (quoting Jesse David, Edgeworth Economics). According to Edgeworth Economics, between 2004 and 2009, NFL players sustained a total of 16,500 injuries—approximately 1.5 injuries per year per player. Further, each player has a "one-in-seven chance" of experiencing a season-ending injury.

19. *Id.* (quoting Reuters columnist Felix Salmon) ("[he] referred to the concept in a piece that declared Fantex the 'bad investment of the day.' He called the language Fantex used in its prospectus 'deliberately dehumanizing: The athlete is referred to not as a person, but as a 'brand,' throughout.").

20. *Id.* (quoting John Moffitt).

have expressed enthusiasm for the company because it presents opportunities for professional athletes to enhance their image and monetize their brand.<sup>21</sup> Davis, then a tight end for the San Francisco 49ers, explained how his deal with Fantex was not just about the money, noting: “I like to take risks. I’m an entrepreneur. . . . Anytime there’s something new, I like to be involved.”<sup>22</sup>

Given the novelty of “investing” in a professional athlete’s lifetime future earnings, it is understandable that Fantex’s business model has been met with enthusiasm and skepticism.

However, while Fantex may be the first company to securitize income-share agreements with professional athletes, it is not the first company to provide upfront payment to individuals in exchange for a portion of their future earnings.<sup>23</sup>

A. *Precursors to Income-Share Agreements: Milton Friedman and David Bowie*

In the 1950s, American economist Milton Friedman advocated for a new model of college funding whereby investors could fund a student in exchange for a minority share of his or her future earnings.<sup>24</sup> In Friedman’s seminal work, *The Role of Government in Education*, he discussed the tremendous risks that educational loans pose in education because there is no collateral for lenders, and no guarantee that borrowers’ salaries will increase after graduation.<sup>25</sup> In response to these risks, Friedman proposed a new approach to education financing based on equity investing, whereby investors would fund a student in exchange for a guarantee of his or her future salary.<sup>26</sup> Friedman explained how:

The counterpart for education would be to “buy” a share in an individual’s earning prospects: to advance him the funds needed to finance his training on condition that he agree to pay the lender a specified fraction of his future earnings. In this way, a lender would get back more than his initial investment from relatively successful individuals, which would compensate for the failure to recoup his original investment from the unsuccessful.<sup>27</sup>

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21. William Alden, *Vernon Davis Breaks Silence Over Fantex I.P.O.*, NY TIMES (June 14, 2014), [http://dealbook.nytimes.com/2014/06/04/vernon-davis-breaks-his-silence-over-fantex-i-p-o/?\\_r=0](http://dealbook.nytimes.com/2014/06/04/vernon-davis-breaks-his-silence-over-fantex-i-p-o/?_r=0).

22. *Id.*

23. Schwartz, *supra* note 16, at 1121.

24. *Id.* at 1124.

25. *Id.* at 1124-25.

26. *Id.*

27. *Id.* at 1125 (quoting Milton Friedman, *The Role of Government in Education*, ECONOMICS AND THE PUBLIC INTEREST 135-43 (Robert A. Solo ed., 1955)).

Eventually, Friedman's ideas would materialize in the 2000s with the advent of companies, such as Lumni, which have created mechanisms for investors to fund students in exchange for a portion of their future earnings. Interestingly, outside the field of economics, entertainers, like the late David Bowie, explored ways of selling shares of musicians' future royalty earnings. Bowie, celebrated for his artistic ingenuity, was among the first entertainer to sell investment rights in his work by securitizing royalties from his record albums.<sup>28</sup> In 1997, Bowie, who had purchased rights to his music for nearly \$27 million, collaborated with his financial manager, Bill Zysblast, and investment banker David Pullman to securitize royalties from his albums.<sup>29</sup> Bowie signed a deal with EMI, a record label, which enabled Bowie to securitize royalties from a total of 25 albums.<sup>30</sup> Underwritten by Fahnstock & Co., the royalties backed the issuance of \$1,000 bonds for a total of \$55 million.<sup>31</sup> Prudential Insurance purchased the full bond issue, which paid 7.9% interest for ten years.<sup>32</sup> After ten years, 100% of the royalties were payable to Bowie.<sup>33</sup> Later, David Pullman coordinated similar bond arrangements with other artists, including Marvin Gaye, James Brown, Ashford & Simpson, and the Isley Brothers.<sup>34</sup> Friedman's human equity investing proposals and Bowie's unique bond arrangements were important precursors to the income-sharing agreements that now exist.

