By Jeremy VanEtten

One Athlete's Personal Bankruptcy Illustrates How the Process Works

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Celebrities' financial woes are often headline-grabbing sound bites, but the news stories are often slim on details as to how — if at all — the celebrity recovers from his/her financial troubles. This story of Jack Johnson, an acclaimed defenseman for the Pittsburgh Penguins, is unique in two respects: (1) It is chock full of details; and (2) the story ends well.

When free agency opened in July 2018 and the Penguins signed Johnson to his new five-year, $16.25 million contract, many hockey pundits hailed the move as a gamble that he would return to form as a sturdy, "top-4" defenseman who would solidify the Penguins' defensive core, giving the club the opportunity to make modern hockey history by winning its third Stanley Cup in four years. Beneath the surface, however, there was another group who bet on Johnson's future success, and that bet has paid off with this most recent contract.

Johnson's chapter 11 filing in October 2014 was a unique news story in the hockey world, but it was a blip on the radar compared to the stories emerging at the beginning of a fresh National Hockey League (NHL) season, such as the Chicago Blackhawks' effort to win its third Stanley Cup in six seasons, or the emergence of Carey Price as the league's preeminent goaltender. Frankly, an athlete filing for bankruptcy was hardly news coming on the tail of high-profile celebrity bankruptcies, and mainstream stories of Johnson's struggles dissipated as the news cycle quickly turned. Now, with a brand-new contract in hand and four years of hindsight, one can look back and reflect on this case as one that is both similar and unique among athlete bankruptcies in its nature, process and end results. This article will contrast Johnson's bankruptcy case with those of other athletes, and point out the key similarities and differences in his plan, which is trending toward a favorable result for all parties involved.

The Similarities

According to a *Sports Illustrated* article,[1] young athletes fall into a similar pattern of mistakes that ultimately lead to financial hardship or bankruptcy. Unsurprisingly, many of these themes are prevalent in Johnson's case.

The Lure of the Tangible

Young athletes are often enticed by investments in tangible items such as real estate, nightclubs, inventions, etc. Ed Butowsky, a financial manager who contributed to this article, explained that a typical investor's portfolio should include "5% to private equity, 7%-12% to real estate, 50%-65% to a mix of public securities (stocks, mutual funds and the like) and the rest to alternatives such as gold and hedge funds."[2] For athletes, this investment mix is often flipped. According to court filings, the Johnsons "focused their investment efforts on real estate, life insurance, diamonds and gold,"[3] thereby falling into the same trap of over-reliance on tangible items as opposed to traditional, less risky investments.

Misplaced Trust

The *Sports Illustrated* article compared a young athlete to "a lottery winner — who's often in his early twenties."[4] A classic mistake made by young athletes, and one that is often chronicled when this topic is discussed, is an overreliance on friends and family members instead of advisors with a proven track record and experience in investing. Furthermore, young athletes are easy prey for questionable inventors who come calling and promise excessive returns, which are much more lucrative than traditional investments. This issue, more than any other, is what grabbed headlines in the fall of 2014 when Johnson filed his bankruptcy case. Johnson trusted his parents to act in his best interests, as they had for his entire life. In fact, Johnson mentioned how appreciative he was to his parents for their years of guidance and actual sacrifice in order to advance his career. While Johnson focused on hockey, his parents made investments and purchases funded by high-interest loans against Johnson's future earnings.

Family Matters

Although one could say Johnson has family issues of his own with his parents, he has been able to avoid the time- and money-consuming experience of divorce and child support, which often rear

1 Pablo S. Torre, "How (and Why) Athletes Go Broke," *Sports Illustrated* (March 23, 2009), *available at* si.com/vault/2009/03/23/105789480/how-and-why-athletes-go-broke (unless otherwise specified, all links in this article were last visited on Oct. 29, 2018).

2 *Id.*

3 *In re Johnson*, 546 B.R. 83 (Bankr. S.D. Ohio 2016), *available at* www.leagle.com/decision/inbco20160302958.

4 *See* Torre, *supra* n.1.

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their head in, or even cause, other athletes' filings. Although Johnson is married, there have been no reports or issues to date in the bankruptcy related to his marital status. One should hope for Johnson and family that they beat the estimated professional athlete divorce rate of 60-80 percent.

Great Expectations

The *Sports Illustrated* article[5] concluded by discussing the pressure that athletes feel to prop up their friends and family — basically the people who got them there — once the money starts coming. This can be evidenced through direct cash support, or reliance on friends and family to perform duties for which they are not qualified. Johnson confirmed this desire in a deposition:

> I wanted to take that chance to pay back my mom and dad for all the sacrifices and opportunities they gave me to get me where I was. And I was perfectly fine with them, you know, being able to pay the bills with that, live comfortably until they got back on their feet. And that was my opportunity to pay them back. So, yes, they were — it was intended that they would live off my — my income and my salary.[6]

The issues leading to Johnson's financial hardship ended up being the typical struggles that many young athletes endure. On the other hand, what has been unique is Johnson's ability to identify these problems and correct them through bankruptcy. Furthermore, the problems were identified early enough that he has been able to "earn his way out" of the financial situation in which he found himself with a bankruptcy plan and meaningful distributions to creditors.

The Nature of Johnson's Case and Results

A neutral observer would not accuse Johnson of living an outlandishly lavish lifestyle or funding the living expenses of multiple individuals with varying familial connections, as chronicled (perhaps to the extreme) on television shows dealing with the lifestyle of athletes like HBO's comedy/drama "Ballers."[7] Johnson had two homes (including the proceeds from one recently sold at the time of filing) and four vehicles. His debts were borne out of a desire to monetize his player contract and realize more immediate returns than if he would have waited to be paid in the normal course of the contract and had made traditional investments. Although it might have been the product of good intentions, Johnson was left facing some $13 million in secured, high-interest debt.

