ROUND ONE – Line Change

JUDGES' SUMMARY

N.B. These specifics are provided to give you background and guidance in evaluating the teams. There are few rigid, "right," or "wrong" answers to negotiating problems. Some moves by negotiators may be poorly thought out or based on a misunderstanding of the facts or violate specific instructions from their clients. Those should cause you to grade that team poorly. Conversely, some moves by negotiators may be especially well planned, based on a complete mastery of not only the facts, but an understanding of their client's real-world interests, and may meet their client's interests in a creative way. Those characteristics should cause you to grade those teams highly. In between, there are a myriad of behaviors that you will need to use your best judgment on how effective each team was in representing its client's interests.

Background

This round involves a negotiation of local television broadcast rights, internet rights, and mobile device rights between the Stanley Cup Champion Chicago Blackhawks of the National Hockey League ("NHL") and WGN, a local Chicago area television network. The Blackhawks current television contracts with WGN and Comcast are coming to an end, and the team is looking to solidify their broadcasting across these three platforms with one broadcast partner for the next five to seven years (but will go as long as 10 years with opt outs). WGN is looking for a longer term of seven to ten years. This fact pattern is based on real life parties, and competitors are not limited in information they can use *unless it conflicts with the assertions and material presented within the fact patterns themselves*. The competitors are an attorney and an executive for each side.

The Blackhawks believe a broadcast rights agreement will put the team on solid financial footing for the next decade. In addition to this agreement, the team has advertising, ticket, national broadcast, NHL licensing, merchandise sales, parking, and other revenue sources. The money brought in with this local television contract will be able to cover the vast majority of team payroll, allowing the team to be flexible in other areas of the franchise. Their primary focus should be to maximize the overall value of the agreement and to at least obtain a contract worth $280 million in total revenue for the next six years; with suitable compensation for any years over six. The Blackhawks want to focus their return in the next five to seven years because they hope to opt out of any period longer than that.

WGN does not want to be going through a similar process any time soon and will not accept a deal of less than seven years. Thus, WGN is willing to spend up to $350 million for a seven-year deal (and a proportional amount for additional years), but only if there is enough value in the deal so a significant profit can be earned The top-dollar offer should include internet and mobile device rights in addition to TV broadcast rights, but because WGN is conservative about their ability to create a substantial revenue flow from new media such as internet and mobile phones and apps, the economics of the deal must yield them a gross margin of at least 20% (preferably 25%) of the contract price based solely on projected TV broadcasting.

Issues/ Parties Instructions:

The stated issues in this negotiation are: (1) overall contract value; (2) breadth of broadcasting rights (a red herring; neither team will agree to *a la carte* rights; **must** be a package of all three – TV, internet and

mobile devices); (3) the length of the contract; and (4) opt-out rights. The grid below shows the parties' instructions on each of these issues and in addition the prices for a la carte options for TV, internet and mobile.

	Blackhawks	**WGN**	**Zone of Possible Agreement**
Games Broadcast per Season	60 -70 games to avoid saturation. Some evidence that 74 games would avoid saturation	Want as many games as they can get. Least they will accept is 50	70 games; If Hawks will go to 71 or more K price can rise
Total package Price	5yrs @ $250 M 6rys @ 280 M 7 years @$330M Additional years @ $50 M AAV	$290M for 7 yrs & 70 games $340 M for 7yrs & 70 gms $350M for 7 yrs & 71 gms Any deal must meet 20% gross margin requirement. Willing to add 3 more yrs @50M AAV per year if meets 20% gross margin req.	340 for 7 yrs & 70 gms to 350 for 7rs & 71 gms
Contract Term	5-7 yrs; would prefer 6. Can go up to 7 yrs. Will agree to as much as 10 years with opt outs for years 8, 9 and 10	7 years minimum with options for 8th, 9th and 10th years and or mutual opt outs after year 7	7 to 10 years with opt outs after 7 years
Opt-out requirements	Prefer to be able to opt out if they achieve a 3.25 rating for 3 of the first 5 years; Must have unilateral opt out for years 8, 9, and 10. Would prefer no opt-outs for WGN; if not would prefer to restrict opt outs by WGN to poor ratings after 7 years. Will agree to unconditional annual opt outs in years 8, 9 and 10	Would prefer to have a general opt-out if ratings are "poor" apparently at any time; Will not agree to any opt outs for Blackhawks that do not include reciprocal opt outs for WGN. Would prefer to have unilateral opt outs after year 7. Would agree to unconditional opt outs for Blackhawks for years 8, 9, and 10	Mutual unconditional opt out rights for years 8, 9 and 10. Potential opt out rights for Blackhawks if they achieve a 3.9 rating for two consecutive seasons.

