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**Abstract**

The article documents the high incidence of insolvencies occurring in recent years among professional British football clubs which has led to a select committee of the House of Commons to call for a change in insolvency law to make illegal the so-called “football creditors rule”. The rule has been cited as a major cause of financial mismanagement (and the high level of insolvencies) in professional English football. The article considers the 2012 High Court decision in *HMRC v The Football League* which represented an unsuccessful attempt by Her Majesty’s Revenue and Customs to obtain a declaration from the High Court that the football creditors rule contravenes the basic principles of insolvency law, the *pari passu* rule and the anti-deprivation principle which are described in detail. The article also analyses the governance of English football and considers whether self-regulation should give way to legislation to prevent the insolvency malaise that afflicts the professional game in England. The article concludes by assessing whether the Financial Fair Play rules introduced in 2012, which may mitigate the harmful effects of the Football Creditors Rule, are a long term solution to the indebtedness of top flight professional football clubs.

Keywords

Insolvency; sport; football creditors rule; Financial Fair Play rules.

***British football club insolvency: regulatory reform inevitable?***

Introduction

Two reports published in 2011[[1]](#footnote-1) and 2013[[2]](#footnote-2) by the House of Commons Department of Culture, Media and Sport select committee (“DCMSSC”) articulated a grave concern with the current governance of the English national game and in particular with the football authorities’ failure to regulate the financial recklessness of many professional clubs. In the introduction to the 2013 report the Committee referred to the collapse of the preeminent British football club Glasgow Rangers FC in June 2012 as

“*a powerful example of the excesses of professional clubs in competing with one another, and the consequences for their community when mismanagement leads to financial collapse”.*

The committee’s stark recommendation was that the government intervene to remedy the lack of proper governance in the national game; and introduce legislation to outlaw the so-called Football Creditors Rule (“the FCR”) which it branded “immoral” and both a cause and symptom of the mismanagement of football clubs’ finances. The All Party Parliamentary Football Group advocated the abolition of the FCR as long ago as 2004.

The FCR provides that when a club playing in the English Football League (“the FL”) becomes insolvent, repayment should be made first to football creditors of the insolvent club (chiefly players and other league clubs); and that where football creditors are not paid a club can be expelled from the FL. The FL comprises three divisions, the Championship and Leagues One and Two. A similar rule to the FCR applies (subject to minor variations in detail) to clubs in the division above the FL, the Premiership (the top league in English football and the wealthiest domestic league in world football). Two striking examples of the operation of the FCR, referred to by the DCMSSC, are the administrations of Crystal Palace FC in 2010(£1,925,000 of football creditors) and Plymouth Argyle in 2011 (owing Her Majesty’s Revenue and Customs (“HMRC”) £300,000[[3]](#footnote-3) and football creditors i.e. players and other club employees £3.5 million[[4]](#footnote-4)) both of which resulted in payment in full to the football creditors and payments to other unsecured creditors (including HMRC) of 2 pence and 0.77 pence in the pound respectively[[5]](#footnote-5).

Delivering the January 2013 report of the DCMSSC John Whittingdale MP, Chair, calling for new law to outlaw the FCR said:

"*the financial risk-taking by clubs is a threat to the sustainability of football as a family and community orientated game, which it should be. This is a central issue which must be addressed and real solutions – and the will to make the necessary changes - have been glaringly absent from the proposals so far. We recommend that the DCMS make it clear to the football authorities that further progress on these issues is expected within twelve months. If football cannot reform itself, the Government should introduce legislation as soon as practically possible."[[6]](#footnote-6)*

This article explains in detail the FCR, analyses a decision of the High Court in 2012 on the lawfulness of the rule, and considers in the light of the growing number of insolvencies in professional football clubs in the UK whether, and if so how, the government needs to step in to rescue the national game from its own governing body.

The Court of Justice of the European Union[[7]](#footnote-7) has referred to the specificity of sport in excepting the decisions of sports regulators from rules on discrimination and unfair competition. This article will consider whether “the sporting exception” applies equally to insolvency law.

Football Governance

The Football Association (“the FA”) is the governing body of English football and has responsibility for the domestic game at all levels (professional, recreational and youth) and represents English football internationally. Ultimately the responsibility for the existence of the FCR lies with the FA.

“*Football is the worst governed sport in this country, without a shadow of doubt*", in the words of the then United Kingdom Sports Minister Hugh Robertson in a House of Commons debate on 20th January 2011[[8]](#footnote-8). The FA has a dual board structure comprising the main Board (the executive) and the Council. The Council has approximately 120 members[[9]](#footnote-9) (two thirds of whom historically are aged over 64) and meets five times a year for approximately two hours to approve Board decisions without the benefit of any detailed briefing papers. Clearly power lies with the main Board. Because this twelve member Board was dominated by representatives of the professional leagues, the 2011 DCMSSC report concluded that the structure of governance represented by the Board and Council gave too much power to the top professional clubs with insufficient scrutiny from independent experts and the grassroots including junior and women’s football. The select committee therefore recommended (in addition to scrapping the FCR) a rationalization of the committees and bodies reporting to the Board and for a majority of the Board to be executive FA officials not representatives of the football leagues.