*B. Income-Share Agreements: Lumni, Upstart, Pave, and 13th Avenue*

Friedman's ideas have since materialized over the past decade with the emergence of companies offering income-share agreements for students and entrepreneurs. Lumni, for example, manages pools of diversified investment funds that invest in students. According to its website, Lumni manages funds in the United States, Chile, Colombia, Mexico, and Peru, and has provided financing to more than 7,000 students.<sup>35</sup> Touting itself as a "pioneer in the field of human capital financing," Lumni receives financing from investors interested in financing students' educations.<sup>36</sup> In exchange for the funds received, students agree to pay a fixed percent of their income for a specified period after they graduate.<sup>37</sup> Similarly, 13<sup>th</sup> Avenue Funding, a non-profit organization, enables individuals to invest in the

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28. John Burke, *Do Bowie Bonds Have a Future?*, ECONOMY WATCH (Jan. 18, 2016), <http://www.economywatch.com/features/Do-Bowie-Bonds-Have-a-Future0118.html>.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *See About Us*, LUMNI, <http://www.lumni.net/about/>.

36. *Id.*

37. *Id.*

education of local community members.<sup>38</sup> In exchange, student participants agree to pay a percentage of their future income to 13th Avenue Funding.<sup>39</sup>

Upstart offers traditional loans, which are based in part on an individual's credit score, years of credit, education, area of study, and employment history.<sup>40</sup> However, prior to offering traditional loans, Upstart also offered investors an opportunity to fund individuals in need of financing for their educational or entrepreneurial ventures in return for a fixed percentage of their earnings for a specified period of time.<sup>41</sup> The income-share agreement included a contractual provision which enabled recipients of the loan to defer payment of their earnings to Upstart if their income fell below a determined income level.<sup>42</sup> If a recipient deferred income payments, an additional year of payment was added to the contract.<sup>43</sup> Ultimately, in light of scarce policy or regulatory guidance, Upstart announced it would no longer offer these types of investment arrangements because "while many regulatory and policy efforts are underway to facilitate the development of the market, these efforts will likely take many years."<sup>44</sup>

Like Upstart, Pave also launched an income-share arrangement whereby investors could fund students or entrepreneurs in exchange for a fixed percentage of their future earnings over a period of ten years.<sup>45</sup> However, like Upstart, it appears that Pave now offers more traditional loan offerings, which are based on credit scores, educational background, employment status, and future earning potential.<sup>46</sup>

### III. About Fantex: Brand Contracts and Tracking Stocks

While income-share agreements are not entirely novel, Fantex is the first company to offer these agreements to professional athletes and securitize them. Fantex Holdings is the parent company to both Fantex, the entity that contracts with athletes to obtain a minority interest in their future earnings and develops tracking stocks linked to their performance, and Fantex Brokerage, the trading platform that enables individuals to invest in those stocks.<sup>47</sup>

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38. See 13TH AVENUE FUNDING, <http://www.13thavenuefunding.org/>.

39. *Id.*

40. See *Invest*, UPSTART, <https://www.upstart.com/invest>.

41. See Oei & Ring, *supra* note 14, at 690.

42. *Id.*

43. *Id.*

44. Oei & Ring, *supra* note 15, at 270 (citing David Girouard, *Sunsetting Income Share Agreements on Upstart*, UPSTART BLOG (May 6, 2014), <http://blog.upstart.com/post/84980267394/sunsetting-income-share-agreementson-upstart>).

45. Oei & Ring, *supra* note 14.

46. Oei & Ring, *supra* note 14. See also PAVE, *Underwriting Methodology*, [http://support.pave.com/knowledge\\_base/topics/what-is-paves-underwriting-methodology](http://support.pave.com/knowledge_base/topics/what-is-paves-underwriting-methodology).

