# Defined Gross Revenues, The Triggering Event, and the San Diego Chargers:

# A Report on Economic Issues for The Citizens' Task Force on Chargers Issues

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October 2002

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## Introduction and Executive Summary

An essential question for the citizens and elected leadership of the City of San Diego is whether or not the "triggering event" related to the lease with the San Diego Chargers has indeed occurred. If the "triggering event" occurs then the team can seek to renegotiate the lease; the threat of a possible relocation of the franchise to another city has also surfaced.

**Based on the best available data the "triggering event" has not occurred.** There are other issues that the City of San Diego may need to address with regard to the team's future but these conversations can take place without fear of unilateral action by the San Diego Chargers or a requirement to renegotiate the lease signed on May 30, 1995.

In presenting the community with this opinion I do not wish to minimize the importance of other issues that must be addressed in terms of securing the long-term future of the team. After discussing the immediate issue of the "triggering event" this report will turn to these other points and also highlight a critical aspect of the very positive financial position of the team's owner.

Readers are reminded that the conclusions drawn and presented in this report are based on the best available data. The National Football League Players Association (NFLPA) also uses these data in their acceptance of and agreement to the amount of money to be spent by each team for player's salaries and by the NFL as a collective for player benefits. Neither the team nor the NFL has made any other data available (as of October 1, 2002) to facilitate the analysis of (1) the situations confronted by the San Diego Chargers and (2) the triggering event as defined in the lease signed on May 30, 1995.

As part of the collective bargaining agreement between the players and the owners of all NFL teams the two sides have agreed to a concept know as "defined gross revenue" and the proportion of these funds to be used for player salaries. The definition of DGR is a matter resolved by the two parties and the exact elements excluded are not made available to the public. For the purposes of this analysis the exclusions stated in the agreement between the team and the community to define DGR were expected to be the same as those agreed to by the players and owners.

If differences do exist in teens of the definitions of DGR then the team would be obligated to present to the community (1) a complete breakdown of the definition of defined gross revenues used by the owners and players **and** (2) the differences in terminology and revenue levels between that definition and the one accepted by the city and team for the Chargers' lease. Calculations illustrating the differences between these two definitions for the Chargers and all other teams in the NFL would also be needed.

## Defined Gross Revenue and the Triggering Event

Relative to the ability of the San Diego Chargers to seek changes in their lease or relocation to another city, the proportion of money spent for players as it relates to a defined set of gross revenues is the central part of the issue before the City of San Diego. The "triggering event" refers to a measurement of a proportion of funds earned by the club and spent for player salaries. If this proportion exceeds a specified level then the team can renegotiate its lease and could take steps that might lead to relocation.

Defined Gross Revenues (DGR) is defined in the lease agreement. DGR

> "shall mean the aggregate revenues received or to be received on an accrual basis, for or with respect to any "League Year" by the NFL and all NFL teams (and their designees) from the following sources only:
>
> (1) regular season, pre-season, and post-season gate receipts (net of admission taxes and surcharges paid to stadium or municipal authorities which are deducted for purposes of calculating gate receipts subject to revenue sharing) including ticket revenues from "luxury boxes," suites and premium seating subject to gate receipt sharing among NFL teams; and
>
> (2) proceeds from the sale, license, or other conveyance of the right to broadcast or exhibit NFL pre-season, regular season, and play-off games on network and national cable television....
>
> For the purposes of this Agreement only, Defined Gross Revenues does not include any proceeds from the sale, license, or conveyance of the right to broadcast or exhibit NFL pre-season, regular season, and playoff games to and on any source including, without limitation, local television, pay television, satellite encryption, international broadcasts, radio, or any other means of distribution.
>
> Team salary cap shall mean for any year, on a cash basis, seventy-five percent (75%) of Define Gross Revenues for such year, divided by the number of teams playing in the NFL during each year."