In a joint communication dated 9th March 2012 to the DCMS[[10]](#footnote-10) from the FA, the FL, the Premiership and the National Game Board (a committee of the FA Board), the football authorities responded to the recommendations made in the committee’s 2011 report. While the communication proposed some minor changes to the way the national game is run by the FA, it fell short of adopting the recommendations for root and branch governance change made by the select committee in 2011. Consequently the select committee issued its second report on 29th January 2013 which called for the government to step in and legislate to outlaw the FCR. The select Committee expressed the view that football’s governance system was so weighted towards representatives of the football leagues (including the Premiership) that it precluded self-reform:

“*While it is inevitable that the paymaster will have far greater influence than the other bodies in a representative organization like the FA, we are disappointed that the proposals have not sought to alter this balance of power….We are concerned that a number of key decision areas have been delegated from the FA to the NGB (the National Game Board) and PGB (the Professional Game Board), with the regulator in effect ceding power to the regulated.”****[[11]](#footnote-11)***

Application of the Football Creditors Rule by the Football League

The FL is a limited company in which 72 shares of five pence each have been issued, one to each of the clubs playing in one of the three divisions comprising the League. Any club joining the League via promotion from the Football Conference (the tier of clubs below the FL) or demotion from the Premiership has a share transferred to them from the club they are replacing. The share is known in football circles as the “golden share”.

Relations between the FL and individual clubs playing in it are governed by the **articles of association** of the FL, and the **Regulations** which are adopted by the clubs in general meeting under article 26.1. An **Insolvency Policy** adopted by the FL Board sets out the policies of the FL in the event of an individual club’s insolvency.

Individual clubs in the FL do not negotiate and earn their own income, this comes to them largely through membership of the FL. The FL collectively represents the FL clubs in negotiating the contract for the televising of FL matches (the biggest single source of the clubs’ income stream)[[12]](#footnote-12). In addition to receiving from the FL their share of these television monies the clubs each also receive a “basic award payment” representing other sponsorship and media deals negotiated by the FL on behalf of all its member clubs (in 2012 £620,000 for a club in the Championship, the top FL division[[13]](#footnote-13)). The FL negotiates both the TV rights and other media and sponsorship deals as principal on behalf of all the clubs in the FL, and the monies from the deals are paid direct to the FL, with the right of the individual clubs to receive them being conditional on their abiding by the FL rules (including the articles and Regulations referred to above). The clubs receive their respective shares of the media rights and sponsorship monies from the FL out of what is known as the **“Pool Account**”.

The component parts of the FL’s constitution which together comprise the FCR were analysed in the judgment provided in the High Court challenge to the FCR by HMRC (see further below) as follows:

**Article 4.7.4.** This imposes a share transfer clause obliging a club on being “subject to an insolvency event” to transfer its FL share. An insolvency event is defined under the articles as including all the statutory insolvency regimes under the Insolvency Act such as administration, Company Voluntary Arrangement, an arrangement with creditors generally and winding up.

**Article 4.8.** This provides that the FL may suspend the share transfer call if football creditors[[14]](#footnote-14) are paid in full. Therefore the contractual right to withdraw the golden share (which if activated would cause the club to cease to exist and repay to the FL all payments from the Pool already made for that season, see below) is suspended on condition that football creditors are repaid.

**Article 77.3.** This makes it a condition precedent of receiving the payments from the Pool Account that a club plays all its fixtures in a season: "*Payments to Member Clubs under the Articles only become a legal liability of The League to a Member Club, if the Member Club completes all of its fixture obligations to The League for the relevant Season.*" The clubs receive under article 77.1 twelve monthly interim payments on account during the season but article 77.3 provides that they are repayable on demand if not all fixtures for the season are completed.

**Article 80.2.** This provides that the FL may use monies due to a club from the Pool Account to pay football creditors if a club defaults in a payment due to a football creditor. Football creditors are defined by articles 2.1 and 80 and include any monies owing by clubs to employees (i.e. wages), the FA and the major clubs associated with them including all Premier League, FL, Football Conference clubs.

**Regulation 61.** This stipulates that on ceasing to be a member of the FL (i.e on transfer of the golden share) player registrations lapse (vesting in the FL) and clubs therefore lose the possibility of selling the players. Usually the most valuable assets owned by the clubs are the players registered with them.

The combined effect of these rules is to force football clubs to pay “football creditors” (if necessary in preference to other creditors) or face expulsion from the League and effective dissolution as commercial entities; thus frequently leaving non-football creditors (for example the taxman i.e. HMRC) high and dry.

One effect of the FCR is that clubs have traded extravagant sums in return for selling players to one another, in the knowledge that the debts are effectively underwritten by the “rules of the club” which place football creditors (i.e other football clubs) in a preferred position to other club creditors (i.e. normal unsecured trade creditors). The FCR has in effect created a false market within the world of football; one reason for the spiraling wages of footballers. The FCR encourages clubs to overreach themselves and many have as a result become insolvent.

In 2012, the year when the High Court delivered a verdict on the legality of the FCR (see further below), the then current television deal for broadcasting rights for Football League matches brought £264 million[[15]](#footnote-15) to the Football League over three seasons, and yet in the ten years leading up to the case there had been 36 [[16]](#footnote-16)insolvencies in clubs attached to the Football League.