47. FANTEX, INC., ANNUAL REPORT (Form 10-K) 5-6 (Dec. 31, 2015).

A. *Fantex's Evaluation Process for Prospective Brands*

To determine if a professional athlete is a suitable contract party, Fantex conducts a detailed analysis of the prospective party's brand.<sup>48</sup> Fantex considers an athlete's brand to include "a complex set of associations people make with respect to an individual, including performance, appearance, history and personal story, products or services they are associated with, public statements or positions on matters of public concern, how an individual acts or the image they project to the world."<sup>49</sup> Ultimately, Fantex seeks professional athletes with brands that "convey images and associations that . . . will be recognized and valued in the market place."<sup>50</sup>

When evaluating a prospective brand, Fantex considers multiple factors, including whether: 1) the athlete is anticipated to maintain a career for at least 3 years in his or her given sport; 2) the athlete is estimated to earn at least \$5,000,000 in his or her given sport, and 3) the athlete is estimated to earn at least \$200,000 from future endorsements.<sup>51</sup> Additionally, Fantex assesses the athlete's reputation and character vis-à-vis personal references and background checks, and also reviews the athlete's individual performance metrics (e.g., yards per carry or selection to All-Pro teams in the NFL).<sup>52</sup>

B. *The Structure and Terms of Fantex's Brand Contracts*

To date, Fantex has entered into eleven brand contracts with professional athletes in the NFL, MLB, and PGA.<sup>53</sup> When Fantex contracts with a professional athlete, the company pays a purchase price in exchange for a minority interest in the athlete's lifetime future income.<sup>54</sup> The percentage of income Fantex is entitled to under the brand contract is referred to as acquired brand income ("ABI").<sup>55</sup> While each contract varies, ABI for Fantex brand contracts typically include gross funds the athletes receive as a result of their skill or brand.<sup>56</sup> For example, ABI income includes salary and wages received for work as a professional athlete, and income received in relation to his or her career as a professional athlete, such as endorsement contracts and media appearances.<sup>57</sup> Additionally, ABI consists of the following:

Other compensation from the contract party's assignment of rights in his persona, including use of his name, voice, likeness, image, signature,

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48. *Id.* at 6-7.

49. *Id.* at 6.

50. *Id.*

51. *Id.*

52. *Id.* at 7.

53. *Id.* at 5.

54. *Id.*

55. *Id.* at 60.

56. *Id.* at 16.

57. *Id.*

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talents, live or taped performances, in connection with motion pictures, television and Internet programming, radio, music, literary, talent engagement, personal appearances, public appearances, records and recording, or publications; any use of his persona for purposes of advertising, merchandising, or trade, including sponsorships, endorsements and appearances, and any other assignment of rights in his persona, to generate income; and any other personal services performed by the contract party which are of the type typically performed by individuals in the particular professional sports because of their status as a professional athlete in that sport (including, without limitation, sports casting, coaching, participating in sports camps, acting as spokesperson).<sup>58</sup>

However, ABI does not include cash received from the athlete's investments, provided that such investments or ventures do not use the athlete's name in its promotional activities.<sup>59</sup>

In the event that a player does not comply with the respective career contracts or endorsements included in the ABI, Fantex may "seek damages for the breach of that contract to the extent that such breach adversely affects brand income. Whether [Fantex] elect[s] to pursue damages for any alleged breach of the terms of the brand contract or any included contract will be based on management's business judgment as to the best interests of the company and its stockholders at the time of such breach."<sup>60</sup>

Additionally, Fantex may exercise its rights to co-invest with Fantex-affiliated athletes. For example, Fantex recently opted to pursue a co-investment right with Vernon Davis.<sup>61</sup> Davis, the owner of a Jamba Juice franchise, decided to purchase additional franchises, and Fantex opted to take action on these investment opportunities too. CEO Buck French explained:

When we see an opportunity that we think is a good one, we'll exercise our co-investment right and get it done. I don't think it's going to be common, but I think it'll happen on occasion. At the end of the day, my job as CEO is to create greater shareholder value for our investors, and I think this does that, so we're going to take advantage of it.<sup>62</sup>

Thus, if a new business venture materializes for a Fantex-affiliated athlete, then Fantex's management team will explore the opportunity to

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58. *Id.*

59. *Id.*

60. *Id.* at 20.