The triggering event that permits a renegotiation of the lease

> "shall occur if on December 1 of -any Triggering Year the sum of the following items exceeds the Team Salary cap for the year in question: (i) the actual Team Salary of the Chargers for such year, plus (ii) the total actual benefit payments provided by the Chargers to its players for such year, plus (iii) the total actual benefit payments provided by the NFL to the Chargers' players for such year.

## DGR, the Triggering Event, and the San Diego Chargers

In the absence of any other information from the Chargers and/or the NFL, DGR as reported by the NFLPA was used for this report. Table 1 shows the growth in DGR from 1995 through the current or 2002 season for the NFL (as a whole).

**Table 1. Defined Gross Revenues for Purposes of Player Compensation in the NFL.**

| Year | Defined Gross Revenue | Percent Change |
|---|---|---|
| | | |
| 1995 | $2,002,000,000 | - |
| 1996 | $2,168,000,000 | 8.3 |
| 1997 | $2,286,000,000 | 5.4 |
| 1998 | $2,813,000,000 | 23.1 |
| 1999 | $3,185,000,000 | 13.2 |
| 2000 | $3,513,000,000 | 10.3 |
| 2001 | $3,771,000,000 | 7.3 |
| 2002 | $4,277,000,000 | 13.4 |

Source: National Football League Players Association (NFLPA).

The triggering event occurs when player compensation expenses (salary plus the cost of benefits) paid to players for the San Diego Chargers exceeds 75 percent of the defined gross revenues of the teams in the NFL. What this means is that DGR is divided by the number of teams (31 in 2001, for example) and then that figure is multiplied by 75 percent). Listed in Table 2 are the "triggering event" thresholds for 1995 through 2002.

**Table 2. Triggering Event Dollar Level: Compensation Paid To Charger Players**

| Year | Number of Teams | Triggering Event Level |
|---|---|---|
| | | *(DGR/Number of Teams x .75)* |
| 1995 | 30 | $50,050,000 |
| 1996 | 30 | $54,200,000 |
| 1997 | 30 | $57,150,000 |
| 1998 | 30 | $70,325,000 |
| 1999 | 30 | $79,624,995 |
| 2000 | 31 | $84,991,935 |
| 2001 | 31 | $91,233,387 |
| 2002 | 32 | $103,475,800 |

Total compensation is defined as the payments made by the Chargers to their players plus the compensation provided to each player by the league. The cost of the benefits provided by the league to each player and retired players is a cost that is divided equally among all teams in the NFL. As noted in the lease agreement, these costs are to be included in the calculation of total payments made by the team. Total compensation as paid to Charger players is detailed in Table 3.[1]

**Table 3. Total Compensation Paid To Charger Players**

| Year | Club Expenditures | Cost of NFL Benefits To Chargers | Total Compensation |
|---|---|---|---|
| 1995 | $35,497,800 | $4,950,000 | $40,447,800 |
| 1996 | $43,173,600 | $5,000,000 | $48,173,600 |
| 1997 | $42,986,300 | $5,160,000 | $48,146,300 |
| 1998 | $71,264,400 | $5,550,000 | $76,814,000 |
| 1999 | $50,648,600 | $7,693,333 | $58,341,933 |
| 2000 | $59,348,200 | $9,387,097 | $68,735,297 |
| 2001 | $78,656,509 | $10,322,258 | $88,978,767 |
| 2002 | $72,217,476 | $11,344,484* | $83,561,960 |

Source: National Football League Players Association (NFLPA).
*Estimate

With a measurement of total compensation paid to Charger players based on the figures used by the NFLPA in their negotiations and assessment of the economic state of the NFL, a comparison can be made between each year's total compensation figure and the triggering event level; this is done in Table 4.

[1] Compensation paid to the players by the Chargers includes salaries, signing, reporting, renegotiation, and workout bonuses, other incentive payments, and other payments benefits. The "other payments and benefit" expenditure by the Chargers was S1.5 million in 2001.