Background to Her Majesty’s Revenue and Customs’ challenge to the FCR; the anti-deprivation and *pari passu* principles of UK Insolvency law

In 2012 HMRC, who not being a “football creditor”, have been the biggest loser from the FCR and the spate of football insolvencies, challenged the legitimacy of the FCR before the High Court. An unusual feature of employment contracts offered to athletes in team sports such as football is that they tend to be long fixed term contracts. This of course means that the club’s PAYE and NIC obligations for expensive players are a commensurately large liability owed to HMRC by clubs.

The outcome of HMRC’s legal challenge to the FCR turned of course on UK insolvency law. The overiding principle of UK insolvency law is the rule that an insolvent’s estate must be distributed to their creditors equally without preference to either an individual creditor or indeed a particular class of creditors. These rules are found in ss.238-245 of the Insolvency Act 1986 in the case of companies and ss.339-344 in the case of individuals, and prevent diminution of an estate, through preferences and transactions at an undervalue entered into prior to insolvency. The overarching principle of treating all creditors fairly is of course subject to enhanced rights to some creditors, such as those who have taken security for their loan, and a general statutory class of “preferential creditor” (largely now confined to employees in respect of a small part of their unpaid wages).

Underpinning this principle are two, possibly overlapping as we shall see, common law rules, namely, the *pari passu* principle, and secondly, the anti-deprivation rule.

The *pari passu* principle

The common law *pari passu* principle ensures creditors are paid in equal shares. In *British Eagle International Airways Ltd v. Cie National Air France* [1975] 1 WLR 758, the House of Lords upheld the rule that any attempt by parties to contract out of the *pari passu* principles contained in UK insolvency law is void.

Peter Gibson J in *Carreras Rothman Ltd v. Freeman Mathews Treasure Ltd [1985] Ch 207* at 226 summarised the ratio of the decision in British Eagle thus:

"*where the effect of a contract is that an asset which is actually owned by a company at the commencement of its liquidation would be dealt with in a way other than in accordance with [the statutory pari passu rule] …. then to that extent the contract as a matter of public policy is avoided*" (approved in *Belmont*, see below, at [8] by Lord Collins).

It matters not what the purpose of the parties making the contract was; and, as in *British Eagle*, a contract may be void even though it was a bona fide commercial arrangement made for reasons unconnected with insolvency.

The anti-deprivation principle and its relationship with the pari passu rule

The common law anti-deprivation principle prevents contractual provisions between parties whereby one agrees to transfer to the other its assets in the event of the transferor’s insolvency. The existence of the anti-deprivation rule was upheld by the Supreme Court in *Belmont Park Investments PTY Limited v BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc [2011] UKSC 38* in which Lord Collins at paragraph 1 stated:

"*The anti-deprivation rule and the rule that it is contrary to public policy to contract out of pari passu distribution are two sub-rules of the general principle that parties cannot contract out of the insolvency legislation. Although there is some overlap, they are aimed at different mischiefs….The anti-deprivation rule is aimed at attempts to withdraw an asset on bankruptcy or liquidation or administration, thereby reducing the value of the insolvency estate to the detriment of creditors. The pari passu rule reflects the principle that statutory provisions for pro rata distribution may not be excluded by a contract which gives one creditor more than its proper share*."

It is of course possible for both principles to apply simultaneously, as Lord Mance noted at [149] in Belmont "*it is unsurprising that the facts of some of the authorities (e.g. Whitmore v Mason 2 J&H 204 and ex parte Mackay) might plausibly have been analysed as falling within either principle*". The judge made anti-deprivation principle therefore complements the statutory rules (which as noted above are found at ss.238-245 of the Insolvency Act 1986 in the case of companies and ss.339-344 in the case of individuals) which prevent diminution of an estate, through preferences and transactions at an undervalue entered into prior to insolvency.

However *Belmont* is also authority for the principle that “*bona fide* commercial transactions” (i.e. those not specifically designed as a means to subvert the statutory insolvency regime) can save an agreement from running foul of the anti-deprivation principle. The facts of *Belmont* had to do with subordination or “flip” clauses in the issue of loan notes. The validity of the “flip” clauses were upheld. At [104], Lord Collins said:

"*The policy behind the anti-deprivation rule is clear, that the parties cannot, on bankruptcy, deprive the bankrupt of property which would otherwise be available for creditors. It is possible to give that policy a common sense application which prevents its application to bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy*."

The tensions between the provisions of the Insolvency Act and the *pari passu* and anti-deprivation rules, as applied to *bona fide* commercial arrangements were examined in a High Court decision in 2012 specifically ruling on the legality of the FCR.

HMRC v The Football League[[17]](#footnote-17)

The background to the case was the reform to UK insolvency law made by the Enterprise Act 2002 in which HMRC lost its preferred creditor status. As a preferred creditor HMRC had been ranked above ordinary unsecured creditors in terms of unpaid tax bills when a liquidator was winding a business up. As a result of the FCR, HMRC, since it no longer enjoys preferential creditor status, loses significant income from unpaid taxes due from insolvent football clubs. A BBC investigation for the Donal MacIntyre programme found that in the years 2000-2008 alone 42 professional clubs in the Football League and lower divisions went into administration leading to nearly thirty million pounds in unpaid tax bills being written off. Leicester City FC’s administration saw just 10% of the seven million pound tax bill being received by HMRC.[[18]](#footnote-18)

To counter these losses therefore, HMRC brought a claim to the High Court for a declaration that the FCR infringed both the *pari passu* rule, which as we have seen holds that the assets of an insolvent estate are distributed in equal shares to all creditors (saving certain secured and preferential creditors, as defined by statute), and the anti-deprivation rule, which operates to make unlawful any attempt to deprive creditors on account of an insolvency of the assets from an insolvent’s estate.