61. FANTEX, INC. FORM S-1, EXHIBIT 10.2 – APPENDIX I (filed Nov. 21, 2013).

62. Daniel Roberts, *Fantex is buying Jamba Juices with Vernon Davis*, FORTUNE (April 2015) <http://fortune.com/2015/04/20/fantex-vernon-davis-jamba-juice/>.

determine if it will be a fruitful co-investment opportunity for Fantex shareholders too.

<b>Summary of Fantex's Brand Contracts with Professional Athletes as of April 2016<sup>63</sup></b>				
<b>Contract Party</b>	<b>Primary Career</b>	<b>ABI Effective Date</b>	<b>Brand Income % Payable to Fantex</b>	<b>Purchase Price for the Brand Contract (in millions)</b>
Vernon Davis	Professional Football Player – Tight End	Oct. 30, 2013	10%	\$4.00
EJ Manuel	Professional Football Player – Quarterback	Feb. 14, 2014	10%	\$4.98
Mohamed Sanu	Professional Football Player – Wide Receiver	May 14, 2014	10%	\$1.56
Alshon Jeffery	Professional Football Player – Wide Receiver	Sept. 7, 2014	13%	\$7.94
Michael Brockers	Professional Football Player – Defensive Tackle	Oct. 15, 2014	10%	\$3.44
Jack Mewhort	Professional Football Player – Offensive Tackle	Feb. 15, 2015	10%	\$2.52
Kendall Wright	Professional Football Player – Wide Receiver	Dec. 1, 2014	10%	\$3.13
Andrew Heaney	Professional Baseball Player – Pitcher	Jan. 1, 2015	10%	\$3.34
Terrance Williams	Professional Football Player – Wide Receiver	Feb. 1, 2015	10%	\$3.06
Ryan Shazier	Professional Football Player – Linebacker	Sept. 1, 2015	10%	\$3.11
Scott Langley	Professional Golfer	Oct. 25, 2015	15%	\$3.06

### *C. Brand Enhancement Services*

In addition, to acquiring a minority interest in the athlete's future earnings, Fantex also attempts to enhance the brand value of the contracting parties by

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<sup>63</sup> FANTEX, INC., *supra* note 47, at 5.

providing their portfolio of athletes with brand enhancement services.<sup>64</sup> Specifically, Fantex claims that it helps athletes “extend the reach of their brands across multiple marketing mediums, including broadcast, print, digital, live events, and social.”<sup>65</sup> It is not entirely clear what types of services Fantex provides affiliated athletes; however, Fantex does explain in its prospectus that each of the athletes has a “‘brand liaison’ . . . responsible for monitoring the brand and brand activities and serving as a liaison to find opportunities for [Fantex] to provide brand enhancing activities.”<sup>66</sup>

Fantex has developed a “brand persona” for each of its contracted athletes. For example, Vernon Davis’ brand persona is “transformational.”<sup>67</sup> Describing his ability to “persevere and evolve through challenging circumstances,”<sup>68</sup> Fantex notes how Davis “has become a successful football player, team leader, student of the arts, philanthropist, and entrepreneur.”<sup>69</sup> And, “[a]s one of the first athletes to sign a brand contract with [Fantex], he is helping transform how athletes look to build and enhance their brands.”<sup>70</sup>

#### *D. Public Offerings of Fantex Series Convertible Tracking Stock*

What makes Fantex’s model unique is that Fantex has offered individuals an opportunity to purchase shares in its brand contracts with professional athletes. In 2014, Fantex garnered media attention for its initial public offering of convertible tracking stock linked to its brand contract with Vernon Davis.<sup>71</sup> Fantex raised \$4.2 million from the sale of 421,100 shares in the Davis I.P.O.<sup>72</sup> Fantex paid Davis \$4 million in exchange for interest in his lifetime future income.<sup>73</sup> Pursuant to Davis’ agreement, Fantex will receive 10% of Davis’ brand-related income, which includes all funds that he earns as a professional athlete, and any money received from activities that involve the use of his name, voice, likeness, or image.<sup>74</sup>

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64. *Id.* at 8.