**Table 4. Total Compensation Paid And Triggering Event Level**

| Year | Total Compensation | Triggering Event Level | Differential |
|---|---|---|---|
| 1995 | $40,447,800 | $50,050,000 | $9,602,200 |
| 1996 | 548,173,600 | 554,200,000 | $6,026,400 |
| 1997 | $48,146,300 | $57,150,000 | $9,003,700 |
| 1998 | $76,814,000 | $70,325,000 | **($6,489,000)** |
| 1999 | $58,341,933 | $79,624,995 | $21,283,062 |
| 2000 | $68,735,297 | $84,991,935 | $16,256,638 |
| 2001 | $88,978,767 | $91,233,387 | $2,254,620 |

Based on the data used for this report the San Diego Chargers did not reach the triggering event in 2001 that would require renegotiation of the lease. Only in 1998 did the triggering event occur. The triggering event has not occurred for the past three seasons. As stipulated in the lease, however, the ability to renegotiate the lease as a result of a triggering event required the triggering event to occur after January 1, 2000. **Within this time period, the triggering event that would require renegotiation has not occurred.**

In making this observation based on data received from the NFLPA it should also be noted that independent observers have sometimes calculated that the amount of money spent for total compensation (to the players) is (somewhat) greater than what is reported by the NFLPA. It is not possible to verify without independent audits why other sources report different payment levels. In the absence of any independently verified figures, the compensation packages and payments reported by the NFLPA are the best available data for the San Diego community to utilize in its consideration of the issues and challenges facing the team and its continued presence in the city.

## The San Diego Chargers, The Economy of the NFL, and San Diego

The main objective of this report has been to help the San Diego community understand the concepts of DGR, the triggering event established in the current lease, and the possibility that the benchmarks set in the lease had been exceeded permitting the team to pursue a set of options that might be quite unfavorable for San Diego. Based on the best available data the triggering event that would require renegotiation of the lease has not taken place, but other issues relative to the team's fiscal performance were uncovered; the community needs to consider future decisions and actions based on these outcomes.

Team owners, much like any of us, seek to maximize the value of their assets and their profitability. Changes in the collective bargaining agreement with the players have had an impact on the annual cash flows generated by each team for their owner (or owners) and changed their perspective and the focus of revenue generation efforts.

For example, from 1964 through 1993 team owners met the entire cost of their player payrolls from the revenue generated from contracts with the television networks. From 1994 though 1997 player costs exceeded television revenues by an average of 11 percent in each year. During the current contract player costs have exceeded television revenues by a more modest 5 percent. For almost thirty years, then, owners were used to a system where television revenues more than paid for players. In several periods, national broadcast revenue exceeded the player salary expenditures by more than 30 percent. As recently as 1993, an owner could pay the entire cost of fielding a team from national broadcast revenues and still have surplus income of 12 percent (above player salary costs) from that revenue source. When this system changed there was a substantial interest in expanding other revenue streams to offset the lost profitability (see Table 5).

**Table 5. National Television Revenues and Player Salary Expenditures.**
Percentages indicate the extent to which national television revenues exceeded or were less than player payroll costs.

| Contract Period | Television Revenues Player Salary Expenditures |
|---|---|
| 1964-65 | 20 Percent |
| 1966-69 | 24 Percent |
| 1970-73 | 35 Percent |
| 1974-77 | 16 Percent |
| 1978-81 | 13 Percent |
| 1982-86 | 31 Percent |
| 1987-89 | 8 Percent |
| 1990-93 | 12 Percent |
| 1994-97 | *(11 Percent)* |
| 1998-2001 | *(5 Percent)* |

The first issue that confronts all owners who seek to maximize the value of their team is that with national telecast revenues now insufficient to meet player costs, the more profitable teams are those with access to other revenue sources. As a result, as owners have had to use revenue from other sources to meet the costs of fielding a competitive team there has been an effort to maximize these other revenue sources. These other revenue sources include luxury seating as well as the other amenities that are now common in the newer facilities (e.g., expanded retail and eating and drinking establishments, opportunities for substantial advertising revenues, and improved amenities and seating or sight lines to permit higher priced tickets).