The opening paragraph of the Court’s 2012 judgment in HMRC v The Football League (which runs to 189 paragraphs) summarises the FCR:

“*These proceedings concern the so called "football creditor rule" operated by The Football League Limited (the FL). Its purpose and effect is to ensure that in the event of a member club becoming insolvent particular classes of creditors, such as other clubs in the FL, the club's players, managers and other employees and the FL itself, are paid in full in priority to any other creditors. These preferred creditors are called "football creditors" by the FL. It means, the FL acknowledges in its evidence, that football creditors will be paid in full before, for example, the St John Ambulance which provides first aid at many clubs' grounds during matches*.”

HMRC’s claim was against the Football League but as similar principles to the FCR apply to insolvent clubs in the Premier League (the Premiership), the top flight of English football, the Premier League intervened in the case.

HMRC’s case

HMRC pleaded that:

“*The Football League applies its Insolvency Policy so that the Notice of Withdrawal [of the golden share] is suspended subject to conditions including that all Football Creditors are paid in full. Thus the Football League acts with the deliberate intention that where a Club is insolvent Football Creditors are paid in full whilst other unsecured creditors who belong to the same class are not. This intention is manifest from the provisions of the Articles and the Insolvency Policy referred to above…..”*[[19]](#footnote-19)

HMRC argued that the interim monthly payments to the clubs out of the FL’s Pool account was property belonging to the clubs as soon as they received them; and that the FL’s rules that these payments were not the clubs’ property until the end of the season when all fixtures had been completed, was a sham designed to avoid the overarching insolvency law principles of treating all creditors equally (Article 77 states in terms that the monthly interim payments are not the property of the clubs, and can be demanded back, until all fixtures for a season are completed). HMRC put its case thus:

*“Article 4.7.4 and Section B1 are deprivation provisions and are void and unenforceable as a matter of public policy because property of the company[[20]](#footnote-20) – the FL Share – is purportedly removed from the company on the onset of insolvency.[[21]](#footnote-21)*…..*Articles 72.3 and 77.3 as applied under Section F and in particular F1 are deprivations and/or are penalty clauses and are void and unenforceable as a matter of public policy because their intended effect is that property of the company namely the right of the Club to payment is purportedly removed from the company on the onset of insolvency and the Club is obliged to repay all sums already paid to it by the Football League in that Season*." [[22]](#footnote-22)

The Football League’s defence

Although the FL did not specifically invoke the principle of the “sporting exception” thread that underlies so much of the jurisprudence of sports law, it is implicit in the FL’s submissions that sport is unique (and therefore the usual rules should be applied differently). For example:

i) in the interests of sporting competition, limits need to be imposed on the ability of clubs to gain an unfair advantage by buying players from other clubs and defaulting on paying for them;

ii) the whole edifice of a competitive sports league depends upon all clubs completing all fixtures, (and therefore only clubs who completed all fixtures should be entitled to keep monies from the Pool Account). In support of this submission, the FL argued that any sporting league structure is completely devalued if one or more clubs cannot complete all fixtures because for whatever reason they have pulled out of the league part way through the season. This principle applies equally to, say, an Under 11s eight a side rugby league as it does to professional football leagues. There cannot be a worthy winner unless all competitors have tested themselves equally in an “all play all” system;

iii) the nature of sport increases the risk of the “domino effect” i.e. where one club overspends, and then defaults on debts to other clubs, they might in turn become insolvent, leading to a string of insolvencies if not controlled. One of the most high profile cases of a leading football club becoming insolvent in recent years is Portsmouth FC. Football sources pointed out that were it not for the FCR then Watford FC could not have survived Portsmouth’s insolvency.[[23]](#footnote-23)

The FL argued that with regard to HMRC’s submission that monthly receipts from the Pool account, and the golden share vested in each Football league club, were property owned by the clubs, which therefore were subject to insolvency laws like any other assets, neither had any value until a club had completed all the season’s fixtures. Clubs only receive monthly interim payments on account of their Pool Account monies in order to trade through the season, but this did not alter the fact that they had no legal entitlement to the monies until they had completed all the season’s fixtures. Similar logic was applied to the “golden share”. The FCR deprives a club of its share in the FL in the event of insolvency, but, argued the FL, that share has no value since the club has no entitlement (under Article 77) to any monies from the Pool account unless it can honour all its fixtures for the relevant season. It follows from this, submitted the FL, that if the FL under Article 80 pays football creditors out of monies in the Pool standing to the account of the club, that is not property belonging to the club, since it only becomes entitled to the monies upon completion of the season’s fixtures.

The FL further argued that it would be unreasonable to expect clubs to continue to accept as a member of the League a club unable to pay its debts to the other clubs in the League. The FL referred to the case of *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd[[24]](#footnote-24)* in which a member was forced to transfer in the event of their insolvency their share enabling them to continue as a member of a Stock Exchange; in that case the liquidator lost their claim that the forced transfer was an infringement of the anti-deprivation principle.

Pari passu and anti-deprivation rules; administration and liquidation distinguished

The court provided a detailed analysis of the application of the *pari passu* and anti-deprivation rules to the FCR.

i) Article 80 payment from the Pool Account to football creditors.

