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Sports Investing 101

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Investors following the bouncing ball have seen sports emerge as a distinct and compelling asset class. Over the last six months, a series of professional sports franchises have sold at record-breaking valuations. This includes the March sale of the Boston Celtics to an investment group led by William Chisholm for a purchase price of at least $6.1 billion – a record for the highest valuation for a sports franchise at the time the deal was announced. That record lasted all of three months before being eclipsed in June, as the Buss family announced the sale of a majority stake in the Los Angeles Lakers at a valuation of $10 billion. These were followed in short order by the August sale of control of the Portland Trail Blazers by the estate of Paul G. Allen to an investor group led by Tom Dundon at a valuation of $4.25 billion.

This crescendo of dealmaking follows a trend of escalating NFL franchise sales, including the 2022 sale by the Pat Bowlen Trust of the Denver Broncos to the Walton-Penner family for $4.65 billion, along with the 2023 sale by Dan Snyder of the Washington Commanders to an investor group led by Josh Harris for $6.05 billion, in what was at the time the most ever paid for a professional sports franchise. Just this month at their annual fall meeting, NFL owners approved a trio of minority stake sales at eye-watering valuations: Julia Koch and her family bought a 10% stake in the New York Giants at a valuation of more than $10.5 billion; Dean Metropoulous and Sixth Street Partners bought an 8% stake in the New England Patriots at a $9.7 billion valuation; and Pete Briger Jr. and his family bought a 3.2% stake in the San Francisco 49ers at a valuation of $8.6 billion.

This rise in dealmaking was accelerated by extraordinary media rights investments by both linear broadcasters and streaming services and strong demand for live events, and is poised to continue as investors seek to capitalize on rumored expansion in MLB and the NBA and opportunities to invest in women's sports, including the WNBA and National Women's Soccer League. As the pace and scale of investments in sports franchises and the broader sports and media categories by individual investors and institutional asset managers proliferates, dealmakers should be aware that investing in sports franchises involves a distinct dynamic and unique rules of engagement that differentiates it from other transactions.

The challenge of building a winning team (of buyers)

In the past, it was common for teams to be acquired by single individuals or families, but with sports team valuations now regularly reaching into the billions of dollars, the number of individuals and families with both the desire to become owners of premier sports teams and the financial wherewithal to rely only upon their own wealth and assets to do so is vanishingly small.

Acquisitions of flagship properties in other industries often rely upon leverage and institutional capital, but most of the major American sports leagues have distinct rules about how their franchises can be capitalized:

- **Debt and security limits.** League rules often limit the amount of debt that a team can use to finance the acquisition of a team, and generally do not permit team assets to serve as security for such acquisition financing. Typically, these debt limits are in the hundreds of millions of dollars and are far short of the amount needed to meaningfully finance the acquisition of a team valued in the billions of dollars.
- **Limits on number of owners and minimum size of investment.** League rules often limit the number of individuals (e.g., 25) who can be an owner in a sports team and further require that each owner must own at least a minimum percentage (e.g., 1%) of a team to qualify as an owner.
- **Limits on institutional ownership.** While participation by institutional investors is generally permitted across the major American sports leagues, most leagues limit the amount of equity that institutional investors and sovereign wealth funds can hold in a team (generally between 15% and 30%, depending on the league).
- **Fitness for ownership.** Further limiting the sources of capital available for a potential buyer are league rules concerning the suitability of a prospective investor as an owner. The leagues tend to require extensive background checks, obligate owners to provide capital to the franchise as and when required to cause the relevant teams to be operated in a first-class manner,

and to indemnify the sports league and its affiliates, often on a joint and several basis.

Taken together, these constraints to capitalizing an acquisition and requirements of ownership have increasingly led prospective owners to pursue deal structures with multistep funding mechanisms and ownership syndicates and structures resembling those of investment funds, with reliance on a principal managing or controlling partner and a series of limited partners who provide capital but have limited participation in governance matters.

Playbook complexity

As a consequence of the complexity involved in assembling a group of buyers that satisfies the financial and other requirements imposed by applicable league rules, the transaction structures used to acquire teams are often unique.

Multistep structures

One way to reduce the immediate financing needs of a transaction is to sell control of a team in multiple steps, which gives buyers time to raise and deliver the capital required to purchase a team at current valuations. In the Celtics transaction, for example, the transaction was structured such that the investor group led by William Chisholm agreed to acquire all of the equity from its former owners in two stages, with at least 51% of the ownership interests in the team being transferred in the first step. In a similar vein, Mark Walter acquired a 26% interest in the Lakers in 2021 at a $5 billion valuation, subject to a right of first refusal to acquire a majority of the interests in the Lakers, which paved the way for him to acquire a controlling interest in the franchise in his recently announced acquisition.