65. *Id.*

66. FANTEX, INC., *supra* note 9, at 125.

67. *Id.* at 147.

68. *Id.*

69. *Id.*

70. *Id.*

71. Alden, *supra* note 21. See also Richard Brand & Cheryl L. Ho, *Athlete IPS: Good for Players, Risky for Investors*, LAW360 (Feb. 19, 2014) <https://www.law360.com/articles/510440/athlete-ipos-good-for-players-risky-for-investors>.

72. Alden, *supra* note 21.

73. *Id.*

74. FANTEX, INC., FORM S-1, EXHIBIT B – FANTEX BRAND AGREEMENT 1 (filed November 21, 2013).

Davis' contract includes a clawback clause, which specifies that should Davis resign from the NFL within two years of the contract without "good reason,"<sup>75</sup> Fantex may terminate the agreement.<sup>76</sup>

Since the Davis I.P.O, Fantex has issued additional public offerings for its other contracted athletes.<sup>77</sup> Other athletes include: EJ Manuel, quarterback for the Buffalo Bills; Mohamed Sanu, wide-receiver for the Atlanta Falcons; Alshon Jeffery, wide-receiver for the Chicago Bears; Michael Brockers, defensive tackle for the Los Angeles Rams; and Jack Mewhort, offensive lineman for the Indianapolis Colts.<sup>78</sup>

Contrary to media headlines,<sup>79</sup> individuals who purchase tracking stocks related to a brand contract are common stockholders in Fantex.<sup>80</sup> That is, holders of Fantex's tracking stocks do not have ownership interests in the brand income.<sup>81</sup> For example, an individual who purchases shares of Fantex Series Vernon Davis stock does not have an ownership interest in Vernon Davis' brand contract.<sup>82</sup> Rather, the Fantex Series Vernon Davis stock purports to "track" the economic performance of Vernon Davis' brand contract.<sup>83</sup> Ultimately, "the economic performance of [Fantex's] tracking series, including Fantex Series Vernon Davis, will be dependent, in part, upon the aggregate financial performance of Fantex."<sup>84</sup> In large part, purchasing the Vernon Davis series of tracking stock is an investment in Fantex—not Vernon Davis.

In addition to the existing Fantex Series shares trading on Fantex Brokerage, Fantex has filed with the U.S. Securities Exchange Commission ("SEC") to list a portfolio of players under a single symbol on NASDAQ Capital Market ("NASDAQ").<sup>85</sup> In November 2015, Fantex filed a Form S-1 registration statement with the SEC for an initial public offering of "Fantex Sports Portfolio 1" on NASDAQ.<sup>86</sup> The individual security, which Fantex intends to list as "FXSP," will be tied to the income generated by multiple athletes.<sup>87</sup> The Fantex Sports Portfolio

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75. Pursuant to the agreement, "good reason" includes injury, illness or medical condition. FANTEX, INC., *supra* note 61, at 1.

76. *Id.* at 4.

77. Tom Kanki, *Fantex Primes 6th Football Player Brand's \$2.7M IPO*, LAW360 (June 24, 2015), <https://www.law360.com/articles/671903/fantex-primes-6th-football-player-brand-s-2-7m-ipo>.

78. *Id.*

79. Darren Rovell, *421K Vernon Davis shares available*, ESPN (Apr. 21, 2014), [http://espn.go.com/nfl/story/\\_/id/10816433/shares-vernon-davis-san-francisco-49ers-go-sale-next-week](http://espn.go.com/nfl/story/_/id/10816433/shares-vernon-davis-san-francisco-49ers-go-sale-next-week).

80. FANTEX, INC., *supra* note 75, at 4.

81. *Id.*

82. *Id.*

83. As Fantex noted in its filing of the Davis I.P.O., "while we intend for our tracking series, including Fantex Series Vernon Davis, to track the performance of the associated brand (in this case, the Vernon Davis Brand), we cannot provide any guarantee that any tracking series will in fact track the performance of the associated brand." FANTEX, INC., FORM S-1, at 4 (Nov. 21, 2013).

