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ARTICLE

Paid in Full: A Critical Look at the Law and Economics of the Football Creditors Rule

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The Football League has recently modified its Football Creditors Rule. Once the sport's financial regulatory *bête noire*, the changes met with little fanfare. However, these amendments do not fundamentally change the essential structure of a regime that has seen criticism from the media, the judiciary, academics, and indeed has been subject to litigation by the British tax authorities. This paper examines the law and economics of insolvency in English football, framing the case of *HM Revenue and Customs v. The Football League Limited & The Football Association Premier League Limited* in its prevailing economic context and considering the particular legal challenge brought by HM Revenue and Customs, which was ultimately unsuccessful. Moving beyond the decision in the above cited case, a critique of the underlying cogency and validity of the Football Creditors Rule is provided, which is centred on the views espoused by Michael J. Sandel in *What Money Can't Buy: The Moral Limit of Markets*. Particularly, it is posited that the nature of the rule has served to debase the norms that should govern football clubs' financial management and has instead abetted a climate of free spending by systemically diminishing the downside risk of insolvency between football clubs.

Keywords: Football Creditors Rule; insolvency; financial regulation; Michael Sandel; sports law

Introduction

> 'The FA, Leagues and clubs all appeared defensive and uncomfortable about the Football Creditors Rule. They are right to be. The moral argument against it—that it harms the communities that football is supposed to serve—is persuasive on its own. There is, though, also a compelling systemic argument against it, namely that it positively encourages excessive financial risk-taking, in a system that already offers other inducements to so do, by offering a safety net to those who seek to benefit from such practices. The Football Creditors Rule should be abolished.'
>
> — Culture, Media and Sport Committee Report on Football Governance 2011

Insolvencies in football are emotive events. There are few organisations whose financial travails could provoke large-scale protests outside the headquarters of their bankers; however, this was precisely the scene as Crystal Palace faced liquidation in 2010 (Guardian 2010). Unfortunately, football insolvencies are also familiar; a surfeit of insolvencies has been the corollary of the more Gadarene tendencies of British football clubs. Szymanski (2012: 2) has described insolvency as 'a chronic problem in the world of professional Association football'.

The Union of European Football Associations (UEFA) has attempted to address the solvency issues within its jurisdiction through its 'Financial Fair Play' initiative, and its hegemonic influence has precipitated domestic imitations of these rules. Such developments have, perhaps, distracted commentary from the existing insolvency policies of the Football League (FL) and Premier League (PL) commonly known as 'the Football Creditors Rule'.

The Football Creditors Rule (the FCR), updated by the FL in June 2015, has itself generated no little amount of controversy and was subject to judicial scrutiny in the case of *HM Revenue and Customs v The Football League Ltd. & The Football Association Premier League Ltd. [2012] EWHC 1372 (Ch) (25 May 2012)*.

This paper will look to assess the rationale for the decision in *HM Revenue and Customs*, the legality of the FCR, and the cogency of the underlying objectives of the rules. This will be achieved by examining the available empirical evidence to establish the economic context and the efficacy of the rules, and providing a critique of a market-driven approach to the financial regulation of football, a position influenced by Michael Sandel's (2012) admonition of the evolution of a market society propounded in *What Money Can't Buy: The Moral Limit of Markets*.

HM Revenue and Customs v The Football League Ltd. & The Football Association Premier League Ltd.

Broadly speaking, the FCR entails payment to a certain class of creditors – namely 'football creditors', including, inter alia, 'other clubs in the FL, the club's players, managers and other employees and the FL itself' (*HM Revenue and Customs*, para. 1) – before other creditors in the event of an insolvency. This is instituted by a sophisticated mechanism of corporate structure; one, given its efficacy, that is a testament to FL and PL's lawyers' drafting skills.

Case history

Historically, in the context of insolvency, HM Revenue and Customs (HMRC) was considered a preferential creditor[1] and as such ranked ahead of other unsecured creditors in the distribution of an insolvent company's estate. However, the enactment of the Enterprise Act 2002 saw an erosion of the breadth of creditors on whom preferential status was conferred, including the abolition of preferential status for HMRC debts. It has been suggested that this, along with an increase in insolvencies brought about by the global financial crisis of 2007, 'left HMRC battered and bruised and showing signs of a reasonably obvious sense of humour failure' (Roberts 2012). Not only had HMRC lost its place at the front of the queue for the post-insolvency disbursement of funds, but the structure of the FCR was such that football creditors had been bestowed priority ahead of HMRC.

Having had its priority supplanted by football creditors, HMRC (and its predecessor body, the Inland Revenue) sought to challenge the application of the FCR in the insolvencies of Wimbledon FC and Portsmouth FC. In *The Commissioners of the Inland Revenue v The Wimbledon Football Club Limited [2004] EWHC 1020 (Ch),* the Inland Revenue challenged the validity of a Company Voluntary Arrangement (CVA) proposed by the administrators[2] of the 'hopelessly insolvent' (para. 1) Wimbledon FC on the basis that it would, *inter alia*, cause them 'unfair prejudice' (under section 6 of the Insolvency Act 1986). The CVA would pay the Inland Revenue 30% of the debt owed to it, whereas football creditors would be paid in full. The Inland Revenue was unsuccessful in its application, with Lightman J. concluding that the Inland Revenue's 'single minded pursuit of their principled objection to the payment in full of [football creditors] can only bring down the whole edifice and secure a nil return for all concerned' (para. 23).