While a deferred acquisition structure may facilitate acquisition of an initial stake to fully finance the transaction by delaying or staging the remainder of the franchise sale, a key challenge arises – how can sellers ensure that the buyer follows through with its promise to acquire the remaining equity of the team in each subsequent stage? There are a great number of risks that should be considered when designing an appropriate group of safeguards, including:

- Potential funding failures, which could be precipitated by adverse change in the fortunes of a member of the investor group or changes in macroeconomic conditions.
- Potential contract disputes, which could relate to the timing or manner of the purchase of interests in the second stage (as seen in the acrimonious second step of the sale of the Minnesota Timberwolves to an investor group led by Marc Lore and Alex Rodriguez).
- Potential failures to obtain final approvals of the league to complete the transaction due to intervening events or circumstances surrounding a buyer or group of buyers.

The risks of a default in the final stage of a transaction are further complicated by league rules that may limit the kinds of remedies that are usually employed when limited partners fail to fund required capital contributions or an acquirer fails to close following the exercise of a put or a call option. League rules and the conditions for approval of an acquisition may limit the ability of a buyer to pledge the assets of the team or interests in either the buyer or the franchise to serve as security of an obligation of the buyers, or otherwise require the franchise to pursue a subsequent control sale or change its governance as a result of a failure by an owner or group of owners to complete a planned acquisition of outstanding interests held by minority or legacy owners.

As a result, transactions with deferred closings typically include a series of interrelated and often overlapping protections of both buyers and sellers to ensure that the buyer group (and each of its members with a funding obligation) funds and closes as and when contemplated, including various financing covenants, mechanisms to call capital, financial penalties, termination fees, specific performance remedies and other contractual means to disincentivize a failure to fund or close. Buyers themselves may also impose these in their own organizational documents and allow themselves the flexibility to obtain replacement financing in the event that a member of their investor group fails to fund or otherwise fails to obtain requisite approvals to fund.

Assembling a buyer investment group

League rules generally require that each team have a “controlling owner” who beneficially owns a significant percentage of the team. Such controlling owners are expected to have the ultimate decision-making authority with regard to the team and its operations and responsibility for causing the team to operate in accordance with

the league rules and its contractual obligations. The allocation of these rights to a specific controlling owner is intended to avoid governance by committee, but limits one of the common rights offered to significant investors in any enterprise – influence on governance. These rules do not preclude significant investors from requiring or exercising certain approval rights on changes to an investment structure or fundamental changes like relocation of the team, but it does mean that there is a very real limit on how much governance can be offered as an incentive to participate as an investor in a sports team.

But while sports teams often offer limited governance opportunities for noncontrolling investors, they do offer something that many other kinds of enterprises cannot offer – enticing perks and engagement with a sport and the community. Generally, the kinds of individuals and families who invest in sports teams are wealthy already, and their investment decision is motivated less by prospective financial return than the prestige and opportunity to be part of the team's ownership group. The appeal of association with a beloved sports team, the cache of ownership, the access to exclusive team events for oneself and one's family members, and occasions to interact with other owners and sponsors is often a motivating factor for investors – just as or more important than any governance or economic rights as an owner.

Institutional investors have more recently been permitted to invest in sports franchises, and certain investment managers have raised funds with long lifespans or evergreen funds in order to invest in sports franchises. Private equity investors pursuing sports investments must calibrate their liquidity expectations to meet the specific requirements of the leagues designed to preserve ownership stability and the intentions of the controlling owners who often seek to extend their ownership over a generational time period. Leagues generally disfavor rights that could disrupt the operation of a franchise by requiring a franchise to complete a sale of the team or consummate a liquidity event within a certain time frame or on certain terms. In certain instances, institutional investors negotiate express rights to market and sell their interests in advance of a full change of control transaction, with assistance of the team and its controlling owners to ensure a path to return capital on a timeline that is acceptable to the investors' limited partners.

Keeping score

- Interest in sports and live events and the rising importance of sports offerings in media distribution arrangements have further increased the valuation of sports franchises and the focus on sports franchises as an investment asset class.
- Sports franchise owners are subject to unique rules regarding how these entities can be capitalized – including debt limitations, complex investor qualification rules and limitations on control and liquidity rights.
- Franchise buyers have sought to design transactions intended to allow for changes in ownership over time, providing liquidity in stages and optimizing the amount of capital required to fund each stage of the ownership transaction.
- As franchise values rise, institutional investors will raise capital and use tailor-made structures to pursue capital appreciation in these franchises.

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