----- Forwarded Message ----
From: "Johnson, Gerry" <Gerry.Johnson@klgates.com>
To: mike@mcgavicks.com; Wally Walker <wf.walker@yahoo.com>
Sent: Saturday, October 6, 2007 3:25:10 PM
Subject: Finals

Here you go. Slade will bring color copies. Thanks. Gerry

<<blackburn11.ppt>> <<blackburn10.ppt>>

Gerry Johnson
K&L Gates
925 Fourth Avenue, Suite 2900
Seattle, WA 98104-1158
Phone: 206-623-7580
Direct Fax: 206-370-6094
Email: gerry.johnson@klgates.com
www.klgates.com

DEFENDANT'S EXHIBIT
CASE NO. C07-1620MJP
EXHIBIT NO. 567

ATTORNEYS ONLY MATERIAL

The Sonics Challenge

Why A Poisoned Well
Affords A Unique Opportunity

The Big Three Challenges of U.S. Sports Team Ownership

- Scarcity: They are hard to come by
- Economics: They are hard to operate profitably
- Reputation: They are hard on the owner's reputation

The Big Three Challenges of U.S. Sports Team Ownership

- Scarcity
  - Monopoly conditions, devoted fan bases, media-friendly content make them scarce and valued = expensive
  - League ownership rules in the "big four" leagues (NFL, MLB, NBA, NHL) add a meaningful barrier to entry beyond cost
  - Odds of a particular franchise becoming available to a particular region at a particular time are poor (for example, big four franchises have been available for sale in Seattle market 11 times in their combined 100 years of operation) (Mariners 4/30; Sonics 4/40; Seahawks 3/30)

The Big Three Challenges of U.S. Sports Team Ownership

- Economics
  - With the exception of the NFL, many professional sports teams struggle to make money (for example, about half the NBA operates at a profit in any given year, and it is the larger markets that tend to be consistently profitable)
  - Entry price and appreciation prospects are critical, especially as returns from operations can be volatile (meaning that effective due diligence requires understanding the league as well as the franchise) (see Goldman Sachs pages 11-14)
  - Critical to most operations' financial prospects is a partnership with the local community to provide a sound facility (see review of other arena financials)

The Big Three Challenges of U.S. Sports Team Ownership

- Reputation
  - Few sports team owners are loved (or even just not reviled) by the local community
  - Franchises can be seen as "rich boy toys," subsidized by public
  - Communities often feel passionate sense of ownership of team (a passionate fan base is a good thing!), but anything less than winning is viewed as a betrayal: the fault of a cheap and/or unwise ownership
  - Huge media sector preys on this passion and lives off of the (usually negative) energy of this phenomenon

Seattle's Current NBA Situation Mitigates All Three Challenges

- Scarcity
  - Current ownership faces bleak prospects and may be pushed to sell
- Economics
  - The Mayor is now willing to lead efforts to create a viable facility/lease at KeyArena
- Reputation
  - History shows that late-arriving local owners can potentially be viewed as white knights and, managed properly, can retain this reputation for some time
- The balance of this presentation explains these beliefs and outlines a campaign to capture them

Seattle's Current NBA Situation Mitigates All Three Challenges

- Scarcity
  - Current ownership faces bleak prospects and may be pushed to sell
    - It has poisoned its relationship with the fan base, likely diminishing a key revenue source – it went from break-even in 2005-06 to operating losses of $17 million in 2006-07
    - It has changed the composition of the team in a way that makes competitiveness unlikely in the near-term, further diminishing fan interest/ticket revenue
    - It faces a lease fight with the City* which proposes to force it either to absorb significant costs if it leaves early, or endure the unfavorable lease economics with a weakening fan base for three more years

* See "lawyering up" and related articles

Seattle's Current NBA Situation Mitigates All Three Challenges

- Scarcity (cont.)
  - The owners, while in a fraternity that generally protects its own, risk pressure from the NBA to accommodate a Seattle-based solution:
    - The league has a history of success in Seattle, and would rather stay; NBA's over-riding concern is the need for a competitive facility
    - Departure would double (from 1 to 2) the number of top 20 DMAs in which NBA is absent (today the NBA is only absent from #12 Tampa-St Pete. Seattle is #14 2006 DMA; Oklahoma City is #45)
    - The league has other franchises in flux which may provide a way to satisfy multiple interests

Top 20 Designated Market Areas (2006)

