

Mergers & Acquisitions

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Navigating The Purchase and Sale Of Sports Teams



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Of all the trophy assets one can own, a professional sports team is one of the most coveted, exclusive and elusive. Sports team acquisitions have garnered headlines over the past few years, with several recent team prices ranging in the billions of dollars. Since 2000, the top five U.S. team sales were at prices in excess of the billion

dollar threshold, the highest being the \$2 billion sale of the NBA's Los Angeles Clippers in 2014 and the \$2 billion sale of MLB's Los Angeles Dodgers in 2011. In New York, the NFL's Buffalo Bills were purchased in 2014 for \$1.4 billion. Not long ago, sports franchises were run like small businesses, with any net profit generated being an additional, but not

always expected, benefit. Today, given rising acquisition costs and the lucrative revenue opportunities teams offer, they are run as sophisticated enterprises with the purpose of yielding profit for their well-heeled investors.

On the surface, the buying and selling of a professional sports team may seem like a regular M&A transaction. However, the many issues unique to the sports industry give these deals complicated twists that require extensive due diligence and the guidance of experienced counsel well-versed in a number of areas specific to the sports landscape. Potential team buyers and sellers need to be able to navigate the transaction process under the watchful eyes of respective leagues and governing bodies, while negotiating a plethora of business and legal issues.

Supply and Demand

Before a potential buyer can initiate the process for making a team purchase, there must be a team available for purchase. However, professional sports teams are limited commodities. Within the four major leagues, there are only 122 teams. As team values increase, the pool of potential buyers who can afford to purchase them dwindles. With a limited pool of qualified potential buyers, competition among them is fierce, as teams do not change ownership often. This trend is common to all of the major leagues. For instance, the NHL's Chicago Blackhawks haven't changed ownership since 1954, the MLB's Chicago White Sox since 1981, the NBA's Indiana Pacers since 1983, the NFL's Arizona Cardinals since 1972, and MLS' New England Revolution since 1995. The limited supply and large demand further contributes to the rise in team valuations, thus creating a continuous cycle that drives team prices upward. On the infrequent occasion that

a team is for sale, the transacting parties need to ensure that they are adequately represented at the deal table.

League Guidelines

Each major sports league has its own constitution and bylaws that set forth the process for transfers of team ownership. Before a team transfer can occur, buyers are vetted extensively and are required to submit to an in-depth back-

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ground check process, which includes completing a comprehensive application, requiring the disclosure of personal, professional, and financial information. Depending on the league and the circumstances, it is not uncommon for potential team owners to have their financial wherewithal confirmed via a forensic review process.

While each major sports league has its own criteria, the majority of the leagues impose restrictions regarding the number of investors that can comprise a buying group and have certain minimum investment requirements to be eligible for both majority and minority ownership interests. There are also specific requirements as to how much equity the lead investor must have to hold a controlling interest in a respective franchise.

While leagues generally prefer to deal with individual owners because of efficiency and to limit the discord that can exist among owners of a larger buying group, rising team valuations have limited the pool of individual purchasers

capable of buying a major professional sports team on their own. The existence of an individual capable of purchasing a team without the assistance of an investment syndicate has a preemptive effect on a buying group, particularly in relation to a team bidding process. Leagues scrutinize and regulate debt and equity structures, and impose debt limitations relative to their respective franchises. The financial stability of an owner group obviously affects the owned team, but also affects the strength of the league as a whole. Accordingly, leagues are careful to ensure that prospective owners have the resources to undertake team ownership, including related financial obligations.

The Stadium/Arena

One of the most valuable assets of a professional sports team is the real estate associated with the team—the stadium/arena, practice facilities, corporate offices and parking facilities. Potential buyers should engage in diligent review of any applicable stadium- or arena-related lease to identify obligations that will be assumed on completion of a potential transaction and to identify whether any potential development opportunities exist. A critical aspect of reviewing a team acquisition opportunity is whether the facility where the team plays is owned by the team or a governmental authority.

In an era of modern stadium and arena development, potential owners will have interest in ensuring their facilities are maintained as first-class professional sports venues. If properly operated and maintained, stadiums and arenas can drive significant revenue streams from fans that are increasingly looking for a total entertainment experience. Potential owners should be aware as to whether they are responsible for facility

improvements or whether the governmental authority, if applicable, would cover the costs of improvements. If public support is anticipated with respect to stadium or arena improvement, new owners should gauge local government and community support for taxpayer funding.

In situations where governmental funding assistance has been provided (whether for initial construction costs or improvements), such assistance is often conditioned upon the team entering into a non-relocation agreement. Another important aspect of assessing the arena/stadium situation as it relates to a team acquisition target is whether the owner will have the right to operate the venue and have the right to retain the revenues generated from such operation. For example, a team owner will want to know whether it has the right to book non-sporting events at the venue, all of which generate additional revenues for the owner. Accordingly, buyers should have a clear understanding of the terms of any existing agreement that might impose restrictions with respect to the use of a stadium or arena. Further, if multiple teams share a facility, potential buyers need to consider additional issues such as obligations to additional team tenants including scheduling concerns, sharing of costs and revenues, and venue promotional rights.

Expenses and Revenue Opportunities

Perhaps the most important aspect of the due diligence process in relation to assessing team valuations, is gaining a firm understanding of the various expenses and revenue-generating opportunities that come with owning the team. In terms of expenses, the main costs to owners are those related to player payrolls and servicing the debt on the team and the stadium/arena. Add luxury

taxes for teams that exceed respective league salary cap limits, and an organization can become crippled from a cost perspective.