Re Portsmouth City Football Club Ltd (In Administration) [2010] EWHC 2013 (Ch) again involved HMRC challenging the validity of a CVA proposed by the administrators of a football club. Again, it was alleged that the CVA caused HMRC unfair prejudice. Again, HMRC was unsuccessful. Mann J. remarked that HMRC had 'a deep-rooted antipathy to the football creditor rules' (*Re Portsmouth*, paragraph para. 42), and whilst the FCR was germane to the issues in *Re Portsmouth*, and the case 'brought [the FCR] into sharp focus' (James 2013: 256), Mann J. concluded that the case was 'not the appropriate place for deciding the point' (para. 14).

Consequently, in separate legal proceedings, HMRC sought a declaration from the courts (under Part 8 of the Civil Procedure Rules, which is used to seek the court's determination on a question 'unlikely to involve a substantial dispute of fact') to the effect that the FCR contravenes insolvency law and thus should be held invalid.

The legal structure of the FCR

The FL is a company limited by shares. It has share capital of £5, divided into 100 shares, of which 72 have been issued: one to each of the 72 member clubs of the FL. This share is colloquially referred to as the 'Golden Share' (*HM Revenue and Customs*, para. 105), the holding of which is a necessary condition for competing in the FL. Ultimate control of the ownership of any given Golden Share is retained by the FL: the articles of association of the FL, at Article 4.5, hold that upon the happening of certain events, 'the board of the FL may give the member club concerned written notice to transfer its share or shares to such person as the board shall specify at the price of 5p per share' (*HM Revenue and Customs*, para. 14). A club becoming subject to an 'Insolvency Event'[3] is one such circumstance.

The objects of the FL, set out in clause 3 of its Memorandum of Association, include organising league and cup competitions, regulating the activities of its constituent clubs, and undertaking 'any business or other activity which… may conveniently be carried on in connection with any of the other objects of The League' (*HM Revenue and Customs*, para. 13).

Thus, the FL has 'substantial commercial functions', including the central negotiation of television rights, a proportion of the revenues from which are subsequently distributed to clubs (*HM Revenue and Customs*, para. 14). There is, however, an important caveat at Article 77.3:

> '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. This means that any interim payments under this Article 77 are repayable to The League on demand if the Member Club does not complete all of its fixture obligations.' (*HM Revenue and Customs*, para. 28)

So, under Article 77.3, clubs have no legal entitlement to television revenue (or other centrally-held monies) until and unless they complete the season. If a club does not complete the season, any interim payments received become liabilities and the club in question – or the insolvent estate of that club – deprived of its Golden Share, will not be eligible for any further payment from the FL.

The forfeiture of commercial revenues otherwise due from the FL was one source of friction in *HM Revenue and Customs* and formed one prong of HMRC's legal argument against the FL. It was argued that the manifestation of these rules was a violation of insolvency law's anti-deprivation principle.

The second point of objection raised by HMRC was that the FCR was vitiated by the *pari passu* principle (also known as 'the rule in *British Eagle*' after *British Eagle International Airlines Limited v Cie Nationale Air France [1975] 1 WLR 758, HL*). The *pari passu* principle states that creditors have an equal *pro-rata* entitlement to the assets of an insolvent estate;[4] thus any attempt to pay one creditor or group of creditors from the assets of an insolvent estate in priority to other creditors will be void.

The FCR entails payment of football creditors before other creditors. In addition to the safeguards instituted in its articles of association as detailed above, the FL endeavoured to ensure that football creditors were paid in full through its Insolvency Policy, which was used to 'provide guidance on the manner in which the board of the FL will exercise its powers in the event of the insolvency of a club' (*HM Revenue and Customs*, para. 34).

The FL is able to request the transfer of the Golden Share held by a club subject to an insolvency event under its articles of association. The Insolvency Policy goes on to institute a system whereby withdrawal of the Golden Share is suspended pending repayment of football creditors at a minimum:

> '[The] notice of withdrawal will be cancelled where the board is satisfied that either the appointment of the administrator has been discharged following payment in full of all creditors, or a CVA or scheme of arrangement has been approved and the debts due to football creditors have been paid in full or secured, or in such other circumstances as the board thinks fit.' (*HM Revenue and Customs,* para. 42)

The efficacy of the Insolvency Policy is considered further below, but first, to elucidate upon the central legal issues on which *HM Revenue and Customs* hinged, being the anti-deprivation principle and the *pari passu* principle of insolvency law. Fletcher (2013: 1) described the judgment in *HM Revenue and Customs* as:

> 'notable... both for the clarity of its exposition of the nature of the two "fundamental principles" in question and their respective functions and purposes, and for the indications it provides concerning the proper approach to be employed when seeking to apply those principles in cases concerning company administrations.'

The anti-deprivation principle

Historically known as the 'fraud on the bankruptcy law' (Mendelsohn 2012), and dating back to the eighteenth century,[5] the anti-deprivation principle 'renders void' (Lawrence 2012) any arrangement that has, 'as its predominant purpose, the removal of an asset from an insolvent entity on that entity's insolvency' (Clifford Chance 2012). The 'deprivation' in question being suffered by the insolvent entity's creditors when assets that could be used for their benefit from the insolvent estate are put out of reach.