	DMA Rank	Percentage of U.S. Average Disposable Income (EBI)*	Number of Big 4 Teams	NFL	MLB	NBA	NHL
NYC	1	119 (3)	9	✓✓	✓✓	✓✓	✓✓✓
Los Angeles	2	108	6		✓✓	✓✓	✓✓
Chicago	3	116 (5)	5	✓	✓✓	✓	✓
Philadelphia	4	109	4	✓	✓	✓	✓
San Francisco/Oakland	5	142 (1)	6	✓✓	✓✓	✓	✓
Dallas/Fort Worth	6	113 (7)	4	✓	✓	✓	✓
Boston	7	118 (4)	4	✓	✓	✓	✓
Washington, DC	8	132 (2)	4	✓	✓	✓	✓
Atlanta	9	109	4	✓	✓	✓	✓
Houston	10	110 (+.9)	3	✓	✓	✓	
Detroit	11	110 (+.9)	4	✓	✓	✓	✓
Tampa/St. Petersburg	12	95	3	✓	✓		✓
Phoenix	13	103	4	✓	✓	✓	✓
Seattle	14	112 (8)	3?	✓	✓	?	
Minneapolis/St. Paul	15	108	4	✓	✓	✓	✓
Miami/Fort Lauderdale	16	101	4	✓	✓	✓	✓
Cleveland/Akron	17	94	3	✓	✓	✓	
Denver	18	115 (6)	4	✓	✓	✓	✓
Orlando	19	96	1			✓	
Sacramento/Stockton	20	99	1			✓	

FYI → Oklahoma City #45/83

*Effective Buying Income.

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics
  - There are three levels of economics to consider
    - Purchase price
    - Prospects for appreciation
    - Operating economics/prospects
- Two of the three, price and operating economics, are affected by the current situation

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (cont.)
  - Purchase Price
    - It is reasonable to believe that the $350 million established as the price for the Sonics by the 2006 Goldman auction is a reasonable price for it to trade again. One could argue value has been diminished, but local ownership stability creates powerful positive momentum. This has been the case with both Seahawks and Mariners.
    - A franchise that is free to move (i.e. New Orleans), may command a premium if other markets were permitted to bid
    - This would leave current owners out their first year losses of $17 million, but avoids the continuing losses they face through the end of the KeyArena lease
      - There may, however, be ways to address this, such as the league orchestrating a sale of another franchise (say, New Orleans) to the Oklahoma City owners at an offsetting cost

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (cont.)
  - Appreciation
    - The Sonics franchise has traded 4 times

Sonics Franchise Appreciation			
Year	Buyer	Price	CAGR
1966	Schulman	$1.75 mm	15.74%
1983	Ackerley	$21 mm	13.34%
2001	Schultz	$200 mm	12.10%
2006	Bennett	$354 mm	NA

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (Appreciation cont.)
  - Examples of recent NBA transactions:

Recent NBA Sales			
Year	**Franchise**	**Price**	**Revenue Multiple**
2001	Sonics	$200 mm	2.7x
2002	Celtics	$360 mm	4.0x
2004	Nets	$360 mm	3.8x
2004	Suns	$401 mm	3.7x
2005	Cavaliers	$374 mm	3.6x
2006	Sonics	$354 mm	4.1x

  - Much of the value is tied to the league's future prospects

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (Appreciation cont.)
  - As one of a limited number of media content franchises that still attracts the attention of demographically desirable consumers, and with rapidly growing interests overseas (especially in China), and unfilled markets in the U.S., the league's economic prospects remain very strong
  - Not greatly affected by this transaction, though losing a presence in the 14th largest DMA is not helpful especially when it has the 8th highest disposable income in top 20 DMAs

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics
  - This is where the greatest necessity/opportunity exists for change (post 2010 -- $30-$40 million positive swing)
    - Gradual improvement possible in interim through franchise stability and management; lease modifications; and capital investment in facility
    - To be made reasonable to operate in Seattle, KeyArena must be overhauled, and its revenue streams redirected to the Sonics
    - Mayor has offered to redirect revenues in new lease
    - This makes possible a $30-$40 million revenue annual pick-up from break-even 2005-06 operations (see chart on next slide)
    - As the following pages illustrate, if these issues are addressed, the franchise, with proper cost controls, can be run profitably and with a payroll that would allow for a competitive product

Seattle's Current NBA Situation Mitigates All Three Challenges

Incremental Revenue Due to Arena Improvements and Normalized Lease		
	2006(a)	2011(e)
Tickets	$27,643	$41,000[1]
Sponsorship	$17,122	$29,000[2]
Suites	$1,424	$8,500[3]
Concessions & Retail	$1,982	$3,500[4]

1. Reflects enhanced amenities/access and the Sonics retaining 100% of ticket revenue. Still only approximates NBA average.
2. Includes improved local media rights, arena naming rights and unencumbered sponsorship categories (e.g., financial institutions).
3. Remodel creates better customized suite/loge seating options. Sonics retain 100% of suite revenue.
4. Sonics control all event retail/concessions. Enhanced concourse space.