Article 80 allows the FL to pay to football creditors monies in the Pool standing to the account of a club where a club defaults in payments to football creditors.

Would such payments infringe the anti-deprivation and pari passu principles? Richards J held that this would depend on whether insolvency proceedings are afoot and what stage they have reached; and that the two principles apply in different ways and at different stages of the insolvency.

Counsel for the FL and the Premier league submitted that the **anti-deprivation principle** cannot be applied until an administrator issues a notice of intention to make a distribution under rule 2.95(1) of the Insolvency. (It is only since the amendments to the statutory role and duty of the administrator made by the Enterprise Act 2002 that administrators have been authorized to make distributions.)

It is trite law that the anti-deprivation principle does not apply **before** an enterprise enters administration:

*“….where article 80.2 is triggered by a default in payment of a football creditor which occurs before the administration or liquidation, the anti-deprivation rule will not apply”[[25]](#footnote-25).*

This is based on *Belmont* where Lord Collins at [80] says without qualification that the anti-deprivation rule "is intended to operate only where the provision is made for deprivation on bankruptcy".

Richards J held that the anti-deprivation rule applied immediately upon a company entering administration, and not just from the point if and when an administrator made distributions*:*

“*But the purposes of an administration, which are as much a proceeding for the benefit of creditors as liquidation or bankruptcy, are equally hampered or frustrated by dispositions designed to avoid the administration process. The interests of creditors are likely to be best served by a survival of the company or its business, but depriving the company of assets on or by reason of administration may make that outcome more difficult to achieve and will certainly reduce the assets available to meet creditors' claims whether in full or on a composition under a scheme of arrangement or a company voluntary arrangement……In my judgment, there is no necessary reason for viewing the anti-deprivation rule as limited in its purpose to a support for the distribution of assets among creditors. Its purpose is to prevent insolvency proceedings from being undermined by dispositions of assets designed to avoid the effects of the insolvency proceeding. While liquidation and bankruptcy were the only insolvency proceedings, it was naturally referred to as a fraud on the bankruptcy law.”*[[26]](#footnote-26)

It follows therefore that where the FL operated article 80.2 in respect of non-payment of a football creditor by an administrator i.e. after administration has commenced, then the anti-deprivation principle would come into play, but only once the season had been completed, since until that point monies in the Pool Account were not an asset owned by a club. It seemed an unlikely possibility that a club would enter into administration after the end of the season and that the FL would then operate article 80 i.e. it would pay football creditors monies standing to the account of the club. As there was no evidence in the proceedings directly to the point the Court did not consider it necessary to rule definitively on this point.

On the other hand, **in the case of the *pari passu* rule**, Richards J found that the rule applied in the case of administration only afterthe administrator had commenced distribution*.*(In the case of bankruptcy and company winding up the rule applies from the outset since both conditions inevitably lead to a distribution of assets). The statutory purpose of administrations was where possible the rescue of a company and not its winding up and subsequent distribution of assets, which only arose in an administration where rescue was not possible:

*“As long as the survival of the company is the aim, or even the survival of the business as a going concern albeit under new ownership, application of the pari passu principle so as to render void some of its contracts could be very damaging…..In my judgment, the pari passu principle serves a purpose and should come into play only if the purpose of the insolvency procedure is to effect a distribution. In the case of liquidation or bankruptcy, this is when the company enters liquidation or the debtor is declared bankrupt. In the case of administration, this is when the administrator gives notice of the proposed distribution.” [[27]](#footnote-27)*

Further justification for this view is the fact that insolvency set-off applies in an administration to debts from the date the administrator gives notice of distribution.

 ii) the transfer of the golden share

Under article 4.5 the FL can compel a club to transfer its “golden share” if it goes into administration or liquidation. Is the anti-deprivation principle offended? Only if the share is of any value. Is the share of any value to an insolvent club? No, according to Richards J, for the simple reason that other clubs would in any event refuse to play a club who had no prospect of meeting its debts to other football clubs which is the effect of the FL Articles, Regulations and Insolvency Policy.

*“It is true that this stems from the articles and the power of the board, not from the ad hoc decision of clubs individually or collectively. However, the FL is composed of the member clubs. The articles are the collective expression of the member clubs. The articles were adopted by the member clubs and they can be amended by the member clubs. The obligations of member clubs to play all other member clubs in the league exist alongside the provisions in the articles applicable to insolvent clubs. The latter are the terms on which member clubs commit themselves to play the other member clubs. As HMRC put it in their particulars of claim, the articles, regulations and Insolvency Policy "are the terms upon which clubs contract with the Football League and with each other".”[[28]](#footnote-28)*

The fact that other clubs have the right further to the articles to insist football creditors are paid if the club is to stay on in the league is a contractual arrangement all clubs are party to.