The scope and applicability of the anti-deprivation principle was recently set out in the case of *Belmont Park Investments Pty Ltd and others v BNY Corporate Trustee Services Ltd and another [2011] UKSC 38*. Whittaker (2012: 193) sets out five areas in which *Belmont* clarified the law as to the anti-deprivation principle:

i) There must be deliberate intent to deprive the insolvent estate of the asset in question.
ii) The deprivation must be triggered by the insolvency itself.
iii) A contingent interest in an asset that is determinable on bankruptcy is to be distinguished from an absolute interest that is forfeited on insolvency.[6]
iv) There are common law provisions that institute the permissibility of certain deprivations (such as the termination of a lease on insolvency).
v) For executory contracts, the extent to which the insolvent company had performed the contract may be considered.

It can be surmised from *Belmont* that the courts, in considering whether the anti-deprivation principle is engaged in marginal cases, will take a practical, commercial approach under which the autonomy of contracting parties is respected. Worthington (2012: 114), in her deliberation on the rationale in *Belmont*, submits:

> '[The anti-deprivation] policy can be given a common sense application so that *bona fide* commercial transactions which do not have as their predominant or main purposes the insolvency-triggered deprivation of the debtor's property, do not fall foul of the anti-deprivation rule.'

In the context of *HM Revenue and Customs*, the assets that were alleged to have been removed from insolvent estates were television revenues. Article 77.3 of the FL's articles of association expressly states that entitlement to television revenue only becomes due to clubs upon completion of all fixtures in a given season; ergo, of the points in *Belmont* identified by Whittaker above, point iii. and point v. *may* apply to *HM Revenue and Customs*, and the interaction of these

two points is worth considering: football clubs do not have a contractual right to television revenue monies unless they complete the season's fixtures and as such it can reasonably be argued that the insolvent estate should not be entitled to such revenues. However, it is not without merit to suggest that a club should have some *pro-rata* entitlement, having gone some way towards completing their contractual duties. Consider, for example, a FL club that completes 45 games of the 46 game season before entering into formal insolvency. The FL could withhold television revenues from the estate of such a club despite the club having completed 98% of its contractual duty.

However, and at the risk of being facile, the FL season is *46* games long and 98% of matches is not a whole season. The integrity of the FL and the PL as a sporting contest and for league organisers as a commercial endeavour requires assurance that participants will complete all of their fixtures. Not only do the FL and PL rely on this, but all clubs rely on their competitors completing the season for the sake of their own commercial endeavours and for the validity of the league season. Football clubs – and sports teams generally – have a mutual economic dependence. On this basis, it seems reasonable that the FL and the PL reserve their right to withhold television revenues pending the successful completion of the season.

So, in respect of *HM Revenue and Customs*, whilst the asset in question is put out of the reach of creditors, and this is made manifest by an insolvency event, television revenues justifiably do not become an asset of the club until a season is completed.

Therefore, as Fletcher (2013) notes, 'there was no item of property of which the Member Club's estate experienced a "deprivation"' and there is, therefore, no infraction of the anti-deprivation rule.

In the alternative scenario, where a club (or its insolvency practitioner) has assets but distributes them to football creditors in preference to other creditors, a different rule of insolvency law is considered: the *pari passu* principle.

The pari passu principle

The *pari passu* principle has been called 'the foremost principle in the law of insolvency around the world' (Keay and Walton 1999). Finch (1999) describes the basic nature of the principle as being that 'all creditors are treated on an equal footing – *pari passu* – and share in insolvency assets *pro rata* according to their pre-insolvency entitlements or the sums they are owed'.

This rule is not altogether unfettered; it is subject to 'particular identified exceptions' (Shaw 2013): for example, secured creditors and creditors defined as 'preferential creditors' under the Insolvency Act 1986 are usually entitled to payment ahead of ordinary unsecured creditors.[7] However, whilst certain exceptions exist, the *pari passu* principle is 'subject only to such exceptions as the general law may permit' (Shearman & Sterling 2012) and is not generally subject to further derogation as commercial entities see fit.

British Eagle International Airways v Cie National Air France [1975] 1 WLR 758 has been described as the 'leading modern authority on the pre-eminence of the *pari passu* principle' (Oditah 1992). This 1975 case centred on the liquidation of airline British Eagle International Airways in November 1968. British Eagle was, at the time, a member of the International Air Transport Association (IATA), as was the defendant company, Cie National Air France.[8] The IATA administered a 'clearing house' scheme, under which debts and credits owed by and to its various members were paid into a central pooling account, with the balance at the end of each month paid to or by the respective member airlines.

At the time of its liquidation, British Eagle was a net debtor to the IATA clearing house scheme; however, its specific position vis-à-vis Air France was that of a net creditor. So, whilst British Eagle had an overall liability to the IATA clearing house scheme, absent the existence of that scheme, it was owed money by Air France.

It was held that the clearing house scheme was 'contrary to public policy' (Sealy and Hooley 2009: 1211) as its effect was to contract out of the *pro rata* repayment of unsecured debts. Lord Cross of Chelsea, in his judgment on the matter, described it as 'irrelevant' that there were good business reasons for the existence of the scheme. He conceptualised the contractual sidestepping implemented by the clearing house scheme as a 'mini liquidation', and considered that existing insolvency policy should prevail.