84. *Id.*

85. Darrel Rovell, *Fantex Files with SEC*, ESPN (Nov. 30, 2015), [http://espn.go.com/nfl/story/\\_/id/14260459/fantex-files-securities-exchange-commission-sell-athlete-portfolios-nasdaq](http://espn.go.com/nfl/story/_/id/14260459/fantex-files-securities-exchange-commission-sell-athlete-portfolios-nasdaq).

86. FANTEX INC., FANTEX NASDAQ ANNOUNCEMENT, (last accessed on Nov. 30, 2015).

87. *Id.*

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1 Units will consist of tracking stocks linked to: Michael Brockers; Vernon Davis; Andrew Heaney; Alshon Jeffrey; EJ Manuel; Jack Mewhort; Mohamed Sanu; Ryan Shazier; Terrance Williams; and Kendall Wright.<sup>88</sup> CEO Buck French explained that while the existing “IPOs paved the way to unlocking an asset class previously closed to the capital markets . . . [b]y bundling multiple tracking stocks into a single, NASDAQ-listed security, we believe Fantex is providing the next evolution for those looking to invest in the business of professional sports.”<sup>89</sup>

#### IV. Fantex’s Brand Contracts: Moral Hazards and Asymmetric Information

Presumably, a professional athlete, who agrees to share a minority interest of his lifetime future earnings with Fantex, has incentives to increase his future income—that is, the incentives between both contracting parties are aligned. However, what if an athlete takes more risks on the field that subject him to greater chances of injury or opts to *not* negotiate for a higher salary because he prefers to remain with his existing team?<sup>90</sup> By exploring income-share agreements through the lens of economic agency, we can better understand the limitations of each party. Further, doing so “also identifies the reason that such limitations matter, namely the different interests of the parties.”<sup>91</sup>

In general, “the heart of any deal is an exchange.”<sup>92</sup> Depending on the nature of this exchange, parties must consider various factors, including:

- (1) Asymmetric information regarding the quality of the asset being exchanged (or ‘adverse selection’);
- (2) Asymmetric information regarding post-contractual performance (or ‘moral hazard’);
- (3) Timing elements of the deal that give rise to asset specificity and potential hold up or opportunism; and
- (4) In long-term contracts, the need to adjust performance in response to exogenous changes that may occur.<sup>93</sup>

When applied to Fantex’s brand contracting model, the “principal-agent” problem raises interesting questions regarding the types of information exchanged—or not exchanged—between Fantex investors and prospective Fantex athletes.

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88. *Id.*

89. *Id.*

90. See Oei & Ring, *supra* note 14, at 726. As Oei notes, “[t]he Fantex transaction exhibits the potential for adverse selection and moral hazard common to insurance transactions—specifically, that (1) only risky football players would do the deal, and (2) the athletes might behave badly (e.g., by taking excessive risks on the field, accepting less pay, or quitting) because they feel protected against risk.” *Id.*

91. Eric A. Zacks, *The Moral Hazard of Contract Drafting*, 42 FLA. ST. U. L. REV. 991, 993 (2015).

92. MICHAEL KLAUSNER, A BRIEF OVERVIEW OF THE DEAL’S FRAMEWORK (forthcoming), (manuscript at 7).

93. *Id.*

Ultimately, “[t]he principal-agent problem stems from the differences between the motivations and interests of the parties and the accompanying asymmetries of information and control.”<sup>94</sup> Accordingly, “[i]f the interests of the parties are different, and the agent has better information and more control over the agent’s performance, then the agent may face a ‘moral hazard’ and be inclined to act in the agent’s best interest at the expense of the principal (without the principal being able to detect or counteract such behavior).”<sup>95</sup> In the realm of professional sports, where injuries are frequent and careers are fleeting,<sup>96</sup> Fantex’s model raises important questions about the interests and motivations of contracting parties.

For instance, in the event of injury, Fantex does *not* require an athlete to pay back Fantex’s advance purchase price.<sup>97</sup> In some respects, contracting with Fantex may serve as a form of insurance for professional players, and “[o]nce people purchase insurance that protects them from the downside of risky behavior, they have less incentive to avoid that behavior.”<sup>98</sup> As a result, a Fantex-affiliated quarterback, for example, may be more willing to “run the ball” or take other risks which could result in him being pummeled by a defensive tackle more frequently during a game.

