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The Ethical Evolution of the NCAA

Compliance and Ethics

Sports and Entertainment

Cheat sheet

- **NCAA.** The US National Collegiate Athletic Association (NCAA) is a tax-exempt not-for-profit 501(c)(3) organization that serves as the dominant governing body for college sports with an annual revenue of nearly US$1.1 billion.
- **NIL.** As of October 2019, the NCAA will allow college athletes to be compensated for the use of their name, image, or likeness (NIL) by sponsors. However, no guidance has been released to accompany the change in policy.
- **Taxes.** The US Tax Cuts and Jobs Act of 2017 will have several consequences for universities, including no longer allowing the schools to offset income from profitable unrelated business activities with losses from unprofitable activities.
- **Business structure.** The NCAA could consider moving to a nonprofit with a for-profit arm, for-profit entity, or benefit or public corporation business structure to better serve the needs of college athletes.

Consider a hypothetical scenario in which the National Collegiate Athletic Association (NCAA) embraces various radical reforms in pursuit of its stated goals of providing college athletes robust academic services; unique educational opportunities and experiences; financial assistance; wellness and health insurance; and personal and professional development. This fundamentally new and different vision for the NCAA and its member universities would affect in-house counsel who advise any business that interacts with the US$14 billion college athletic industry — from general counsel of universities to billion-dollar apparel manufacturers to the solo in-house counsel advising a local restaurant partnering with the small university down the road.

At a time of increased scrutiny of college athletics and ascendant revenues, calls for reform are getting louder. Athletes have filed numerous lawsuits against the NCAA, which have met with varying degrees of success. Elsewhere, at least some educators are dissatisfied with the current status quo in the NCAA's Division I, which can under deliver on the NCAA's promise of a "world-class education." State and federal legislators in the United States are also now examining ways to increase economic opportunities for college athletes, which could incentivize college athletes to remain in school and complete their degrees before pursuing other opportunities, whether in sports or elsewhere.

Led by California, which recently passed a law that allows college athletes to earn revenue from licensing their name, image, or likeness (NIL) beginning in 2023, the foundation of the NCAA is beginning to shift. In October 2019, the NCAA's top governing board voted unanimously to allow college athletes to be compensated for their NIL in some form or fashion, without yet providing any significant details. Clearly, things are changing.

This article is meant to spur dialogue and highlight possible changes to the current model, including one that leverages new forms of corporate structure to create a distinct ethical framework for college athletics.

Current status

As the dominant governing body for college sports, the NCAA is a tax-exempt not-for-profit 501(c)(3) organization. In 2018, total NCAA revenues were nearly US$1.1 billion, with Division I basketball and its March Madness basketball tournament bringing in US$900 million, about 90 percent of its annual

revenue.

According to the NCAA's 2017 Form 990, "the NCAA is a member-led organization dedicated to well-being and lifelong success of college athletes with more than 1,100 member colleges and universities. The NCAA is united around one goal: creating opportunities for college athletes." Further, per the NCAA, "[e]very year, the NCAA and its members equip more than 480,000 college athletes with skills to succeed on the playing field, in the classroom, and throughout life. They do that by prioritizing academics, well-being, and fairness."

One might question, however, whether the NCAA is fulfilling its stated ethical mission with regard to the well-being of college athletes. Graduation rates, for example, vary drastically by sport and race. Within six years of matriculation, graduation rates for certain college athletes can be as low 40 or 50 percent (or as high as 100 percent for certain sports, divisions, and conferences), and college athletes given a four-year scholarship must pay tuition if they remain in school beyond four years.

The injury rate for college athletes is about 12,500 per year. And while all college athletes are required by the NCAA to have health insurance, the NCAA does not require colleges to pay for it. Thus, when an athlete is injured, the primary reimbursement often comes from an athlete's parent's insurance, if at all.

As questions mount about whether the NCAA is fulfilling its stated mission, we consider two areas for potential reforms: (1) greater engagement with, and fewer economic restrictions on, college athletes; and (2) changes to the NCAA's business model that might better facilitate its stated mission.

Increasing economic and governance opportunities for college athletes

Perhaps the most pressing reform issue among NCAA member schools is the severe economic restrictions that are a condition of an athlete's eligibility. These restrictions are exclusive to college athletes, in stark contrast to the general student body — and NCAA coaches, athletic directors, and executives. Even as incoming revenues from broadcast contracts and corporate sponsorships soar, college athletes cannot monetize their talents and achievements above the cost-of-attendance scholarship, which the NCAA defines as the sum total of their educational expenses.