It is easy to see why, *prima facie*, *HM Revenue and Customs* appears to be a straightforward breach of the *pari passu* principle, insofar as some unsecured creditors were given preferential treatment on the basis they were football creditors, whereas the remaining, non-football, unsecured creditors received a lower proportion of the available funds. Not all unsecured creditors were paid *pro rata* and this would seem to be in direct contradiction of the *pari passu* principle. However, it is on this point that *HM Revenue and Customs* produced 'new law... the most significant feature of this case' (Whittaker 2012: 194). It was held that, whereas the anti-deprivation rule applies to all insolvency proceedings, the *pari passu* principle does not; rather, it applies 'only to distributive insolvency regimes' (Whittaker 2012). Therefore, whereas the *pari passu* principle applies to liquidations from their outset, it would not apply to an administration unless and until a dividend to creditors is paid; it attaches to distributions in insolvencies rather than insolvencies *per se*. It is a quirk of the evolving nature of corporate insolvency law that this differentiation has had to be demarcated as recently as in *HM Revenue and Customs*, as administrators had no power to make distributions under the Insolvency Act 1986, and it was only through the reforms implemented by the Enterprise Act 2002, which, *inter alia*, conferred on administrators the powers to make distributions, that such issues were presented to the courts.

There are, of course, valid reasons to distinguish between insolvency events that do and do not effect distributions for the purposes of the *pari passu* principle; after all, the statutory purposes of administrations include rescuing a company

as a going concern and achieving a better result for creditors as a whole than would have been achieved through a liquidation,[9] both of which may require incidental commercial decisions that place some unsecured creditors in a materially better position than others (such as, in *HM Revenue and Customs*, football creditors). To quote from the Cork Report (1982) – the precursor to the reformulation of domestic insolvency law in the 1980s:

> 'In the case of an insolvent company, society has no interest in the preservation or rehabilitation of the company as such, though it may have a legitimate concern in the preservation of the commercial enterprise.'

The efficacy of the Insolvency Policy

In the judgment of *HM Revenue and Customs*, the Chief Operating Officer of the Football League, Andrew Williamson, is cited as providing three objectives for the Insolvency Policy:

i) the survival of the club (or a successor) as a going concern and ongoing membership of the FL, where possible;
ii) repayment of football creditors; and
iii) protecting the interests of other creditors (*HM Revenue and Customs* paras. 44–47).

It is valuable to establish whether the FCR satisfies these objectives.

As examined in greater depth below, football clubs have a remarkable propensity to survive. Given that the current Insolvency Policy was adopted in 2005 (having been in development in the two decades prior; see *HM Revenue and Customs* para. 43), it is difficult to establish whether the Insolvency Policy has had any material effect on the ongoing survival of clubs; they tended to continue operation in some guise both before the implementation of the Insolvency Policy and after its introduction. It can, at least, be said that the Insolvency Policy correlates with the continued existence of football clubs after insolvency, notwithstanding the difficulty of establishing causation. Irrespective of the underlying cause, this objective is satisfied.

The satisfaction of the second objective can be inferred from the ongoing participation in the FL of all participant clubs that experienced insolvency events since the Insolvency Policy's adoption. Put simply, the fact that insolvent clubs have retained their Golden Share is evidence that they have repaid football creditors in full *per se*. We are, however, able to further analyse details of payments made to creditors through the judgment in *HM Revenue and Customs* and through insolvency practitioners' reports in the respective insolvencies, some of which have been made public with creditors' consent and some of which are available at Companies House (the UK's official registry for companies). This facilitates an appraisal of the third objective: protecting the interests of other creditors.

It is stated in the judgment of *HM Revenue and Customs* (para. 8) that the administrations of Crystal Palace and Plymouth Argyle resulted in full repayment to football creditors and 2p in the pound and 0.77p in the pound respectively to ordinary unsecured creditors. However, the estimated dividend actually paid to unsecured creditors in the insolvency of Plymouth Argyle was even less, being stated in the Final Report on the CVA as being just £13,502, equating to 0.21 pence in the pound (The P&A Partnership 2012). By contrast, Argyle's football creditors were owed – and, we can infer, were repaid – around £3.2 million.[10]

Portsmouth FC notoriously entered into administration while competing in the PL in 2010 (they remain the only club to have become insolvent whilst competing in England's top flight), the first of two times the club entered into formal insolvency proceedings within two years. Under the 2010 administration, Portsmouth's unsecured non-preferential creditors had claims totalling £62.2 m. They were offered a dividend of 20 pence in the pound. Football creditors, meanwhile, had claims totalling £22.4 m, which, we can deduce, were paid in full (UHY Hacker Young 2011).

Fig. 1 below depicts payments made to football creditors and non-preferential unsecured creditors in the insolvencies of Crystal Palace, Portsmouth and Plymouth Argyle. The figures are taken from the reports produced by the respective clubs' insolvency practitioners.

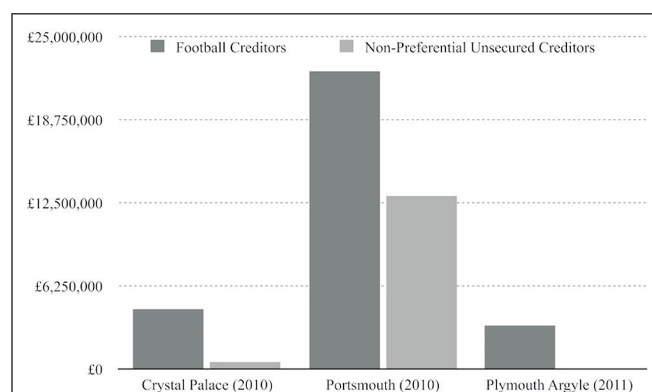

Figure 1: Payments and Football and Non-Football Creditors.