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics (cont.)
  - Franchise Stability and Management
    - The dominant controllable levers in a team's operating profit and loss are ticket revenues (heavily influenced -- more than 50% -- by high end customers) and somewhat influenced by competitiveness, as related to payroll -- especially player costs
    - Sonics have proven that payroll is not necessarily correlated to competitiveness -- from 1999-2006, Sonics were 8th in NBA dollars spent per win (lower being better), and above .500 in wins over the period, with 3 trips to playoffs
    - Payroll has management opportunities
    - Payroll is at an all-time high: $64 million in 2007-08
      - But low-hanging fruit for active management, due to K. Thomas and Sczerbiak contracts

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics (cont.)
  - Workable Partnership with City Is Needed to Improve Lease and Facility
    - Mayor knows the City is facing real loss:
      - Loss of Sonics regional economic contribution (est. at $234 million)
      - Loss of direct Sonics' driven revenue/taxes
      - A white elephant at Seattle Center
      - Loss of stature -- perhaps most acutely felt by those recruiting to the area. Of top 20 DMAs, #14 Seattle would be largest to have less than three of the big four sports leagues, joining only #19 and #20, which as rapidly emerging markets, have only one professional sports franchise each.

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics (cont.)
  - After a long period of brinksmanship, Mayor is now willing to deal and to lead in securing a workable arrangement from other public partners (State and County) for capital investment in facility.
    - Deputy Mayor and Slade Gorton will be briefing NBA officials in NYC later this month on City proposal (rejected out of hand by Bennett who has repeatedly refused to consider KeyArena options).
  - Revised Lease
    - The lease is biased for the City which receives monies that in other cities would go to the team, totaling $77 million in payments 1995-2005
    - Stern accurately called it the worst lease in the NBA

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics (cont.)
  - Capital Investment
    - The facility has structural barriers to capturing high-end customer revenues
    - Getting to proper ticket revenues requires the $300 million overhaul of KeyArena to satisfy high end customers
    - Mayor has put forward an initial proposal for this: $100 million from the City, $100 million from the State/County, $100 million from ownership group that could prove viable (more on this later)
    - If built, and if revenue streams are redirected, the franchise can make money sufficient to produce a viable product and be generally profitable
    - A $300 million overhaul of KeyArena would represent the least costly, most politically viable option for achieving a reasonably competitive facility
    - City has the ability to put additional land in play to enhance KeyArena; create additional revenue opportunities for the franchise; and, possibly, meet other community public facility needs including creation of high end meeting space

Seattle's Current NBA Situation Mitigates All Three Challenges

- Reputation
  - The hole the Oklahomans have dug for themselves creates the possibility that, handled correctly, the average citizen will view a new local owner as a white knight
  - Such a positioning has worked repeatedly in local sports team history
    - Current Mariners and Seahawks ownership still benefit and, notably, both got new stadiums as a reward

Seattle's Current NBA Situation Mitigates All Three Challenges

- Reputation (cont.)
  - Such a positioning is perishable, and it takes careful work to gain full benefit
  - It is not immaterial to the entire effort: it makes possible the politics of appropriate public participation in an upgraded facility
  - It is also important to help cause an NBA-supported sale

Seattle's Current NBA Situation Mitigates All Three Challenges

- Reputation (cont.)
  - There are notable characteristics common to achieving this status:
    - Timing (being late to arrive = savior!)
    - Reticence (not just a rich boy buying a toy = civic act!)
    - Sacrifice (financial contribution to the solution must be meaningful, especially relative to prior ownership's demands = worthy of public partnership)
    - Aligned with rather than fighting local political leadership
  - Two of these four are already true (timing and alignment) and the others are unilaterally controllable

The Path Forward

- To gain fully the benefits of the current situation, it is time to act (heroic entry point, but still time for the right things to happen)
- For the best likely outcome, two things have to happen next: Oklahomans have to be willing to sell and the public folks have to do the right thing

The Path Forward

- The effort hinges on positioning the new ownership to wear the biggest "white hat" possible
  - NOTE: This does NOT mean coming forward will be hugely popular, just sufficiently popular to give politicians the room to help without damaging their careers and mitigate the natural reputation risk of ownership
- Of the four ideas that can contribute to a white hat (timing, reticence, sacrifice and alignment) two are in place and two require effort

The Path Forward

- Reticence
  - This is what separates, in the mind of the public, the "ego-driven" from the "civic-driven" owner
  - Three strategies help
    - Profile
    - Politicos First
    - Sacrifice

The Path Forward

- Profile
  - Think Mark Cuban or Howard Schultz at courtside versus Mariners owner who has never attended a game. Even Paul Allen wasn't visible until the franchise was winning and scars of stadium fight had receded (part of why he has a good reputation with Seahawks and lousy in Portland)
  - Being out of sight also lowers effectiveness of "attacking the billionaire" in the political process
  - Now is perfect time to capture this space, as current work/family commitments make "absenteeism/civic-mindedness" more believable
  - Can always change profile later (when time frees up and to associate with a winning product during less controversial times)