Similarly, once an athlete has received cash upfront, he “may train less dutifully, leading to declining performance and less future compensation for himself and his investors.”<sup>99</sup> Specifically, this could result in losses for Fantex investors, who may lose out on additional earnings. For example, during the 2014 football season, Davis did not attend conditioning training sessions with the San Francisco 49ers during the off-season.<sup>100</sup> Consequently, Davis did not receive a \$200,000 workout bonus.<sup>101</sup> In addition, during the 2014 preseason, Davis did not attend a required minicamp session and, as a result, was fined \$700,000.<sup>102</sup>

In addition to this, not *all* athletes will seek ways to obtain higher salaries or more endorsement deals during their lifetime because not everyone is motivated by money. For example, MLB player Adam LaRoche recently made headlines when he walked away from his contract with the Chicago White Sox because management asked him to limit his son’s time in the clubhouse.<sup>103</sup> In 2015, LaRoche signed a two-year deal for \$25 million with the White Sox, and made arrangements for his

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94. Zacks, *supra* note 91, at 993.

95. *Id.*

96. Beverly Bird, *How Long Is the Average Career of an NFL Player?*, HOUS. CHRON., <http://work.chron.com/long-average-career-nfl-player-12643.html> (last visited May 10, 2017).

97. FANTEX, INC., *supra* note 47, at 17.

98. Schwartz, *supra* note 16, 1142.

99. *Id.* at 1143.

100. FANTEX, INC., ANNUAL REPORT (Form 10-K) 24 (Dec. 31, 2014).

101. *Id.*

102. *Id.*

103. Meghan Keneally, *Adam LaRoche Says White Sox GM Told Him Not to Bring Son to Ballpark “At All”*, ABC NEWS (Mar. 16, 2016), <http://abcnews.go.com/Sports/adam-laroche-white-sox-manager-told-bring-son/story?id=37758766>.

son, Drake, to spend time at the clubhouse with him.<sup>104</sup> Although Drake regularly spent time at the clubhouse last season, Chicago White Sox's management team asked LaRoche to limit his son's presence at the clubhouse during the upcoming baseball season.<sup>105</sup>

While this arrangement was not formally in LaRoche's contract, he expressed his disappointment with the team's sudden policy change. Frustrated with the management's stance, LaRoche opted to retire early, thereby walking away from \$13 million left in his contract. Explaining his decision, LaRoche said: "I had to make a decision. Do I choose my teammates and my career? Or do I choose my family? The decision was easy."<sup>106</sup>

Additionally, when negotiating for contract renewals, some professional athletes may not seek a larger deal in an effort to "keep the team together." Some players, perhaps in an effort to obtain a coveted championship ring, decide to not pursue grandiose salaries because they want to ensure the franchise does not reach any applicable league salary caps, which would prevent the team from re-signing other valuable teammates.<sup>107</sup> For example, Peyton Manning, recently retired quarterback for the Denver Broncos, purportedly restructured his \$19 million contract down to \$14 million during the off-season to ensure that the Denver Broncos would be able to retain Demaryius Thomas, a talented wide receiver.<sup>108</sup>

Likewise, during the summer of 2010, LeBron James left the Cleveland Cavaliers and met Dwayne Wade and Chris Bosh in Miami, Florida, where James took a significant pay cut to play for the Miami Heat.<sup>109</sup> Bosh and James both signed six-year deals with the Miami Heat for \$110 million each, while Wade signed for \$107.5 million.<sup>110</sup>

Although LaRoche does not have a brand contract with Fantex, his decision raises important questions about the decisions professional athletes make in order to accommodate their families. Likewise, although Manning, James, Bosh, and Wade are not affiliated with Fantex, their choices illustrate how professional athletes may not *necessarily* have incentives to negotiate for higher salaries if their primary motivations are to restructure or join a championship team. As a result, a Fantex-affiliated athlete in the midst of contract negotiations, may opt to pursue a *lower* salary option in alignment with his personal or professional values, which would ultimately result in lower earnings for Fantex investors. Fantex acknowledged as

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104. *Adam LaRoche to step away from baseball with \$13M left on contract*, ESPN (Mar. 15, 2016), [http://espn.go.com/mlb/story/\\_id/14980523/adam-laroche-chicago-white-sox-step-away-baseball-13m-left-contract](http://espn.go.com/mlb/story/_id/14980523/adam-laroche-chicago-white-sox-step-away-baseball-13m-left-contract).