Fig. 2, **Fig. 3** and **Fig. 4** below demonstrate the proportion of the aggregated football creditor and non-preferential unsecured creditor payments diverted to football creditors. In **Fig. 2**, the cumulative total repayment to football creditors and unsecured creditors was £5,002,468 The P&A Partnership (2011); in **Fig. 3**, it was £35,414,649; in **Fig. 4**, it was £3,275,942.

It is evident that football creditors are paid in preference to ordinary unsecured creditors. It would seem to follow, on a superficial basis at least, that objective 3 of the Insolvency Policy is not met, as non-football creditors' interests appear to be sacrificed for football creditors' benefit. For example, it can be inferred that in the insolvency of Plymouth Argyle, unsecured non-football creditors received a mere 0.4% of the overall distribution. Intuitively, it does not feel as though ordinary creditors' interests are being protected when they can receive such a small percentage of the funds overall.

However, a purely empirical critique may ultimately be fallacious. In actuality, it cannot readily be established whether the FCR has an adverse impact on non-football creditors in terms of overall cash recovery. This is because the repayment of creditors in an insolvency is not a zero-sum equation. There is not a finite pot of money from which to apportion funds to the various classes of creditors. It is possible that without the FCR, the total amount of money available for all creditors would be less than has been made available to non-football creditors under the existing system.

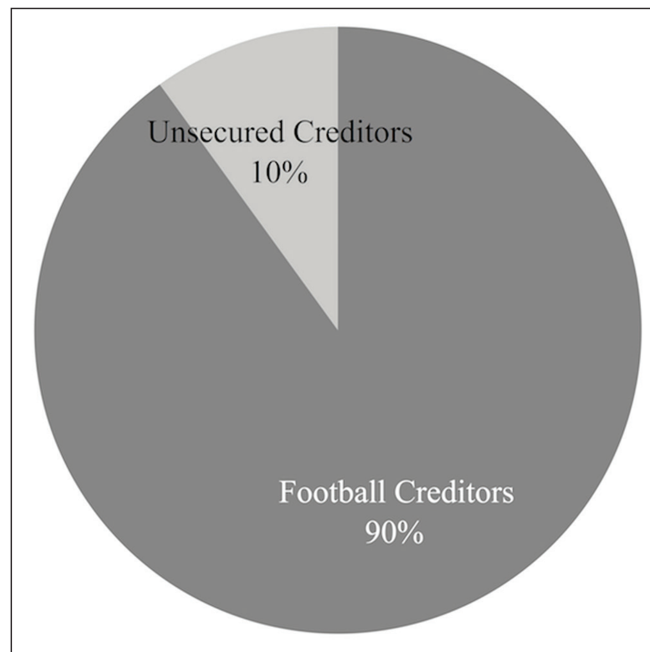

Figure 2: Crystal Palace (2010) Payment Allocation.

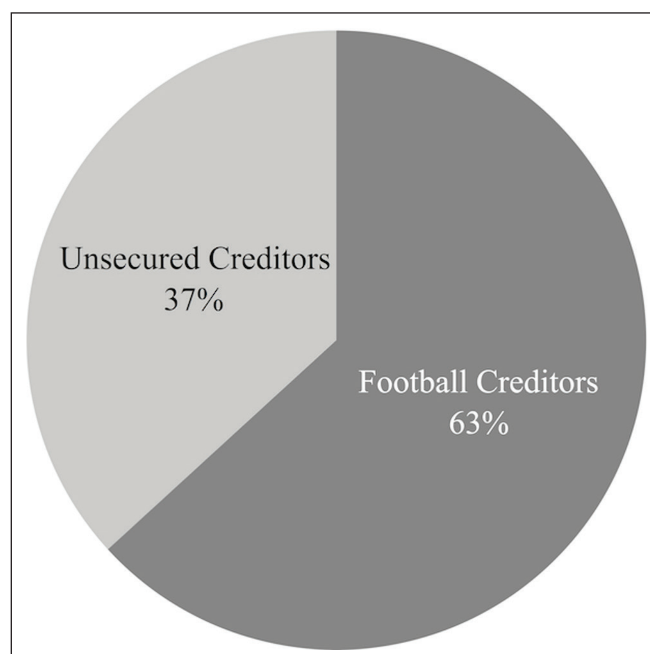

Figure 3: Portsmouth (2010) Payment Allocation.

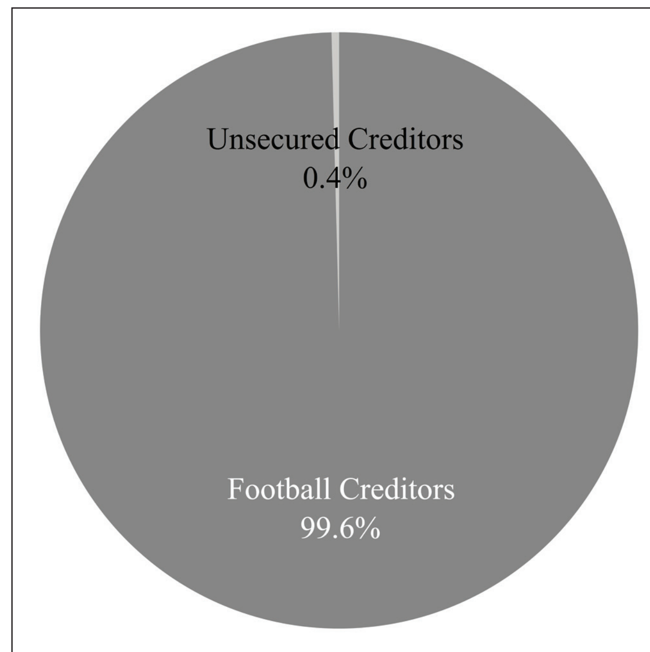

Figure 4: Plymouth Argyle (2011) Payment Allocation.

