UEFA FFPR and related party transactions: analysis

The aim of UEFA's Financial Fair Play Regulations (FFPR) is to protect European football clubs from spending more than they earn. Martin Stopper and Tim Bagger, of Lentze Stopper Rechtsanwälte, examine how prohibitions within the FFPR on transactions with 'related parties' and on investment from third parties could contravene European law, and explain that a salary cap would be a more proportionate method of achieving UEFA's aims.

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Europe is the world economic centre of football. Nowhere else is the commercial exploitation of the game more successful. Europe pays the highest salaries for players and managers and the largest transfer fees. These developments in the professional football market are tied to the extreme pressure of competition that exists in Europe. As a consequence of these developments, the European Club Association (ECA) and European Football Association (UEFA) recognised the need for a controlling mechanism enforced through penalties for non-compliance and implemented by the instruments of UEFA´s regulations. UEFA therefore issued the UEFA Club Licensing and Financial Fair Play Regulations (FFPR). Not only do the FFPR have a controlling function through their control of club accounts, but they also influence the manner in which revenues are generated and costs are incurred, as they indicate which revenues and expenses can be included in the FFPR balance sheet.

The central aspect of the FFPR is to ensure that clubs taking part in UEFA competitions have at least balanced their books within a certain time period. In the event that the club's expenses exceed its income, the club may be sanctioned by UEFA. At worst, a club may be excluded from UEFA club competitions. Cautious financial management shall ensure compliance with the so-called 'break-even regulations'. The main objectives behind the introduction of the FFPR are the protection of the interests of the individual clubs, their players as well as the European football as a whole.

Content of the FFPR

The active monitoring of the financial status of individual clubs by UEFA will start with the 2013/14 season. This will also take into account losses made in the two preceding years (2011/12 and 2012/13). The FFPR are exclusively applicable for clubs qualified to take part in the UEFA Champions League or the UEFA Europa League. They do, however, not apply to national club competitions such as the Premier League or Germany's Bundesliga. Clubs not qualified for any UEFA club competition are not directly subject to the FFPR regulations, but have to apply for a UEFA club license as a part of the FFPR. The FFPR contain requirements in relation to sporting, infrastructural, staff, administrative, legal and financial matters. The FFPR provisions include, *inter alia*, a multi-year evaluation of the club situation in order to get a long-term overview over the entire context of European club football. This goes far beyond the current criteria, which mainly pursue the goal of evaluating the club's short-term financial situation. Compliance with the FFPR is supervised by the national associations within UEFA.

The break-even requirement

The most important principle of the FFPR is the so-called break-even requirement set out in Art. 58 ff. FFPR, which indicates that the club's income must not exceed its expenses. The focus of the break-even requirement is on the target that clubs - in principle - are able to self-finance all of their expenses through their income. Expenses for the 'typical business' of a club have to be financed by income from such 'typical business'. In this sense, Art. 60 FFPR states that income on the basis of which the break-even result is calculated shall be the so-called 'relevant income'. According to its definition in Clause A. 2 a) - h), Annex 10 of FFPR, the 'relevant income' shall include the following:

- income from gate receipts;
- sponsorship and advertising;
- broadcasting rights;
- commercial activities (such as merchandising);
- other operating income;
- income from the disposal of player registrations;
- excess proceeds on disposal of tangible fixed assets; and
- finance income.

However, according to Clause A. 2 i) - k) Annex 10, 'relevant income' is decreased if the above-mentioned elements include any items as follows:

- non-monetary credits;
- income transactions with related parties above 'fair value'; and/or
- income from non-football operations not related to the club.

The definition of 'relevant income and expenses' contains two aspects: Firstly, the non-inclusion of relevant positions allows the promotion of desired effects (e.g. expenses for the promotion of young talent or the financing of a new stadium) and, however, the negative accounting of undesired effects (e.g. income transactions with related parties). Secondly, according to the break-even requirement, the financial injunction of a patron in order to realise the transfer of a player is not considered 'relevant revenue'. This financial contribution will also not be considered for the calculation of the break-even result if the out-going and incoming investments are identical.

Objective valuation in case of related party transactions

Most likely, the most critical legal criteria regarding the break-even requirement is the exclusion of income transactions with 'related parties' above 'fair value'. The FFPR defines 'related parties' in an elaborate and slightly inexplicit way. In principle, it is intended to apply to companies which are related to a club in such way that they assume a controlling function within the club via corporation and/or shares. Parties not related in such a sense are - in particular - club sponsors, which are associated with the club exclusively through their sponsorship. This also includes sponsors who hold a minority share in a club; e.g. adidas at FC Bayern Munich.

According to Clause E. 7, Annex 10 of FFPR, 'fair value' is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable reasonable parties in an arm's length transaction. An arrangement or transaction is deemed to be 'not at an arm's length basis' if its terms are more favourable to either party than those terms which would have otherwise been agreed without any such relationship between the parties. Only transactions with such 'related parties' are subject to the 'fair value' evaluation. For instance, the sponsorship agreement between Volkswagen and the club VfL Wolfsburg will be monitored regarding its 'fair value', as Volkswagen is a majority shareholder of the club. This means that the income from such a sponsorship may only be taken into account for the calculation of 'relevant income' if the value of the transaction is considered 'fair value', and service and consideration face each other in a reasonable proportion.