105. Collen Kane, *Adam LaRoche says White Sox broke agreement about son in clubhouse*, CHI. TRIB. (Mar. 18, 2016), <http://www.chicagotribune.com/sports/baseball/whitesox/ct-chris-sale-adam-laroche-white-sox-20160318-story.html>.

106. Keneally, *supra* note 103.

107. Philip Johnson, *14 Athletes Who Have Taken Huge Pay Cuts*, BUS. INSIDERS (July 15, 2013), <http://www.businessinsider.com.au/14-athletes-who-volunteered-pay-cuts-2013-7>.

108. *Id.*

109. *Id.*

110. *Id.*

much in its prospectus, noting, “[i]n addition, a contract party in the NFL may agree to a salary reduction to assist their team in staying within the league cap, to be on a more competitive team, or to stay with a specific team, all of which may have the effect of reducing potential brand income and conflict with stockholders’ interests in maximizing brand income.”<sup>111</sup>

## V. Possible Solutions

From the perspective of Fantex investors, one of the challenges of the existing brand contract model is that there are few mechanisms in the contract that create incentives for professional athletes to increase their income by seeking larger contracts or new endorsement deals. One of the ways in which Fantex investors could mitigate the risk of Fantex athletes making decisions which do *not* result in higher revenue for Fantex investors is by creating incentives in the contract for athletes to make more money. For example, in mergers and acquisitions, an earnout provision is typically used to incentivize the “seller” to earn a portion of the purchase price based on performance after the company has been acquired.<sup>112</sup> In a merger and acquisition, the earnout—or part of the purchase price—is paid to the seller *after* the business reaches target goals.<sup>113</sup>

Upon signing with Fantex, a professional athlete is “selling” a minority interest in his future earnings in exchange for an upfront payment. However, Fantex’s management team could negotiate with the athlete to include an earnout provision in the contract such that the athlete would not receive an immediate *upfront* payment. Instead, Fantex could include an earnout provision that outlines target financial goals for an athlete based on Fantex’s estimates of his projected future earnings. Then, Fantex’s payment to the athlete could be staggered based on fulfillment of those earnings goals. For example, Fantex could include an earnout provision specifying that Vernon Davis would receive \$2 million upfront in exchange for a 10% interest in his lifetime earnings, and then receive a series of tiered payouts if Davis meets or exceeds income targets.

Moreover, a professional athlete could include terms in the earnout provision that would increase his ability to meet those target goals. For instance, in the aforementioned example, Davis could include a provision in the earnout clause which specifies that Fantex will spend a specific amount of funds annually on “brand enhancement” services to ensure Davis’ brand image continues to grow, so that he will have a greater chance of pursuing new endorsement or business opportunities.

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111. FANTEX, INC., *supra* note 9, at 28-29.

112. Christine Lagorio-Chafkin, *How to Structure an Earn-Out Provision*, INC., <http://www.inc.com/guides/earn-out-structuring.html>.

113. *Id.*

## **VI. Conclusion**

From stadiums to Monday Night Football broadcasts to online fantasy leagues, sports enthusiasts have multiple ways to watch and engage with their favorite teams and players. With Fantex, fans have a new way to track their favorite NFL, MLB, and PGA players by purchasing tracking stocks linked to their lifetime brand contract earnings. By analyzing the ways in which asymmetric information exists in brand contracts between professional athletes and Fantex, analysts can identify ways to adjust the terms of these agreements so that both contracting parties' interests align. Exploring creative options, such as earnout provisions, which set forth earnings goals for athletes or brand enhancement spending levels for Fantex, may be ways to do so. While the efficacy of Fantex's brand contracts and tracking stock remains to be seen, the company's model is innovative and merits ongoing analysis.