By creating a stable economic ecosystem for football creditors, the FL might argue that they have made a more attractive prospect for exogenous investment, serving to inflate the amount of money which purchasers of clubs in financial distress are willing to pay. The net effect of this might be to improve the amount of money that filters through to ordinary unsecured creditors irrespective of the disparity of position when benchmarked against football creditors. That having been said, Boyle and Birdsal. (2011) suggest the 'commercial necessity' of the FCR 'would surely reduce the price that the buyer would otherwise pay'. It is, however, all but impossible to establish a definitive position in the absence of the counter-factual.

Systemic comparison between football insolvencies and insolvencies in other domestic sports, or indeed comparison to football in other jurisdictions, is fraught with methodological difficulties: no other sport in England and Wales operates on the same economic plane as professional football; whereas sports in other countries operate under different legal, social and economic conditions. However, by way of illustrative example, one might look to the insolvencies of Scottish football clubs Heart of Midlothian, who entered into administration in June 2013, and Rangers FC, who entered administration in February 2012.

Heart of Midlothian exited administration by way of CVA, in which no payment whatsoever was made to unsecured creditors (Companies House 2014). Rangers, meanwhile, were unable to successfully exit administration and as such the company was put into liquidation, with the underlying business sold to a new company set up with the purpose of continuing football as Rangers FC, albeit restarting from the bottom of the league pyramid. As part of the deal, the purchaser agreed to take on the existing obligations to football creditors despite the FCR not existing in Scottish football (*Final Progress Report to Creditors*, Companies House 2012).[11] The position of ordinary unsecured creditors, including HMRC, remains unresolved at the time of writing, as the liquidation is yet to conclude.

These Scottish examples provide some evidence that ordinary unsecured creditors suffer bad outcomes irrespective of the FCR. The evidence that the FCR improves outcomes for ordinary unsecured creditors does, however, appear weak.

A sounder basis on which to interrogate policy is in terms of justice, necessitating that we establish a barometer for what is 'fair'. From a legal perspective, in the context of CVAs, the repayment in full of one class of creditor does not necessarily indicate the unfair treatment of another creditor who is not paid in full (*Mourant & Co Trustees Ltd v Sixty UK Ltd (In Administration) [2010] EWHC 1890 (Ch)*) although such a situation will require 'careful scrutiny'. The basis of that scrutiny should be considered: whilst the data is an instructive starting point for examining the disparity of outcome between football and non-football creditors, it cannot provide the whole picture and the moral angle should be considered equally.

So, while the FL's Insolvency Policy meets its first two objectives, it is at best neutral in meeting its third objective. Given the limitations to examining the empirical data alone, broader considerations should be explored in determining whether the Insolvency Policy is fair towards ordinary, unsecured, non-football creditors. Irrespective of the functionality of the Insolvency Policy, the mere establishment of the satisfaction of the economic goals set out therein would not in itself authenticate the policy's validity. There are non-economic, normative aspects of the FCR, which should be fully considered in any assessment of the rule. However, the broader socio-economic-moral aspects of the Insolvency Policy and the FCR were, by expression of the basis on which the case was brought, not dealt with in *HM Revenue and Customs*.

Case summary

HM Revenue and Customs does not give a definitive response on the compatibility of the FCR with the *pari passu* principle and the anti-deprivation principle. This is acknowledged at paragraph 59 of the judgment:

> 'The detachment of HMRC's claim from the facts of any particular case causes some difficulty. The arguments on the applicability of the pari passu principle and the anti-deprivation rule will vary according to the precise circumstances.'

Notwithstanding the potential for the idiosyncrasies of individual cases, Richards J. held that, 'in most circumstances in which the relevant provisions of the FL's articles and Insolvency Policy will operate, they will not be rendered void by the anti-deprivation rule or the *pari passu* principle' (para. 187). However, the judgment continues by stating that 'The FL should not regard the result of this case as an endorsement of its approach to football creditors. It is, as I said at the start, a decision on a challenge brought on a particular legal basis' (para. 189). The judgment concludes:

> 'These proceedings are not concerned with whether giving priority to football creditors is socially or morally justified. The issue is one purely of law, whether the provisions which together accord this priority are void and of no effect on the grounds that they are contrary to insolvency law' (para. 3).

However, such technicalities are a concern for neither football's governing bodies nor the UK government, both of whom are sufficiently empowered to consider whether the FCR is 'socially or morally justified' and to amend the legal structures governing the rule accordingly. Whilst there have been amendments made to the FCR since *HM Revenue and Customs* (discussed below), the changes still propagate the payment of football creditors ahead of ordinary unsecured creditors. This paper will now turn to the socio-economic-moral aspects of the FCR, and to the question of whether it would be warranted to abolish the rule altogether.