It is doubtful if the FFPR restrict the freedom of movement of capital and/or the freedom of competition in a proportionate and reasonable way

The question as to whether a club has concluded a sponsorship agreement with a related party or an unrelated party has already led to the first 'creative' third party transactions in professional European football. It is reported that Qatar Sports Investment, which controls the club Paris St. Germain, has provided financing of approximately €250 million since 2011. Qatar Sports Investment, as a related party, would not be permitted to make any payments beyond the scope of the 'fair value' rules. In the future, the Qatar Tourism Authority will pay Paris St. Germain a sponsorship fee of approximately €150 million-€200 million per annum as an unrelated party. According to the FFPR, the question as to whether these large amounts are a justified sponsorship fee shall not be relevant as long as the Qatar Tourism Authority is not a related party. This example and other recent cases may demonstrate that the classification in terms of 'good' and 'bad' income is likely to fire the creativity of the clubs. Furthermore, it is generally doubtful as to whether this classification of club sources of finance is legally permitted.

Restriction of the freedom of movement of capital

According to Court of Justice of the European Union's (CJEU) decision in Meca Medina/Majcen[1], regulations of sports federations - such as the FFPR - fall into the scope of European Union law. According to Art. 63 of the Treaty on the Functioning of the European Union (TFEU), all restrictions on the movement of capital between Member States and third countries are prohibited. A restriction on the freedom of movement of capital is only justified if it is suitable to protect any legal interest in a proportionate and reasonable way, and the scope of the freedom of movement of capital becomes secondary to this legal interest. The legal interest which UEFA intends to protect by the FFPR is not kept general (such as a denomination 'preservation of the culture of football'), but it defines its purpose of protection by the question of how these goals may be reached. UEFA wants the clubs to keep their books balanced on a sustainable basis, but also wants to restrain the upward spiral regarding payments for players, transfers and agents in such a way that 'arbitrary' high levels of investment from parties related to the clubs are excluded. This may only be achieved if such payments are not approved as relevant income.

The FFPR functionally restricts investment decisions in the free market in such a manner that a football association may exert influence over any third party. It appears highly doubtful that the FFPR thereby meet above-mentioned criteria regarding the proportionality and reasonability. Why should influencing corporate decisions of third parties be justified if the same legitimate purpose can be reached by enforcing a restriction of capital flow for the clubs directly? In the event of such a direct restriction on the club, there would also be the possibility of suitable penalties. Compared to forcing any related third party to invest in a club sponsorship within the scope of an externally indicated 'economic rationality', it could well be considered a more proportionate restriction of the freedom of movement of capital if a club is restrained from spending more than a certain amount in a year, especially on players, managers and agents. For UEFA, such an option would be a far easier task to implement than having to define which payments are to be considered to be in accordance with the 'fair value' regulation.


Tim Bagger

Restriction of the freedom of competition

For the purposes of application of Art. 101 TFEU to a particular case, account must first of all be taken of the overall context in which a decision was taken or produces its effects. It has then to be considered whether the consequential effects are inherent in the pursuit of those objectives and are proportionate to them. Freedom of competition is the pursued objective which may be exclusively restricted by justified interventions. As a consequence of the FFPR, a related party is - for example - restricted in its commercial decision to what extent and what terms it wants to compete for a club sponsorship. The FFPR's distinction between related and unrelated parties does not seem comprehensible, because the aim of the restriction is not only to limit the influence of third parties, but also to prevent the uncontrolled rise of the salaries of players and managers, as well as agent fees.

This restriction of the freedom of competition by the FFPR can therefore be considered an unsuitable and unjustified restriction in order to regulate the quality of the financial flow of third parties, as this could also be achieved by directly restraining clubs regarding their expenditure.

Salary cap alternative

A more reasonable and proportionate restriction of European fundamental rights could be achieved by the introduction of a salary cap, as operated in US professional sports. In principle, a salary cap could impose a maximum season budget which a club is permitted to spend on player salaries. This would not necessarily be a cap on individual remunerations, as a club would still be permitted to hire expensive 'star players' as long as the cap for the entire team - which means the sum of all salaries - is not exceeded. It has recently been reported that England's Premier League is considering the implementation of a salary cap in order to control club spending on player salaries and to ensure the long-term sustainability of the Premier League clubs.

But European leagues - unlike the professional leagues in the US - do not have a stand-alone position. Football is played worldwide at a more or less comparable level. In this respect, the implementation of a salary cap in Europe could lead to the emigration of players or managers to jurisdictions which do not operate a salary cap. Furthermore, a salary cap would restrict the autonomy of the European clubs, which would go against the historical development of them as autonomous entities and could shake the self-conception of many clubs to the core - even if such a restriction was legally permitted.

Conclusion

UEFA's FFPR are about the goal that in principle, the clubs participating in European competitions should not spend more money than they earn. As a reasonable budget management of a professional football club is indispensable, appropriate provisions and penalties are, beyond doubt, generally lawful. At a national level, similar licensing procedures have already been in existence for a long time. In addition to the pursued objective of reasonable budget management, UEFA wants to achieve other sporting political goals through the FFPR, such as limiting exorbitant payments to players and agents. To achieve this, UEFA decided that only certain income and expenditure are considered admissible to the FFPR accounting of the clubs. A special restriction has been established for 'parties related to the clubs', as they are not permitted to make 'excessive' payments to a club. Regarding the provisions of the TFEU, it is doubtful if the FFPR restrict the freedom of movement of capital and/or the freedom of competition in a proportionate and reasonable way. A more appropriate restriction would be a regulation on the level of club spending as opposed to a restriction on the investment level of related third parties. This could be achieved, for example, by the implementation of a salary cap that could set a clear and transparent limit for the amounts which a club may spend on players per season.

If any salary cap system introduced in England is successful, excessive payment flows for player salaries paid by related parties may become less relevant. But in any event, for other European leagues, the FFPR will remain an on-going topic for the coming years.

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1. See 'Doping: Meca-Medina and Majcen v Commission', World Sports Law Report Volume 2 Issue 11, November 2004. Available at http://www.e-comlaw.com/world-sports-law-report/article_template.asp?ID=646