Previous authorities support this proposition, namely the decisions of the Privy Council in *The Official Assignee of Bombay v Shroff (1932) 48 TLR 443 (Shroff)* and Neuberger J in *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd [[2002] 1 WLR 1150](http://www.bailii.org/cgi-bin/redirect.cgi?path=/ew/cases/EWCA/Civ/2001/117.html" \o "Link to BAILII version) (MMI).* These cases both concerned shares in the company or association owning the assets of a stock exchange and their compulsory transfer for no consideration from a member expelled on account of his insolvency. In both cases the claims by trustee in bankruptcy or liquidator of the expelled member that the compulsory transfer offended the anti-deprivation rule failed.  In Richards J’s words

*“The importance of these cases for present purposes lies in their recognition that members of a trading association cannot be required to deal with, or play against, a member which defaults in its obligations to other members and the loss of membership for no consideration is a permissible response to such default.”[[29]](#footnote-29)*

The Court’s ruling in the HMRC case

In a judgment running to 189 paragraphs the High Court opted not to give the declaration sought by HMRC that on public policy grounds the FCR be ruled unlawful as infringing the principles of insolvency law. Whilst the court accepted that a strong moral case could be made against the FCR; and the court acknowledged that the FCR meant in practice that normal unsecured trade creditors such as kit suppliers not to mention organizations like the St Johns ambulance service who attend matches to treat serious injuries lose out to highly paid footballers, in the words of the judge, Richards J. :

*“These proceedings are not concerned with whether giving priority to football creditors is socially or morally justified*[[30]](#footnote-30)*”*

Evidence was given at the High Court trial by Andrew Williamson, the FL’s Chief Operating Officer, an employee since 1971 whom the judge, Richards J., credited with “*immense knowledge and experience of its workings*”. Richards J summarized Mr Williamson’s justification of the FCR and the FL’s Insolvency Policy:

*“(1) the football**club continues to exist in membership of The Football League**and so the interests of its supporters and their community and the continuity of The League are assured; (2) football**creditors are paid in full; and (3) the interest of all other creditors are also satisfied, as confirmed by the creditors' approval of the CVA which brings transparency to the sale process. "[[31]](#footnote-31)*

The reference at (3) is to the fact that the FL Insolvency Policy is to waive its right to transfer the golden share of a club in administration in order to allow the administrator to put together a Company Voluntary Arrangement (“CVA”) on condition that a term of the CVA is that football creditors are be paid in full. Under the 1986 Insolvency Act CVAs must, as a matter of law, be approved by 75% of unsecured creditors. Mr Williamson gave evidence of successful football club CVA administrations falling into two categories. In the first case the administrator is able to sell the major club assets i.e. its players, to allow the club to trade through the insolvency and emerge post administration as a solvent entity again, as happened in the case of Crystal Palace FC. The other type of administration sees the administrator obtaining loan funding from a consortium willing to buy out the club (as happened in the administrations of Wimbledon FC and Luton Town FC). A legal requirement of a CVA is that there is a 28 day period for any challenge to the High Court of the arrangements proposed in the CVA (one of which in the case of football clubs is that all football creditors are paid).

The Court found many aspects of the FCR very troubling. The Court held that

“*a club which buys players and is able to pay for them by not paying its lenders, suppliers or HMRC gains a competitive advantage over those clubs which live within their means”.[[32]](#footnote-32)*

The Court agreed with HMRC that the FCR actually encourages risk taking, since clubs can trade high prices in players knowing that they will get paid even though the buying club is not able to pay other creditors.

“*The rescue culture is not designed to advance the interests of one group of creditors over another”[[33]](#footnote-33).*

Significantly, HMRC pleaded its case in general terms, and did not rely on the facts of any particular club insolvency. Originally the claim had been linked to an application under the Insolvency Act 1984 in the administration of Plymouth Argyle FC, but that application was dropped when it transpired that Plymouth did not in fact have a significant level of football creditors. Richards J observed that although HMRC adduced evidence from various football club insolvencies

*“some of the critical facts which would be relevant to a challenge specific to many of those cases are not apparent.” [[34]](#footnote-34)*

Much evidence was adduced in relation to Portsmouth City FC, but as this club was during its administration relegated from the Premiership to the FL, the relevant issues related to the Insolvency Policy of the Premiership which was not technically in issue in the proceedings.

Richards J observed that the operation of the FCR in practice had two implications: i) the FCR invariably went into operation during the season, that is before all fixtures had been completed; and ii) the FCR was applied to clubs before the clubs went into administration let alone any distributions being made by the administrator. The court’s ruling on the lawfulness of the FCR was therefore based, in the absence of a detailed claim in a particular case, on a

*“paradigm case of an insolvency of a member club, an administration commencing during the season with no prior default in the payment of football creditors” [[35]](#footnote-35).*

The central issue in the case was HMRC’s submission that the monthly interim payments from the Pool Account were the legal entitlement, and hence property of, the clubs once received; this was rejected by the Court.

HMRC had submitted that the right of the FL to demand repayment by a club of Pool monies in the event a club did not complete all its fixtures was a “sham”. There is no evidence the FL has ever made any such demand. The court held that the fact that most clubs go into administration and are allowed to play through the season, explains why the FL has not made such a demand. Forcing an administrator to pay monies back to the FL would of course scupper the chances of the administration succeeding, making it likely that the club would not be able to fulfill its fixtures for the season, thereby damaging the integrity of the competition, the mischief that the FL was most keen to avoid.

The Court accepted the FL’s articles as a genuine contract between all Football League clubs, and as evidence that clubs agreed that only once all fixtures were complete did they have any entitlement to monies from the Pool Account, with the corollary that any instalment payments must be paid back if a club was unable to complete all fixtures.