Understanding the Prevalence of Insolvency Events in English Football

Limited companies in England and Wales 'have for many years been required to produce annual accounts', and have been 'compelled to publish a balance sheet' since the Companies Act 1908 (Boyle and Birds 2011). As a result of the early professionalisation of football, 'most English clubs adopted limited liability status' in the nineteenth century (Szymanski 2006), with 'all but two of the league's eighty-six members [having] followed suit' by 1921 (Dobson and Goddard 2011: 187),[12] meaning historic accounting information for English football clubs is widely available. Similarly to companies' accounts, insolvency events are also matters of public record. The ready availability of relevant data and prior inquiry into football insolvencies from an economic and business management perspective has created a strong platform to interrogate policy in England and Wales (for example Beech, Horsman and Magraw 2008; Szymanski 2012).

In assessing the legal issues surrounding the insolvency of domestic football clubs, it is important to understand the frequency of those events and the reasons they occur. Insolvency is, of course, a natural part of a capitalist economy; however, it must be considered whether there are additional catalysing factors in the case of football clubs.

European football's win maximisation model

It is a basic assumption of economic theory that businesses seek to maximise profits. Indeed, for the majority of companies, profit generation is their *raison d'être.* Késenne (2006) suggests that this presumption has been extended to sports clubs: 'In the United States, the profit maximisation assumption is generally accepted by sports economists as an adequate description of the behaviour of professional sports clubs'. This model, however, is incongruent with the behaviour of professional football clubs in England. An alternative theory of the economic behaviour in European football was promulgated by Sloane (1971), who described clubs as seeking to maximise utility, 'such as playing success, attendances, and league health' (Késenne 2006). This theory has been further distilled by Késenne (2006), who suggests that win percentage is the key objective of European football clubs, 'so that all available income is spent on playing talent' (Szymanski 2012). Garcia-del-Barrio and Szymanski (2009) find 'consistent evidence of win maximising behaviour in… the English leagues'.

Pijetlovic (2015) describes the emergence of a contemporary model:

> '… based on professional management in the club administration, ownership by corporate giants including broadcasters, entry into capital markets, and a sole concern for profit maximising and growth to gain the competitive edge over other clubs' financial performance'.

This connotes a harmonisation with the profit maximising behaviour observed in American sports. However, as Pijetlovic (2015) goes on to state, by pursuing the 'contemporary model', clubs are focussed 'on enhancing the main factor that determines the outcome of the matches', i.e. clubs are trying to improve win maximisation by augmenting their financial status.

Whether the win maximisation model ultimately endures the globalisation of the game and the associated increase in sophistication of the business management strategies applied to the running of clubs will require ongoing study. However, by way of observable historic assessment, English football clubs have tended to pursue objectives other than profits: namely, sporting success.

One must be careful, though, to avoid concluding, without reference to data, that because clubs look to maximise wins rather than profits, they are not profitable, or do not break even at worst. It is a conceptual possibility that clubs both seek to maximise wins and retain basic profitability. In order to establish whether this has historically been the case or not requires further consideration of the empirical evidence.

The correlation between wage bills and sporting success

Accepting that English football clubs have historically sought to maximise wins, it is necessary to consider the ramifications that this has on clubs' accounts.

Wage expenditure is highly correlated with success on the field. Kuper and Szymanski (2012: 14) detail a study of 40 English clubs between 1978 and 1997:

> 'clubs' spending on salaries was extremely telling. The size of their wage bills explained a massive 92 per cent of variation in their league position, if you took each club's average for the entire period'.

It is, of course, difficult to establish the flow of causation when considering the relationship between wages and sporting success. Whether a club increasing its wage bill begets sporting success or whether more successful clubs increase pay commensurate with improved table positions is difficult to determine; however, irrespective of the direction of causation, it is uncontroversial to suggest that better players tend to command larger salaries. As the business of football in England is predicated on maximising wins, and as larger wage bills are highly correlated with achieving more wins, the impact of the correlation between wages and success is perhaps inevitable: it engenders a proclivity amongst clubs to increase wage expenditure with the intention of improving relative to their competitors. Unfortunately, this additional input 'is not rewarded in overall terms' (Muller, Lammert and Hovemann 2012: 118) as clubs undertake the same strategy *en masse*. The result of multiple clubs seeking to obtain a mutually exclusive objective is that 'better positions in the table cannot be shared and clubs are stringently banished to inferior ranks' (Muller, Lammert and Hovemann 2012: 118). By the very nature of sporting competition, it is a mathematical impossibility for *all* clubs to improve their league position or number of trophies won.

This behaviour has been observed by various commentators. For example, Dobson and Goddard (2011: 160) state:

> 'For many [Championship] clubs, there is a temptation to gamble on the possibility of achieving promotion to [the Premier League], and the financial resources that would flow as a consequence. The gamble involves ratcheting up expenditure on players' salaries, to levels that would be covered easily if promotion is achieved, but which are unsustainable otherwise'.

Whereas Serby (2014: 21) describes a 'process of ever increasing takings accompanied by higher numbers of financial failures among clubs'. This point – that 'financial failures' persist despite growth in turnover – is crucial. Exponential growth in turnover within the football sector could conceivably have sustained coincidental escalating wage bills. However, ostensibly because of the institutionalised spending behaviour of football clubs described above, the growth seen in the football industry has historically failed to generate concomitant profits.

Growth without profits

Szymanski (2012: 5) describes the 'extraordinary rate of growth' of clubs in the top tier of English football: average revenue increases of 9.3% per annum for 37 years, which equates to 'a 24-fold increase in real terms'. Growth rates across the lower professional divisions have not been as dramatic as at the top level of the game, but 'have still been well in excess of the average growth rates recorded by the UK economy over the period' (Szymanski 2012).