Schools cannot give, and college athletes cannot accept, payment for their athletic contributions, even if both parties are so inclined. College athletes also face myriad outside employment restrictions, beginning with their existing athletic workload (often as many as 40 hours per week for Division I athletes, in season). Were that not enough, college athletes may lose their eligibility if they license their names, images, and likenesses (NIL) to third parties, such as corporate sponsors, at least under present rules. Under the existing rules, it is virtually impossible for college athletes to earn money, a bizarre and unique status in a nation that otherwise prizes economic liberty and freedom.

The history of NCAA athletics

Long ago, when Harvard and Yale met in a sporting competition, getting a ticket was as difficult as getting an NCAA Final Four ticket today. Ivy League rivalries were all the craze in the mid-1800s, starting in the sport of rowing and then moving on to American football. A freestanding organization governed each sport. For example, the Rowing Association of American Colleges or the

Intercollegiate Rowing Association set the eligibility and competition rules for rowing.

This system worked well until other schools began fielding teams, creating inconsistent rules. And injuries quickly became a problem. Then-President Theodore Roosevelt took action in response to on-field football deaths by encouraging 62 higher educational institutions to become founding members of the newly formed Intercollegiate Athletic Association of the United States (IAAUS). The IAAUS officially opened its doors in 1906, and took its present name, the National Collegiate Athletic Association (NCAA), in 1910.

What started as a mere discussion group morphed into a rulemaking, nonprofit entity that established its first national championship in 1922, the National Collegiate Track and Field Championship. Eventually, its single rule book came to span multiple volumes, and the number of championships grew exponentially (the current basketball championship emerged in 1939). It did not take long until the NCAA hired a full-time leader, Walter Byers, in 1951, who further developed the NCAA's media rights deals over their ever-growing inventory of games.

Easing restrictions on college athletes' ability to earn money

Current NCAA rules prohibit college athletes from receiving benefits or compensation from licensing NIL rights to local or national businesses, depriving college athletes of an important source of revenue. Such endorsements are commonplace and represent a substantial income stream for *professional* athletes. Sidestepping for now the debate about the ability of member schools to compensate college athletes for their athletic contributions, there is good reason to explore lessening restrictions on NIL compensation *from outside sources*, because they come, or at least can come, at no cost to the schools.

The California legislature, among those in other states, has recognized the issue — and recently enacted Senate Bill 206, which prohibits California postsecondary educational institutions from interfering with a college athlete's ability to receive compensation as a result of an athlete's licensing their NIL rights to third parties, thereby extinguishing the NCAA's current rule, at least insofar as it applies to California schools. (The law provides certain safeguards to prevent conflicts between individual sponsorships and team sponsorships.) It does not take effect until January 1, 2023.

Other state legislatures are already following suit, for reasons that may include preventing California schools from having a significant recruiting advantage. Finally, after California took the first step to compensate athletes, the NCAA changed course to allow college athletes to be compensated for their NIL, although guidance for implementation is still forthcoming. Previously, the NCAA had vigorously opposed this and other similar efforts as inconsistent with its principles of amateurism.

When, in 2019, the NCAA convened a working group on NIL reforms, it presumably did so in response to pending legislation. That group, whose work continues, "will not consider any concepts that could be construed as payment for participation in college sports," consistent with the proposal embodied by SB 206. Rather than leaving these important changes to the states alone, which may breed inconsistencies, the NCAA might instead choose to embrace the proposal embedded in SB 206 and begin seriously exploring how to regulate the practice. The NCAA's sudden receptiveness to NIL compensation by third parties leaves the door open as to how all three NCAA divisions might craft their own rules.

Never before have college athletes been so uniquely situated to monetize their NIL rights. With the advent of social media, individual branding and self-promotion have become accessible to everyone. Allowing athletes to earn money from their NIL rights could come at no cost to the NCAA or its member schools and provide new financial resources to college athletes, the majority of whom will never go pro. While the NCAA and its member schools have suggested that there is serious potential for individual sponsorships to conflict with team sponsorships — every professional league has found a way to accommodate both, in good faith. So too can be the case here, with the appropriate planning and framework.