*“Completion of all fixture obligations is a condition precedent to the debt arising in favour of the club. If therefore it does not complete its fixtures, no debt becomes due to it…”[[36]](#footnote-36)*

This conclusion can be said to accord with the special position sport occupies in relation to the law; what has been described as the “sporting exception”. The Court was able to distinguish interim payments from the Pool Account from for example stage payments in a building contract under which a builder is entitled under the contract to payment for completion of a stage upon the production of an architect’s certificate. The unique feature of the sporting context lies in the fact that the value of the FL’s competition is precisely that each club plays every other club twice i.e that the season as a whole is a “single venture”. The court accepted that there would be no value in the league structure if clubs dropped out part way through the season. Of course, different principles apply were the FCR invoked at the end of the season, but as stated above that was not considered by the court.

Windsor and Sidle (2012) commented that in future the circumstances where either of the common law insolvency rules could be applied to complex commercial transactions would be greatly limited by the Court’s ruling.

Roberts (2012), on the other hand, commented that the Court’s judgment clearly left the door open to future challenges to the FCR in a claim brought on a clearer factual scenario than that made by HMRC in the instant case. He also commented on the judge’s clear message that statutory intervention through a targeted reform of the Insolvency Act was viable were Parliament to feel strongly enough that the FCR was unjustifiable. MP Damian Collins, formerly a member of the DCMSSC, after HMRC lost their High Court claim, called for the football creditor rule to be made unlawful through targeted amendments to the 1986 Insolvency Act. [[37]](#footnote-37) There is a precedent for this, in the form of an amendment to the Insolvency Act 1986, at section 233, preventing utility providers (gas, electricity and water) making it a condition of continuing supply to a company in liquidation that it pays off existing debts to the supplier. This amendment was passed after the High Court in *Wellworth Cash & Carry (North Shields) Ltd v Northeastern Electricity Board* [1986] BCC 99, 265 refused to grant an injunction prohibiting the creditor, the Electricity Board, insisting as a term of continuing to supply electricity that existing debts be paid by the company in liquidation.

The consequences of HMRC’s defeat in the High Court- greater regulation to restrain financial recklessness in football?

Muller et al (2012, p 118) refer to the phenomenon of the “rat race” (Akerlof, 1976) identified in professional team sports worldwide; the process of ever increasing takings accompanied by higher numbers of financial failures among clubs.

Clubs find it very difficult to reduce expenditure when poor performances on the pitch lead to less income from trophies and most costly of all possible relegation to a lower league where incomes are reduced drastically. There is inevitably a correlation between a club’s demotion and administration, as the following show (the year of demotion is followed by the date of administration) : Middlesbrough (1985/1988); Crystal Palace (1998/1998); QPR (1996/2000); Bradford City (2001/2001); Leicester City and Ipswich Town (2002/2002); Wimbledon (2000/2002); Derby County (2002/2003); Leeds United (2004/2006); Southampton (2005/2009). The introduction of so-called “parachute payments” to demoted clubs has eased this problem.

The FL has over the years introduced various measures designed to curb overspending by clubs, in particular to protect HMRC.

New measures coming into force in March 2010 were introduced forcing clubs to provide the League with more stringent financial information designed to prevent insolvencies. In the absence of a sustainable plan the League is empowered to step in.

The FL has introduced “HMRC Reporting” for PAYE, so that if a club gets behind on PAYE payments to HMRC, embargos are placed on further club spending on players.

A nine point penalty was introduced after Leicester City FC’s administration to deter clubs from entering into administration. However evidence given to the DCMSSC in July 2012 by R3, the body representing 97% of UK Insolvency Practitioners criticized this initiative, saying it encouraged wrongful trading; a club which is insolvent and should call in an insolvency practitioner as an administrator would be discouraged from doing so as it would guarantee a loss of vital points.[[38]](#footnote-38)

A potential further reform is the creation of a new body to oversee acquisitions of football clubs. Currently, prospective new owners have to pass a “fit and proper person” test which has been criticized for failing to decrease the rising tide of football insolvencies. The case of Portsmouth FC illustrates the point where an individual linked to a bank which had been refused a licence to operate in the UK was given the opportunity to buy the club.

“*If Sheikh Mansour bin Zayed al-Nahyan is allowed to enrich Manchester City then Sulaiman Al-Fahim and his successors have to be allowed to impoverish Pompey”*

was how one reporter put it.[[39]](#footnote-39)

Financial Fair Play rules

The FIFA Financial Fair Play Rules are a pan European attempt to control overspending by football clubs. Muller et al (2012, p 118) have described the Rules an attempt to provide long term viability and sustainability of top flight professional European football. The Rules are being introduced in stages from the 2012/13 season to introduce limits on the debts arising from expensive player signings incurred by clubs taking part in European competitions. Clubs are expected to limit their losses to 45million euros in total over the 2011-12 and 2012-13 seasons.

In April 2012 the FL introduced its own version of FIFA’s Financial Fair Play rules into the Championship, with twenty one clubs voting in favour, and three against. The Chairman of the FL, Greg Clarke, commended the vote as “a courageous decision”. These rules require Championship clubs to limit their losses in the current (2013/14) season to £8 million, or face sanctions, in the form of a transfer embargo, or a fine if they have gained promotion to the Premiership.