Internet rights a la carte	$15-24million AAV	$10 -19 million AAV	$ 15-19 million AAV
Mobile rights a la carte	$10-15 million AAV	$7-13 million AAV	$10-13M AAV
Broadcast Rights A la Carte	35 million Average Annual Value ("AAV"); 20% gross margin req.	$33 million AAV	None
Total price per year based on a la carte prices for all three media	$60-74 million AAV; Will not actually sell a la carte; must be a package of all 3	$50-$65 million AAV , but subject to 20% gross margin requirement which would restrict WGN from agreeing to anything more than about $50M AAV for seven -year term; will not buy a la carte; must be a package of all 3	None

Negotiating Dynamics

Strong Reasons to Make a Deal. The session is set up so that both sides have a strong incentive to make a deal, neither side has attractive alternatives, and there is zone of possible agreement on the package between $340 million for 7 years and 70 games and $350 million for 7 years and 71 games. The Blackhawks have an offer from Fox Sports for the TV, internet and mobile rights, and a second offer from Comcast that the team does not consider viable. Fox's offer is for $220 million for broadcasting at least 55 games across all media each season, with Fox options in years 7, 8, and 9. The Blackhawks want much more than Fox is offering. WGN is trying to replace the departure of the Chicago Cubs from the network's television lineup (a confidential fact for the WGN team) by making a profit of at least 20% of the overall contract value from advertising revenue

Red Herring. Although both sides have *a la carte* prices for each item, both are interested only in a package of all three media. The *a la carte* prices are mainly a device for arguing the value of the total contract, but neither of the parties will accept anything less than a package of all three sets of rights. Any team that agrees to less than rights to all three media platforms is not following their instructions. Of course, either team may choose to discuss the *a la carte* prices as a bargaining device, but sale of the rights to one media platform without the other two is not an acceptable result for either team.

Contract Price. The key to the contract value in the negotiation is the WGN's conservative view of the value of internet and mobile rights. WGN's negotiators will not agree to any deal that does not give them a gross margin of 20% based on projected broadcast revenue only (not counting any potential revenue from internet or mobile devices). Gross profit per game is measured as the difference between advertising revenues

from the broadcast and the fees paid for the rights to broadcast each game. To convert the raw gross profit to a gross margin percentage, divide the gross profit by the cost per game of the broadcast rights. Table A[1] shows the gross margin calculations at various contract prices and numbers of games. The bottom line is that, because WGN estimates that advertising revenues are constant at $850,000 per game, the more games it can broadcast, the more revenue it will earn, and the more it can pay for the rights to broadcast. For example, Table A shows that increasing the number of games broadcast by just one game each year of a seven-year contract valued at $350 million, will yield an additional $10 million in gross profits. This should lead some WGN teams to push hard against the 70 game limit that the Blackhawks have imposed on themselves and could tempt Blackhawks teams to negotiate a higher contract price by adding to or seeking further authority to move the number of games up to as high as 74 games (90% of broadcasts), in return for a higher contract price. Note that both teams are willing to agree to an average annual value (AAV) of $50 million per year after year seven, so if teams discuss a 10-year contact the price, it would be $150 million more than the seven-year price.

Contract Length and Opt-Out Rights. The other major issue in this negotiation is the length of the deal, which comes down to the opt-out rights. WGN's minimum term is seven years. The Blackhawks' maximum basic term is seven-years; after that, they require annual, unconditional opt outs for years 8, 9, and 10. Thus the term of the contract must be at least seven-years. WGN requires that any opt-outs be mutual. Thus, since the Blackhawks demand unconditional opt outs for years 8, 9, and 10, WGN will require the same.[2] There is a possibility of a performance opt out for the Blackhawks. WGN would agree to allow the Blackhawks to opt out of the contract at any time the ratings average a 3.9 share for two consecutive seasons. But, WGN's instructions require that any opt outs be mutual. If that principle is applied to the Blackhawks good performance opt out, then WGN's teams may ask that a poor performance opt out be negotiated. Because poor performance is defined in neither teams' instructions and because Blackhawks are instructed not to allow an opt out by WGN before the end of year 7, the Blackhawks would need further authority to agree to a poor performance opt out before seven years and both parties would have to seek further instructions to define "poor performance."

[1] The teams were not given table A. The Blackhawks' negotiators are not aware at all of this requirement. WGN's negotiators were instructed as follows:

It measures gross profits as the difference between advertising revenues from broadcasts and the fees paid for the rights to broadcast. WGN estimates that it can generate $850,000 in revenue per TV broadcast if it broadcasts 60 games per year over the seven-year contract, while the costs for the rights would be approximately $690,000 per game (assuming a $290 million contact price). This would mean a gross profit of $160,000 per game, or $67.2 million over the course of a seven-year contract for the rights priced at $290 million

[2] The Blackhawks confidential facts state that as to WGN opt outs, "They [the Blackhawks] would prefer to keep such opt outs to instances where ratings were low, but it is a deal breaker for unconditional opt outs after seven years for both parties."