Those owners who have access to these other revenue sources generate sufficient funds to field competitive teams (and cover the "shortfall" from their income from television to pay players). These teams then increase in value. In noting that additional revenue permits a team to (1) field a competitive set of players and (2) cover any shortfall from

television revenues to meet player costs, it should be noted that more dollars does not necessarily mean that the team with the most money wins all or most of their games.

Management still plays a key role in team success; decisions with regard to which player to draft are dependent on management expertise, and judging talent and its chances for success in the NFL is, at best, an inexact science (e.g., Ryan Leaf v. Payton Manning). However a team that fails to have sufficient resources to compete for the best players will, in the long run, enjoy less success on the field that teams with greater access to revenue even given the NFL's revenue sharing programs. This results from owners' seeking to achieve profit levels that in the absence of other revenues to offset costs would likely lead to expenditure reductions to insure that profit levels are maintained.

There may well be owners who are willing to accept lower rates of return on their investments, but individuals who are willing to substitute intangible for tangible gains are increasingly rare. Consequently, it is far safer to predict an owner's behavior by anticipating expenditure patterns that are designed to insure industry-wide or maximized profit levels.

What does this mean?

Teams with older facilities and with facilities with fewer amenities generate far less revenue. These teams have lower values and their owners are the ones constantly seeking new facilities or other revenue enhancements to permit them to match the profit levels enjoyed by other team owners. The data in Table 6 illustrates this pattern.

Teams with newer facilities and higher levels of amenities are more valuables (as estimated by *Forbes* magazine) and generate higher levels of revenues for their owners (again, as estimated by *Forbes* magazine). At first glance it might seem that the Chargers have an adequate number of club seats and suites to earn as much revenue as other teams. However, playing in an older facility designed both for baseball and football, the team cannot earn as much as franchises that play in newer, football-only facilities. Facilities designed for one sport offer fans improved sight lines, and it has been demonstrated that in these facilities teams can charge more for regular seating as well as for the premium or luxury seating options. In addition, older facilities, unless dramatically renovated as is planned for Chicago's Soldier Field cannot incorporate all of the revenue generating activities that are built into newer facilities.

The data in Table 6 helps to illustrate the tension or challenge before the team and the community. With many teams now earning in excess of $140,000,000 each season, there is a desire for the owner of the San Diego Chargers to seek a situation where similar levels of income can be earned. Earning S9 million to S20 million less than numerous other teams represents the reduced cash flow that the team would like to enjoy.

In noting that the team generates far less cash flow community leaders should also recognize that the investment made in the San Diego Chargers was far less than what other owners paid for their team. As a result, the rate of return enjoyed by the ownership

of the Chargers does match and might even exceed that of other teams with larger revenue capabilities.

The San Diego Chargers were last sold in 1984 and if that purchase price was adjusted to reflect 100 percent ownership and adjusted to 2001 dollars, the cost of the team would be $122.9 million. It is important to note that Forbes estimates the value of the team to be $447 million. Thus, if the team were sold, the existing owners would realize a handsome gain without a new facility or renovations to the existing facility.

## Conclusions

In the absence of verified and audited data provided to the City of San Diego by the San Diego Chargers and the National Football League, and relying on the best available data (as provided by the NFLPA), the triggering event that would require a renegotiation of the lease between the Sand Diego Chargers and the City of San Diego has not occurred.

NFL team owners no longer earn sufficient funds from national television contracts to meet the cost of player salaries and benefits.

NFL teams with access to new facilities with high levels of luxury seating and other amenities earn $20 million more than the San Diego Chargers each season.