In February 2014 it was reported that several clubs were threatening the FL with a legal challenge to the Financial Fair Play rules.[[40]](#footnote-40) The following extract from a letter from Manchester based law firm Brabners to the Chief Executive of the FL, Shaun Harvey, was quoted in the Guardian newspaper:

 *"It is likely that unless the FFP rules are modified, the Football League should expect a challenge from any number of clubs and/or players or agents suffering sanctions or the consequences of sanctions…".*

The stakes have been raised by the Premier League’s recent £5.5 billion 2013-16 TV deal which has increased to £23 million the “parachute payment” to a club in its first year demoted to the Championship. The winner of the Championship in 2012/13, Cardiff City, owned by Malaysian Vincent Tan, incurred a loss of £31 million, a relatively insignificant amount relative to the bonanza of a place in the Premiership.

Legal challenges are expected also to UEFA’s Fair Play Rules. 76 clubs, almost a third of the clubs involved in UEFA competitions and thus bound by the rules, are being investigated by UEFA for possible breaches of the rules. UEFA’s legal affairs director Alasdair Bell said in early 2014: "We are not afraid of [Uefa decisions] being contested…..We fully anticipate there will be challenges – it would be strange if there weren't. July and August could be a busy time."[[41]](#footnote-41)

Szymanski and Peters (2012, p 1) characterise the Rules as a form of vertical restraint and potentially anti-competitive under European competition law. It is too early to say whether they will have the desired effect, or even avoid a legal challenge. EU Commissioner for Competition Joaquin Almunia has been quoted as approving the UEFA Financial fair Play Rules.[[42]](#footnote-42)

On 30th April 2013 the UK Minister for Sport wrote a letter to the DCMSCC which it published:[[43]](#footnote-43)

 *“The implementation of FFP should gradually lead to clubs reducing their spending, and as a result, see fewer incidents of club insolvencies. I hope that the FFP, should, in turn, negate the need for football to rely on the Football Creditors Rule in cases of club insolvencies. However, we will monitor the effect this self-regulation has on the financial discipline and solvency of clubs, and, if necessary, will re-consider whether legislation is needed to address this issue.”*

Conclusion

Sport is no longer predominantly an amateur pastime as it is in the modern era a business estimated to equal 2% of the European Union’s Gross Domestic Product. However for such a significant part of the economy professional sport has fared particularly badly in terms of financial failures; since 1992, clubs have gone into administration more than 50 times in English football and Her Majesty’s Revenue and Customs has also presented more than two dozen winding-up petitions to football clubs. Franck (2010, p. 109), refers to the “genuine paradox of inexistent or constantly low operating profits despite almost exploding revenues”. As the rewards for success grow then clubs gear themselves higher and higher in the search for success, with the inevitable result that clubs overextend themselves. The Football Creditors Rule has meant that it is not footballers, some of the highest earners on the planet, or the clubs themselves, that lose out when a football club goes into administration but the taxpayer and other unsecured creditors. The successful defence in the High Court by the Football League of Her Majesty’s Revenue and Customs claim that the Football creditors Rule be declared void owes much to the judiciary’s long held view that sport remain self-regulated, as it has a special status. As a commercial organization the Football League relied in the High Court on the Belmont principle (that a *bona fide* commercial transaction can condone what would otherwise be infringement of the anti-deprivation rule) but also on what has been described as the sporting exception (that some latitude is required in applying the law to regulations governing sporting activities). The football authorities successfully argued that their ability to regulate their sport within legal limits should take account of the special nature of sporting engagements. The FL relied heavily in the High Court on the argument that the Football Creditors Rule plays an important part in upholding the “integrity of the competition”. The FL did not in terms submit that the “sporting exception” applies, but the writer suggests, in the light of the FL’s arguments in defence of the FCR, and the court’s judgment, that in effect the case demonstrates an application of the theory of the sporting exception to insolvency law. However, Parliament has stated its clear intention to intervene and outlaw the FCR if the football authorities cannot regulate to reduce reckless overspending by clubs courting financial disaster. It appears that the Financial Fair Play rules may not be as robust a solution to the problem as was hoped, making the prospect of government intervention into football’s financial problems a real prospect, at least in the UK.

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14. defined at articles 2.1 and 80 as essentially other FL clubs and employees thereof , the FA and the Premier League and its clubs, and some other FA associated Leagues [↑](#footnote-ref-14)
15. Paragraph 6 HMRC v Football League [↑](#footnote-ref-15)
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19. See paragraph 52 HMRC v Football League [↑](#footnote-ref-19)
20. HMRC’s case was that a club’s share in the FL, and “the attendant right” to complete fixtures or receive monies from the Pool Account, are each property within the meaning of s. 436 of the Insolvency Act. [↑](#footnote-ref-20)
21. See paragraph 54 HMRC v Football League [↑](#footnote-ref-21)
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27. See paragraphs 87 and 89 HMRC v Football League [↑](#footnote-ref-27)
28. See paragraph 165 HMRC v Football League [↑](#footnote-ref-28)
29. See paragraph 173 HMRC v Football League [↑](#footnote-ref-29)
30. See paragraph 3 HMRC v Football League [↑](#footnote-ref-30)
31. See paragraph 48 HMRC v Football League [↑](#footnote-ref-31)
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33. See paragraph 184 HMRC v Football League [↑](#footnote-ref-33)
34. See paragraph 58 HMRC v Football League [↑](#footnote-ref-34)
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43. <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmcumeds/156/156.pdf> [↑](#footnote-ref-43)