This language was clarified for the teams to read as follows:

"They would prefer to keep such opt outs to instances where ratings were low, but it is a deal breaker if Blackhawks do not have unconditional opt outs after seven years and so if pushed by WGN for reciprocal rights they would agree to unconditional opt out for both parties after seven years."

Evaluating the Teams

Although the two sides differ greatly in what information and leverage they bring to the table in this negotiation, the problem is fairly well balanced in negotiating leverage. The Blackhawks are in a strong position because the team has a valuable commodity and two other parties as apparent suitors. WGN has strength in the ability to pay a large amount of money for these rights, and their ties to the Chicago fan base. Both sides also have weaknesses: the Blackhawks only have one other viable broadcast partner, mobile and internet rights are not likely to have much value apart from television broadcast rights, and hockey has had rocky public relations in the past few years due to turbulent labor relations. WGN weaknesses include: the loss of the Cubs broadcasts, the need to acquire a long deal with the maximum amount of rights with limited funds, speculative viewership on televised hockey games in general, and ratings closely tied to performance of a team it does not control.

There is however a considerable imbalance in information. WGN knows about its 20% gross margin requirement and the Blackhawks do not. This means that the WGN teams can calculate their price points in advance and decide in advance whether and how and to disclose their interest in broadcasting as many games as possible. The WGN teams will have the opportunity to plan in advance and even develop charts like Table A; they may well be able to appear polished and very well prepared. In contrast, the Blackhawks teams must react at the table either by being directly informed by the WGN negotiators of this key requirement, or by ferreting it out or inferring it. Two key skills for the Blackhawks teams may therefore be (1) information gathering on this important issue of contract price, and (2) flexibility in being able to modify or formulate proposals at the table. Ultimately, you need to evaluate the teams based on the cards they were dealt; in other words, be aware of the differences in information, be sensitive to the advantages or disadvantages given to a particular team by the facts, and try to judge each team on how well it did with the circumstances it was given.

Moreover, there are other skills to consider, including relationship building and strategic judgment, used to get a good result for each side. This is a primarily a distributive negotiation – about how much money for the contract and for how long, but with parties who will be working together in the future of the contract and who have a common interest in getting the Blackhawks games on the air. It will be interesting to see where the sides start. One effective strategy for Blackhawks may be to show WGN the *a la carte* menu and justify a big number as their opening proposal. WGN, however, can start by offering a package deal which is likely to be above the Fox offer of $220 million for six years. This may lead some Blackhawk negotiators to be too eager to make a deal; others will see it demonstrating vulnerability and willingness to go a lot higher. All of this suggests that distributive bargaining techniques of high demands, tightly held information, and grudging concessions may be selected. On the other hand, in order for parties to reach the best mutual resolution, WGN has to reveal its strong interest in the number of games. If a distributive tone is set, will the parties be able to exchange the information they need to reach an optimal solution, which might include more than 70 games per year at a price higher than the limit $350 million for seven years given to WGN negotiators? And if the parties do see the possibility of a win-win solution of this sort, will they stay within their negotiating authority (as defined by their confidential instructions).

Ultimately, we expect the performances of the teams to vary widely on this problem. Weaker teams will (1) be unable do the math (or be unable to adapt a strategy for using the math) of the 20% gross margin

requirement, (2) get caught up in the individual prices that are a red herring and fail to spend time productively on the overall deal, (3) be rigid and fail to adapt their proposals to the other side's needs, (4) take positions without explaining why and get so caught up in a distributive mode of bargaining that they miss opportunities for a better deal (i.e., more games for more money), (5) violate their side's instructions, and/or (6) fail to establish a positive relationship with the other side, and/or demonstrate that they have not figured out in advance or at the table how to convince the other side to agree. In contrast, good teams will (A) know that they have to meet an overall number and have done the math specified in the problem, (B) know their instructions and focus on the overall deal, (C) be flexible and know how to incorporate the other side's ideas in finding solutions, (D) explain and the reasons for what they propose and establish a positive relationship with the other side; and/or (E) demonstrate a strategy during the negotiation and articulate it well during the self-evaluation.

Table A: BH-WGN Figures For Gross Margin at Various Price and # of Games Points

1. Deal Amount:	$290M	$290M	$350 M	$350M	$340M	$350M
2. Games/ Year	60	70	60	70	70	71
3. Games/7 yr K	420	490	420	490	490	497
4. Revenue/Game	$850K	$850K	$850K	$850K	$850K	$850K
5. Cost per game (#1 divided by #3)	$690K	$592K	$833K	$714K	$694K	$704K
6. Gross Profit/game (#4 minus #5)	$160K	$258K	$17K	$136K	$146K	$146K
7. Gross profit/k (#6 x #3)	$67.2M	$126.4 M	$7.1M	$66.7M	$71.5M	$72.6M
8. Gross Margin % (#7 div. by #1)	23.1%	43.5%	4.9%	$19%	21%	20.7%