Prospective buyers should also pay keen attention to the revenue metrics of teams that are being considered for acquisition. Key revenue drivers include media rights, ticket sales, sponsorship and naming rights transactions, and concessions and merchandising.

Media Rights

Sports content is one of the last bastions of must-see live TV. While ratings across television have been on a downward spiral for a variety of reasons—DVR and other recording options, the cord-cutting generation, and more variety with respect to TV channels—the public's thirst for live sports content has not waned. In fact, ratings for live sports have seemingly been immune to this decline and in some cases, public demand for sports programming has increased in recent years. As a result, sports networks and distributors are willing to pay top dollar for rights to distribute team games on their respective networks. Team games are distributed over various media platforms, including local broadcast TV, cable TV and Internet streaming, the latter of which is an emerging trend owners will want to keep an eye on.

Sports programming has been so lucrative that some teams have formed their own regional sports networks (RSNs) to distribute their content. In addition, potential owners can look forward to participating in substantial league-wide media revenue resulting from league agreements with content distributors to broadcast games. The recent fees associated with sports team and league revenues have been the key drivers to the recent increase in team valuations.

In reviewing media-related agreements, a buyer should have an understanding of existing league-wide media agreements and the obligations and benefits to the league (particularly those that flow to the teams) as well as how the overall league agreement affects local media rights. Equally important is having an understanding of the local media agreement. In particular, there should be an understanding of the market territory covered by the agreement and any league-mandated out-of-market restrictions or related fees, broadcast preemption rights, copyright ownership, distribution platform rights granted, whether the team or the respective network is responsible for production costs and whether the team or the partner network is responsible for selling advertising inventory—a significant undertaking, but also a significant revenue source.

Ticket and Suite Sales

Ticket sales, particularly season tickets, make up another significant portion of revenue for teams. Personal seat licenses (PSLs) afford long-term ticket revenue streams, by allowing fans to pay for a license that grants the holder the exclusive right to purchase season tickets to the specific seats covered by the PSL. Other ticket products include partial season ticket plans, as well as group ticket sales (civic groups, schools, and religious institutions), and individual ticket sales. Also of significance are luxury suite sales, which represent some of the higher-priced seating inventory within an arena/stadium.

Both season tickets and suites are generally subject to some term of commitment, and potential buyers should pay close attention to committed inventory for purposes of determining contractually obligated income due to the team. Buyers should also closely examine

other obligations stemming from suite licensees and ticket holders, such as obligations related to seat access regarding non-sporting events, parking requirements, unlimited food and beverage offerings or other perks.

Sponsorship Sales

Every major league sports team relies on relationships with companies and brands to form strategic alliances in the form of sponsorships. Companies and brands pay to align themselves with teams for the goodwill associated with a respective team, its league and its players. Such alignment manifests itself in various forms, including signage affixed around an arena or facility, the branding of certain team programs, as well as club and hospitality areas within a playing facility. The most prominent form of sponsorship is the arena or stadium naming rights deal.

Naming rights deals yield significant long-term revenue streams for teams and provide high-profile exposure for companies and brands.

Potential owners need to understand the terms and conditions of existing naming rights agreements given their economic value, but also because certain naming rights transactions, given their and the strength of the naming rights partner, lend themselves to being collateralized for financing purposes. These agreements are generally the subject of heavy negotiation, particularly in terms of exclusivity, length of term, fees, and entitlements. Potential buyers need to be aware of these terms and ensure that they are able to fulfill the obligations under these agreements.

Concessions and Merchandise

Another revenue source familiar to many is sales related to food and

beverage concessions and team merchandise, which probably represent the most familiar forms of team revenue for the average sports fan. Who goes to a game and leaves without consuming a beverage, hot dog, bag of popcorn, or purchasing team memorabilia? With stadium and arena food becoming increasingly gourmet in an effort to cater to sophisticated palates, prices for food have risen commensurately, creating increased revenue opportunities for team owners.

Merchandise sales have become more sophisticated with more quality products entering the market, many times with team stores resembling commercial retail locations. Teams generally outsource concessions functions to companies specializing in arena concessions, and are increasingly outsourcing merchandise functions, often times receiving minimum guarantees in anticipation of future sales. As such, buyers should review and understand the financial opportunities and implications of existing concessions and merchandise agreements.

Closing the Deal

Following extensive due diligence by representatives of the potential buyer, the seller and the buyer negotiate the terms upon which the team will trade hands. Investment bankers line up the financing; attorneys negotiate the terms and draft the purchase and sale agreement as well as any necessary consents, guarantees and covenants; and the respective league reviews the transaction in its entirety to provide its approval prior to submission to the existing owners of the respective league. Though the buyer and seller get to "Yes" in terms of agreement with respect to the transfer of ownership

of a professional sports team, it is the existing owners who have final approval as to whom is admitted into the exclusive club of team owners, with relatively wide latitude regarding their approval or disapproval of prospective team owners. The existing owners review the terms of the pending team sale transaction and vote whether to approve of the transaction. As a practical matter, by the time the transaction is submitted to the full owners group for a vote, the deal has been approved by a subcommittee of owners who work closely with the league regarding the pending transaction.

Conclusion

Buying a team is a complex undertaking. There are many issues potential buyers need to be cognizant of when considering, preparing for, and executing such a transaction. The due diligence for a professional sports team M&A transaction involves in-depth investigation into a broad spectrum of important issues, directly and indirectly related to the team. In pursuing a team acquisition, the potential buyer must, in addition to engaging in extensive due diligence and negotiation, be ever mindful of complying with all applicable league rules and regulations.