In constant dollar terms (2001), the cost to acquire the San Diego Chargers was approximately $123 million. *Forbes* magazine estimates that the current (2002) value of the team at $447 million. Thus, if the team were sold a substantial profit would be realized even if the team continues to play its home games at San Diego Jack Murphy Stadium.

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**Table 6. Team Value and Revenues (2001), Amenities and Age of Facility**

| Team | *Forbes'* Estimated Value | Luxury Suites | Club Seats | Year Facility Opened | *Forbes'* Estimated Revenue |
|---|---|---|---|---|---|
| Arizona Cardinals | $374,000,000 | 68 | 5,000 | 1958 | $131,000,000 |
| Atlanta Falcons | 407,000,000 | 203 | 4,600 | 1992 | 120,000,000 |
| Baltimore Ravens | 607,000,000 | 108 | 7,900 | 1998 | 148,000,000 |
| Buffalo Bills | 458,000,000 | 164 | 10,800 | 1973 | 131,000,000 |
| Carolina Panthers | 609,000,000 | 158 | 11,358 | 1996 | 152,000,000 |
| Chicago Bears | 540,000,000 | Renovations Underway | | | 124,000,000 |
| Cincinnati Bengals | 507,000,000 | 114 | 7,600 | 2000 | 148,000,000 |
| Cleveland Browns | 618,000,000 | 147 | 8,754 | 1999 | 158,000,000 |
| Dallas Cowboys | 784,000,000 | 381 | 0 | 1971 | 189,000,000 |
| Denver Broncos | 604,000,000 | 124 | 8,800 | 2001 | 159,000,000 |
| Detroit Lions | 509,000,000 | 120 | 7,000 | 2002 | 132,000,000 |
| Green Bay Packers | 474,000,000 | 198 | 1,920 | 1957 | 123,000,000 |
| Houston Texans | 700,000,000 | 165 | 7,500 | 2002 | New Team |
| Indianapolis Colts | 419,000,000 | 104 | 4,000 | 1984 _ | 127,000,000 |
| Jacksonville Jaguars | 522,000,000 | 90 | 11,200 | 1995 | 137,000,000 |
| Kansas City Chiefs | 462,000,000 | 80 | 2,400 | 1972 | 138,000,000 |
| Miami Dolphins | 553,000,000 | 182 | 10,184 | 1987 | 145,000,000 |
| Minnesota Vikings | 437,000,000 | 115 | 0 | 1982 | 123,000,000 |
| New England Patriots | 571,000,000 | 80 | 6,000 | 2002 | 136,000,000 |
| New Orleans Saints | 481,000,000 | 137 | 15,584 | 1975 | 139,000,000 |
| New York Giants | 514,000,000 | 119 | 142 | 1976 | 134,000,000 |
| New York Jets | 512,000,000 | 119 | 142 | 1976 | 110,000,000 |
| Oakland Raiders | 421,000,000 | 143 | 6,000 | 1966 | 132,000,000 |
| Philadelphia Eagles | 518,000,000 | New Facility Underway | | | 120,000,000 |
| Pittsburgh Steelers | 555,000,000 | 127 | 6,600 | 2001 | 142,000,000 |
| ***San Diego Chargers*** | ***447,000,000*** | ***112*** | ***7,200*** | ***1967*** | ***131,000,000*** |
| San Francisco 49ers | 463,000,000 | 89 | 0 | 1960 | 129,000,000 |
| Seattle Seahawks | 534,000,000 | 82 | 7,000 | 2002 | 119,000,000 |
| St. Louis Rams | 544,000,000 | 124 | 6,533 | 1995 | 136,000,000 |
| Tampa Bay Buccaneers | 606,000,000 | 197 | 12,000 | 1998 | 151,000,000 |
| Tennessee Titans | 551,000,000 | 176 | 12,000 | 1999 | 141,000,000 |
| Washington Redskins | 845,000.000 | 280 | 15,000 | 1997 | 204,000,000 |