The Olympics' approach to NIL can serve as a model for the NCAA

Prior to the 2016 Rio Games, Olympic athletes frequently tweeted "thank you" messages about their sponsors before the Olympics because, once at the Olympic Games, mentions of their sponsors were not permitted until the end of the events. Rule 40 of the Olympic Charter limits the use of an athlete's image during the dates of the Games.

What is Rule 40?

Under a previous iteration of Rule 40, only Olympic sponsors, such as McDonald's, Nike, Visa, and Coca-Cola, could use an athlete's image in conjunction with the Olympic Games to market or promote their brand or company.

The Rule was created to "preserve the unique nature of the Olympic Games by preventing over-commercialization" of the event. However, many skeptics argue it has more to do with preference for Olympic sponsors that have spent millions of dollars on the exclusive marketing rights during the spectacle.

In 2015, Rule 40 was relaxed:

The International Olympic Committee (IOC) decided to allow "generic" or "non-Olympic advertising" during the Olympic Games (i.e., not mentioning the Games themselves or utilizing Olympic trademarks), starting in 2015. In addition, the IOC allowed the Olympic athletes to comment on social media about their own sponsors as long as they did not use any Olympic properties in doing so.

For example, the non-Olympic sponsors could not use verbiage like "Summer Games," "Olympiads," or "Olympic Games," to name a few. If a message violating these rules occurs, the athlete can be disqualified, or their medals can be stripped.

In 2019, Rule 40 was relaxed further:

In October 2019, the US Olympic and Paralympic Committee (USOPC) relaxed Rule 40 even more, permitting athletes the right to thank their personal sponsors, appear in advertisements for these sponsors, and receive congratulatory messages from them during the Tokyo 2020 Olympic Games.

While the official partners of the USOPC will still maintain exclusive use of terms like "Olympic Games," the athletes' personal sponsors will be permitted to push out generic ads even during the Olympic Games. Notably, a German federal agency ruled in summer 2019 that the IOC was subject to existing competition laws, paving the way for this revised sponsorship rule.

As state legislatures, universities, and the NCAA move toward the licensing of college athletes' NIL rights, the current parameters of Rule 40 can provide a model for athletes to interact with personal and team sponsors in a way that does not detract from or interfere with the overall endeavor.

Changes to the NCAA's business model

The NCAA could also consider moving away from its nonprofit status to another business structure to better serve the needs of college athletes today.

For-profit entity

The NCAA could restructure itself as a for-profit limited liability corporation (LLC) or a C-corporation in order to take full advantage of sponsorship opportunities. Freeing itself of its nonprofit status would allow sponsorship dollars to flow in with total disregard as to its effect on the nonprofit's unrelated business income tax (UBIT) or liability. Anytime a nonprofit engages in a transaction with a for-profit, the nonprofit organization, such as the NCAA, has an obligation to avoid any private benefit and figuring out the definition of private benefit could get one in trouble if one errs in the wrong assumptions.

Even if the NCAA is slow to embrace this structure, some of its schools are moving their athletic departments from nonprofit to for-profit status already. One example is Florida State University (FSU). Although one suspects the motivation is to lower the transparency requirements (a nonprofit must publish its 990 tax returns, for example), this move may also allow schools to prepare for the sea change under the new 2017 tax laws as well as laying the groundwork for the inevitable: paying college athletes for their intellectual property (IP). Presumably, the NCAA would seek a model that retains a great deal of its revenue while still not opening itself to tax liability.

Nonprofit with a for-profit arm

While professional leagues, such as the National Football League, National Basketball Association, National Hockey League, and Major League Baseball, could choose to be a nonprofit member association, they currently are not set up as such. And, as for the player associations in these same professional leagues (National Football League Players Association (NFLPA), National Basketball Players Association (NBPA), etc.), are 501(c)(5), labor union nonprofit entities with a for-profit arm. For example, the NFLPA has Players Inc., a separate limited liability corporation in which 100 percent of the stock is owned by the NFLPA. Similarly, the NBPA has recently established a for-profit entity named the National Basketball Players Inc. for the same purposes — marketing their athletes.