Johnson's filing was relatively early in his tenure, and he was in the midst of his final restricted free-agent contract, which is often the most lucrative period in an NHL player's career. Since he would be just 31 years old (not old for an NHL defenseman) at the end of this contract, he had the possibility for an additional lucrative contract starting in 2018.

After contentious litigation resulting in Johnson's motion to convert the case to chapter 7 being denied, he worked with his creditors toward arriving at a bankruptcy plan that would be acceptable to all parties. After numerous iterations and roughly two years into the bankruptcy case, the third amended reorganization plan was confirmed on Nov. 23, 2016. The plan became effective on Dec. 8, 2016.

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The reorganization plan was funded almost entirely by the debtor's past, present and future earnings. Nearly 90 percent of Johnson's net player contract earnings were made available for creditors. His earnings from the first two years of the case had, to that point, been paid into an escrow, which provided for the immediate funding of interim payments under the plan. Johnson pledged virtually all of the net earnings from the remaining two years of his player contract and 10 percent of his net earnings from the first three years of any future NHL contract. The resulting reorganization plan created seven classes of claims.

Four classes included individual lenders secured by their own collateral. Two classes of unsecured claims were established: a convenience class and a general unsecured claims class that received a timely 35 percent distribution. The final two classes were for settling and non-settling lender claims.

The roughly $11.5 million in lender claims was comprised of eight different claimants, each of which were considered disputed to some degree by the debtor, as Johnson felt that there was cause for each claim to be disallowed or significantly reduced. For this reason, lenders were given the opportunity to settle into a unique class that would provide an immediate 35 percent payment and a share of future earnings of the debtor for the next five years. Non-settling lenders would also share in future earnings but would not receive an immediate payment and ran the risk of having their claims disallowed. Settling lenders were serviced and paid from the debtor's estate; non-settling lenders were serviced by an established Creditors Trust that did not guarantee an immediate distribution.

The lenders' bet on Johnson's future paid off when the Penguins signed him to a five-year, $16.25 million contract that exceeded the $4.5 million needed to trigger an additional distribution to the creditors. Under the plan, 10 percent of his net earnings for the first three years will be made available to creditors, thus doubling the original estimate and providing an additional distribution of roughly $300,000. In turn,

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5 *Id.*
6 *In re Johnson, supra* n.3.
7 *See* "Ballers," Wikipedia, *available at* en.wikipedia.org/wiki/Ballers.

Johnson will be able to keep 90 percent of his net earnings and all of the last two years of earnings from his current contract so that he can plan for his future.

The Takeaways

Bankruptcy professionals will look at this case and see it as an overwhelmingly positive end result. However, an elite athlete who is forced to live on a strict budget for four years might not. A few takeaways exist in this story for both.

Young Athletes Need Good Advice

The issue of athlete bankruptcies came to the forefront during the 2008 recession. Since then, the various leagues and unions have been doing more to educate young athletes, but the problem still persists. In the long run, a basic education about who to trust and what appropriate investment expectations are could be more important than off-season workouts. The teams have an incentive to provide this, as they suffer from the distraction of a star team-member's financial woes. The various players' associations have an incentive to provide this if they are truly working for the players' best interests.

Recognize the Issues Early

An athlete's initial response might be to lever up even more assets and take on further debt in order to continue to service the debt that is spiraling out of control. This might not have been an issue for Johnson, as his matters were approaching a true boiling point, but it is a recognized part of the debt spiral.

Begin the Belt-Tightening as Soon as Possible

The effects of Johnson's efforts in chapter 11 could have been maximized if the belt-tightening had occurred earlier in the process. Setting a fixed budget and hiring the appropriate professionals early on will set the debtor on the proper path through the process and garner good will with creditors and the court.

Utilize Claims Objections

Early claim objections could have considerably sped up the process to confirmation. The objections would have brought the creditors to the table, giving the debtor negotiating leverage and, ideally, resulting in reduced claims.

Develop a Plan that Has Payoff and Pain for Each Party Involved

Lenders might not have appreciated a 35 percent claim payment, but neither would the debtor have enjoyed living on a fixed budget, especially when sharing a locker room with other young millionaire athletes. In this case, a reorganization plan with negotiated settlements yielded an objectively better return for creditors than what would have been realized in a chapter 7 liquidation.

Build in Some Upside

When considering Johnson's age and years of service in the NHL at the time of the confirmation, his next player contract was certainly unknown. This x-factor would have been a considerable risk for all of the parties involved. Lenders would not want to see Johnson signing a lucrative contract in 2018 after taking a significant discount on their claims just a few years prior. He would have been apprehensive about how much of his earnings he pledged to creditors in plan negotiations. Building in a kicker based on a future contract allowed for some comfort to both parties. This way, if Johnson got paid again, it would be a benefit to all parties involved. It also served as a motivator for him to comply with the terms of the reorganization plan, as there was a significant payoff for him personally at the end if he signed a new deal.

Go for the Guaranteed Money

When Johnson signed his new five-year agreement with the Penguins, it turned a lot of heads in the world of hockey pundits. It was not the average annual value of the contract ($3.5 million), but rather the term (five years). He could have signed a more immediately lucrative deal in the short term, but chose to receive less annually over a longer period of time. Unlike the pundits, any professional following this case would not have been surprised, as Johnson signed that contract for security. The first three years of the deal provide additional recovery for lenders, but Johnson now has the security and predictability to lay out his future. One would think that he will not make the same mistakes that got this process started. abi

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