OPINION

Economic and tax opportunities for owners as NFL opens doors to private equity

BY TOM CONAGHAN, PATRICK McCURRY AND GREG BERSON

THE ARRIVAL OF PRIVATE EQUITY INVESTORS to major U.S. professional sports leagues, including the NFL's recent approval of PE ownership, provides a new and professional pool of investors for owners seeking to raise new capital, as well as buyers for longtime investors seeking to exit or realize part of their investment. For their part, PE firms and their limited partner investors now have an opportunity to invest in U.S. professional sports teams, by far the best performing "asset class" in the U.S. over the past 50 years.

The leagues have been cautious in permitting PE and other institutional investors into their exclusive ranks, which have historically been the domain of wealthy individuals and families, several of whom have passed down ownership over generations. PE firms are designed to provide returns to their limited partners, and investment horizons rarely extend beyond five years. PE firms are also known for their hands-on management styles, working directly with management teams to cut costs, find efficiencies and increase profit. PE firms also generally hold multiple investments in various industries, some of which might touch industries (e.g., gambling) that raise concerns or intersect with investments made by players themselves.

To guard against these concerns, MLB, NBA, NHL and now the NFL have each adopted PE investment policies focused on keeping PE investors in a passive position, with no capability to influence team governance or management, no capability to force the hands of controlling owners, no negative control rights and limited rights to information.

MLB, NBA and the NHL each limit the percentage interest an individual PE firm can hold in a team. For the NBA and NHL, it is 20%. For MLB, it is 15%. The NFL adopted a firmer stance, limiting PE firms to no more than 10% in a single team. The NFL is also limiting the PE firms permitted to invest in the league's teams. Thus far, only Ares, Arctos, Sixth Street, and a consortium of Blackstone, Carlyle, CVC, Dynasty Equity and Ludis have been approved to negotiate with NFL owners, although it is anticipated that other PE firms will be granted permission in the near future.

Notably, while other professional sports leagues in the U.S., such as the NBA and NHL, now permit minority investments from sovereign wealth funds, the NFL's announcement explicitly prohibits direct investment from sovereign wealth funds.

Economic opportunities

Allowing PE to enter the NFL ownership ranks will provide an influx of capital welcomed by many NFL owners. The PE firms on the league's initial approved list have committed to providing an initial amount of $12 billion of capital over time. For teams considering whether to build new stadiums or renovate older ones, this capital will offer access to a capital pool previously unavailable to NFL teams. Providing better stadium experiences for fans, with year-round event planning, has become a great way to grow a team's fan base and increase local revenue.

For NFL owners seeking liquidity, but intending to eventually sell their team, selling a small percentage of their team to a passive PE firm may enable them to later sell a larger portion of the team later for a much higher valuation.

Finally, although individual teams will decide whether to allow investment from a PE firm, all the teams will share in the profits, as a portion of the money from the eventual PE sale will go to the NFL and subsequently be shared among all teams, just as with media rights and national sponsorships (i.e., revenue sharing). This will allow teams who choose not to open their doors to PE investment to still reap benefits from the league's decision.

Tax and estate-planning opportunities

As valuations of professional sports teams continue to skyrocket and the investor base expands (including more flexible family trust structures), income tax and estate planning have become more critical than ever for family systems and PE firms looking to transact with professional sports teams.

PE capital may offer critical financing for NFL owners facing large estate tax obligations. As valuations of NFL teams have surged in recent years, NFL owners considering passing teams down to their descendants have been forced to consider giant tax bills that may be waiting on the other side. Selling a small ownership percentage to a PE firm could offer these families a potential avenue for offsetting these tax liabilities.

Income tax planning opportunities are available and receiving more attention lately (due to the higher tax bill) for families looking to both sell and buy controlling and minority interests in professional sports teams. Sellers seek to minimize and/or defer income taxes in connection with transactions while buyers focus on the ability to use tax losses attributable to amortization/depreciation deductions and operations, in addition to other items.

Minimizing, or eliminating, gift/estate taxes for families (especially families who have owned sports teams for decades) in sports deals often dictates deal structures. Additionally, professional sports leagues continue to become more flexible on families' desire to use irrevocable trusts in their structures to maximize estate planning benefits and facilitate long-term ownership and succession of the teams.

The NFL's decision to open its doors to PE ownership should prove to be a boon to both the owners and the league itself. For the teams, PE provides a new and sophisticated pool of capital for stadium renovations, as well as strategic liquidity and tax and estate planning opportunities for controlling owners, or a much-needed exit for a minority owner. Reserving a "carried interest" for the league in a future sale by the PE investor also allows the league itself to profit from its own success.

This article was written by attorneys from McDermott Will & Emery's Media, Entertainment, and Sports team, including Tom Conaghan (partner, Washington D.C.), Patrick McCurry (partner, Chicago), and Greg Berson (associate, Washington D.C.), with thanks to Scott Bowman (partner, Washington D.C.) and Jake Schindler (associate, Chicago) for their contributions.