Thus, the precedent set at the pro level could convince the NCAA to do the same, running its marketing and championships out of a for-profit arm. This would free the new entity of some Interal Revenue Service restrictions on sponsorship for nonprofits. Taking it a step further, it could also open up the NCAA to explore a separate for-profit entity for basketball and football, the dominant revenue-generating sports, that many argue can no longer be deemed "amateur" and fit within their mission statement. In addition, this could allow the athletes to own a portion of the stock in the for-profit entity, permitting the dividends from the stocks to be funneled into an escrow account, ultimately shared with the athletes after graduation.

Although the NCAA is in no hurry to replicate its professional league brethren, some of its member schools have not hesitated. As noted earlier, nonprofit schools like FSU have recently established a new organization, a for-profit entity, that will run the school's athletic department (The Florida State University Athletics Association). While the school is promoting the message of synergy, some have seen this as controversial. This move to privatize FSU's athletics department essentially gives it all the benefits of being a private corporation while still operating on behalf of a taxpayer-funded nonprofit institution. In addition, under Florida state law, the school is immune from any tort judgments over US$200,000. This gives the institution enormous benefits typically unavailable to private corporations.

Furthermore, the creation of a for-profit subsidiary could lay the best tax foundation if any direct IP payments to athletes begin (the recent California law does not address this possibility). It would allow for a full business tax deduction for the IP payments, rather than having to deal with the much more restrictive tax deduction rules governing tax-exempt organizations that earn unrelated business income (UBI).

Another motivator is the new 2017 federal tax law, which changes provisions applicable to nonprofit educational institutions. May 15, 2019, marked the beginning of a period in which nonprofits, such as athletic departments, now have to pay taxes on activities that were not taxable prior to the 2017 changes.

For instance, there is a new requirement for tax-exempt organizations known as the "separate silos" breakdown. This new silo rule requires nonprofits to break down unrelated business income into "separate silos" for each "trade or business" activity, and unlike their for-profit counterparts, nonprofits can no longer aggregate profits and losses in one UBI bucket. Thus, organizations with multiple unrelated business activities can no longer offset income from one line of activity with losses from another line of activity. Prior to the new rule, organizations could aggregate the income and deductions from all of their unrelated business activities.

The impact of the 2017 tax law on educational institutions The US Tax Cuts and Jobs Act of 2017 will have several consequences for universities. Certain private colleges and universities will be subject to a 1.4 percent excise tax on net investment income. There is a 21 percent excise tax on annual compensation of US$1 million or more paid to the organization's top five highest paid employees. Charitable deductions paid to colleges associated with preferential seating at athletic events have been eliminated. Nonprofits with multiple unrelated business activities are no longer allowed to offset income from profitable business activities with losses from unprofitable activities.

Applying this to the FSU example, the nonprofit athletic department could only deduct the player IP payments from a bucket on income that was "related" to the player payments (activity). Conversely, as a for-profit entity, FSU's athletic department can now deduct the player payments from any income as a business expense.

Another new rule in the 2017 tax law applies a 21 percent excise tax on the top five nonprofit employee compensation packages in excess of US$1 million. This hefty tax applies to a college coach's base salary as well as any additional "parachute" payments and noncash benefits (such as apparel deals). Given that 78 percent of college football head coaches in Division I make more than US$1 million per year, it is no wonder the colleges are rethinking the athletic department structure. Colleges are well aware of the controversy that can ensure every time a coach is paid a high-level package, which can undermine other organizational priorities.

Applying this to the highest paid college coach provides an example of why other athletic departments may follow suit. Under the 2017 tax law, Alabama's contract with its football coach Nick Saban could cost the university at least US$1.2 million — on top of the US$11.125 million in basic compensation he was paid in 2018. The tax also applies to his US$4 million signing bonus issued in 2018 and his incentive bonuses that could total US$700,000 each year of his eight-year deal, running through Jan. 31, 2025.

Furthermore, the FSU athletic department could also be looking at keeping their donors happy. Under the new tax law, donations are no longer considered tax deductible if their contributions are tied to rights to purchase tickets and/or business expenses incurred for entertainment costs associated with taking clients to sporting events. Because this generous benefit no longer exists, schools can now move to the for-profit model with fewer complaints from their biggest donors.

Robert Turner, former college athlete and current professor, on the state of the NCAA

Has the NCAA outlived its purpose?

In its current structure, yes. When the NCAA first started, college sports were defined as amateur, and the NCAA was solely a rules organization. Since then, much has changed. However, the NCAA is still trying fit into their original "amateur" definition. This is like trying to shoehorn an amateur sport into a newer model. Especially for the revenue-generating sports, such as football and basketball. Conversely, for sports in categories — such as Division III — that do not award scholarships, the amateur definition still fits.