The Path Forward

- Politicos: Let the Public Guys Lead
  - With the offer the Mayor has made to us and the planned trip to NYC, the Mayor wants to make this happen; let him
  - The benefits of this are myriad:
    - You save time/money/political aggravation
    - You are dispassionate "if this helps the community and can be done right, I'll help, if not, no problemo"
    - You can always lend a hand at certain critical junctures (using others or directly)
    - Changes situation so that politicos have basis for change of heart

The Path Forward

- Sacrifice: Contribute to the Solution
  - The current bunch offered so little as to create the perception – and reality – of enrichment at the expense of the public
  - They also made demands for a facility beyond what is necessary, requiring an even larger subsidy
  - Offering to contribute more and demanding less opens the room for politicos to change their positions

The Path Forward

- Sacrifice: Contribute to the Solution (cont.)
  - The Mayor has proposed a $300 million solution divided evenly three ways: City, State/County, Private
  - Accept that a viable facility can be created for $300 million, although this will take some effort to convince the league -- beginning with Deputy Mayor/Gorton visit
  - Important to offer a contribution calibrated to outshine prior and existing owner offers
  - Creates obvious political alignment with City
  - Leaves a difficult, but realistic, State/County maneuver

The Path Forward

- A Thought About Alignment
  - Many believe (and we agree) that Seattle is the logical location (least disruptive to fans, KeyArena remodel least costly to new owner and to public, etc., most powerful media center will support)
  - Creates alignment with one of the key figures in all of this (the Mayor)

The Path Forward

- These steps get the "biggest white hat possible"
- Now, how to use it to:
  - 1. Make the team available for purchase
  - 2. Get KeyArena and the lease fixed

The Path Forward

- Making Them Sell
  - The critical path is to separate the NBA from the Oklahomans, while increasing the exposure for each
  - The City has taken the first of several steps, and is about to take the second:
    - First, they hired Slade Gorton and used the misstep of an out-of-state arbitration filing to file suit, increasing the prospect of locking them into losses in Seattle
      - This also exposes the league to embarrassment in a market they like
    - Second, the City is going to make sure the league understands its new realism

The Path Forward

- Making Them Sell (cont.)
  - Meanwhile, we have maintained communication with the league, and we believe:
    - It wants a Seattle solution
    - It is frustrated by the Oklahomans
    - It is unsure that the City is serious
      - Again, it is all about the venue
      - It needs to be made to believe $300 million is sufficient
    - But, it knows of no other ownership solution

The Path Forward

- Making Them Sell (cont.)
  - So it is a pincer movement: increasing the Oklahomans costs in an unpleasant environment while increasing the league's belief that an alternative solution gains it a good new owner and keeps it in a desirable market
  - The hope then is that either the Oklahomans choose to exit or that the NBA offers them an out. (A logical example: orchestrate a sale of the Sonics to local owners at a reasonable price and then have the Oklahomans buy New Orleans and keep it in Oklahoma City where it is playing now.)

The Path Forward

- Facility and Lease
  - Mayor's proposal has merit (setting aside the level of private contribution); how do we make it happen? (In part, make it his problem!)
  - The Mayor appears to have identified the resources for the City's $100+ million he is offering and the ability to deliver on both the investment and a new lease (notably, he has not lost any key City Council fight during his service). Note, he already plans to ask voters for additional tax revenues for the Seattle Center next year
    - And the City ponying-up will greatly help political dynamic with State

The Path Forward

- Facility and Lease (cont.)
  - The State/County $100+ million is more problematic
  - The obvious answer is the monies already being raised for the Safeco Field bonds
    - If there is no action, they expire when bonds are paid off (2012)
    - But the taxes were authorized for a longer period (2016)
    - The idea most often discussed is to continue collections through 2016, and not let them expire with the bond pay-off
    - Two groups being taxed (restaurants, car rentals) are generally amenable and together account for the bulk of the income available, but they represent only two of the three key sources
      - The third is a State tax credit, which causes forgone revenues to State (which is why all legislators care)

The Path Forward

- Facility and Lease (cont.)
  - This creates as much as $300 million*, which five groups are eyeing
    - Sonics (the $100+ million)
    - City of Seattle ($44 million or less for repaying balance of existing KeyArena renovation bonds -- amount depends on timing and attendance, so that it could be down to as little as $20 million by 2010)
    - Mariners (stadium needs $100 million or so for refurbishment at end of current lease term)
    - King County (wants a revenue source for other "public amenities," especially recreation)
    - Arts groups (minor monies, really and mostly satisfied from redirection of hotel/motel taxes after Qwest debt retired)

* Depends upon collection rates and how quickly outstanding Safeco debt is retired – this "frees" at least some of the revenue for other uses, but requires State and County legislation to access