What is at the heart of the issue?

This is really about workers' compensation. Athletes get injured and need insurance for life. This is costly and the NCAA and/or NCAA universities do not want to take out the costly insurance policy for their athletes. Thus, they fight to keep a warped definition of amateur to save millions, on the backs of their athletes.

What is the solution?

Universities have no business in the sports business. Thus, simply remove the money. Division III is a perfect money-free example since there are no issued athletic scholarships, no large budgets, and no highly paid coaches. All NCAA member institutions should be at this level, and the revenue-generating sports like basketball and football should be allowed to embrace another independent business model.

What are some impediments to and catalysts for this solution?

We know that a congressman from a state like Alabama (a Division I school) is heavily lobbied by the NCAA to keep the status quo. Consequently, at the federal level, there is zero interest in changing the model. However, at the state level, California, with many top public schools, could come in and mandate some rule changes for their "citizens," possibly causing other states to follow suit.

Robert W. Turner II is an assistant professor in the Department of Clinical Research and

Leadership at The George Washington University School of Medicine & Health Science. He earned his PhD in sociology at the Graduate Center, City University of New York. After attending James Madison University on an athletic scholarship, Dr. Turner played football professionally in the now-defunct United States Football League, the Canadian Football League, and briefly in the National Football League.

Benefit corporation

The NCAA could also register as a benefit corporation. Indiana is one of more than 30 states that have enacted legislation to permit the formation of benefit corporations (also known as a B-Corp). Indiana Code Section 23-1.3-2-7 defines a B-Corp as a for-profit entity that maintains a mission to provide some public benefit. While a corporation certainly does not need to be a B-Corp to do good, the primary goal of for-profit entities is to benefit its shareholders, not to provide a public benefit.

Imagine if the NCAA restructured under the B-Corp model: It could set aside a portion of its revenue (e.g., 80 percent), to go to the nonrevenue sports solely. This would enable the two revenue-generating sports, football and basketball, to either create their own for-profit entity or receive the 20 percent remaining in the B-Corp.

Should the NCAA register as a B-Corp, it would have to stick to its designated “good” to maintain its status and shareholders and could not extinguish or dilute the commitment from year to year. This is quite different from a for-profit company contributing to a charitable organization where the selected tax-exempt organization can change from year to year.

Public corporation

While some B-Corps are privately held, such as Ben and Jerry’s ice cream, a B-Corp can go public if it keeps its mission “to do good” as part of the transformation. This would allow the NCAA to register as a B-Corp, sell stock privately or publicly, and even file for an initial public offering. This is no different than what the Pac-12 conference is currently exploring.

According to reports, the Pac-12 has multiple bids of at least US$750 million from companies seeking to become equity investors in the conference. No college conference had ever sought outside investors before. Should the Pac-12 and other conferences move in this direction, perhaps a restructuring of the relationship with the NCAA will need to follow.

Change is coming

The NCAA knows change is coming, and it must respond to a significant shift in public perception and opinions regarding college athletics. Until the organization enacts significant reforms, college athletes will continue to resort to the courts, and federal and state legislators will press for external solutions.

Taxpayers, who fund public universities nationwide, can also serve as a voice for change. As the NCAA wrestles with its ethical dilemma, in-house counsel should keep an eye on developments as they will have wide-ranging effects on businesses that partner with college and athletes amid a

changing landscape.

Ellen M. Zavian

Professor of Law

George Washington University in Washington, DC

Ellen M. Zavian was the first female NFL agent and has represented US women’s

soccer, softball, break dancers, and extreme athletes. She currently teaches sports/negotiation law at George Washington University in Washington, DC, and she serves as a coach to the GWU Law Students Moot Court program.

Sathya S. Gosselin

Partner

Hausfeld's Washington, DC office

Sathya S. Gosselin is a partner in Hausfeld's Washington, DC office, where he served as trial counsel in the landmark *O'Bannon v. NCAA* litigation, in which he examined and cross-examined witnesses at trial, deposed key NCAA executives, briefed complex constitutional issues advanced by the NCAA and television networks, and helped negotiate a US$40 million settlement with Electronics Arts Inc., which was distributed among current and former college athletes.