Despite this remarkable rate of growth, losses were observed in eight out of the ten seasons between 1993–94 and 2002–03 (inclusive), with a net loss of £957 million between 1995–96 and 2001–02 (Buraimo, Simmons and Szymanski 2006). Szymanski (2012) states, 'While some individual clubs may have sustained profits over some years, on average few do better than breakeven, and many do substantially worse'. Franck (2010) describes the incongruity of negligible profit-making despite 'exploding revenues' as 'a genuine paradox'.

The resources dedicated to wages are strongly correlated with sporting success, which is clubs' predominant business objective. It is perhaps unsurprising, therefore, that 'the percentage of revenues devoted to wages has increased in all the divisions, particularly in the last decade and a half' and that 'a higher wage/turnover ratio leads to a statistically significant deterioration in the balance sheet (Szymanski 2012). Szymanski (2012) submits that 'From this perspective, the increase in insolvencies is perhaps not so surprising'. Buraimo, Simmons and Szymanski (2006) conclude similarly, 'financial losses can be explained only by excessive wage spending'.

Serby (2014) suggests that clubs on a downward trajectory have trouble adjusting costs in line with diminishing revenues:

> '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.'

In a sense, this behaviour is entirely understandable. From a sporting perspective, given the close correlation between wages and success, a reduction in wage expenditure may compound the hypothetical struggling club's maladies. Conversely, sustaining or increasing expenditure increases the club's chances of improving their fortunes (in all senses). Unfortunately, if improved financial performance does not follow, a weakening balance sheet and increased chance of insolvency may ensue. There are many examples of this; perhaps the most stark example being that of Leeds United, who 'invested heavily in the late-1990s,' reaching the semi-final of the Champions League in 2001, before being 'forced to sell off a galaxy of star players at knockdown prices after failing to qualify for the Champions League in 2002' (Szymanski 2015), subsequently getting relegated and ultimately entering formal insolvency in 2007.

It should be noted that there is some variation within the league pyramid as to how spending and on-field performance interact. Research by consultancy group Deloitte (2016) has shown that whereas Premier League performance is highly correlated with league position, there has 'traditionally been a weaker correlation between league position and wage cost rank in the Championship'. However, the average wage-to-turnover ratio is significantly higher in the Championship, at 99%, than in the Premier League, at 61% (Deloitte 2016), indicating less stable spending, and perhaps less efficient spending, further down the league structure.

Taken as a whole, English football has a dependency on spending; it forms a determinative component in sporting success. Historically, profit generation does not seem to have been part of the equation. Indeed, it could be argued profits are antithetical to win-maximising clubs' goals, as every penny of profit is a penny not spent on wages. It should, therefore, come as no surprise that insolvency has become a regular feature of the English football landscape. The nature of the economics of English football is such that clubs have an incentive to increase wages and maximise the proportion of turnover spent on players' salaries; this is an inherently risky strategy.

Franck (2010) summarises the position in which clubs find themselves:

> 'In this specific arms race environment the competitive position of a club is not determined by its profitability, but by its spending power. The spending power of a club depends on two factors: On the ability of the club to generate funds and on the ability of the club to redirect generated funds to football.'

Fundamentally, this ethos does not encourage financial prudence; rather, it seems somewhat pernicious, and hence regulatory responses, such as the cost control initiatives instigated by UEFA with its 'Financial Fair Play' rules and emulated to varying extents by the PL with its Profit and Sustainability and Short Term Cost Control Rules, and the FL with its Championship Financial Fair Play Rules, should be welcomed. There is some evidence that such cost control measures are improving sustainability across Europe (UEFA 2014).

The problem of insolvency

It has been presented as axiomatic that insolvency is undesirable, but this position should be substantiated. Corporate insolvencies are a perfectly common feature of even a healthy and functioning economy. For example, in 2013, there were 2,365 administrations, 577 CVAs and 14,982 liquidations. These numbers were not dramatically different prior to the global financial crisis: in 2006 there were 3,560 administrations, 534 CVAs, and 13,137 liquidations (The Insolvency Service 2014). White (1989) explains, 'Economic theory suggests that [corporate insolvency] should serve as a screening process designed to eliminate only those firms that are economically inefficient and whose resources could be better used in some other activity'.

However, unlike other industries, where the failure of one firm strengthens the position of another, football clubs rely on the ongoing survival of their competitors, whether 'economically inefficient' or otherwise. Football clubs have a mutual economic dependence; when a club ceases to exist, it does not increase the remaining clubs' market share, it simply gives them one fewer fixture to fulfil, albeit impermanently. The ramifications of this will vary dependent on the cultural and economic exposure of the club in question, but a cautionary example is found in the liquidation of Scottish club Rangers in 2012. This had a direct cultural and economic impact: Scottish football lost its most famous fixture, the Auld Firm Derby between Rangers and fellow Glasgow club Celtic; average attendances at Celtic for the season following Rangers's liquidation dropped (BBC 2013); and there was a negative monetary impact on the Scottish Premier League's broadcasting deal (BBC 2014).

It is not merely the economic interdependence of football clubs that makes their survival imperative: there is also a socio-cultural impact (see, for example, The Social and Community Value of Football, Supporters Direct Final Report 2010; García, Welford and Smith 2015a and 2015b), and supporters have been unified in their desire to see not just their own club, but *all* clubs, continue to compete.[13] For fans, football clubs are not fungible.

It is important to note, however, that insolvency does not correspond with discontinuation of business *per se*. Whilst any insolvency event runs the risk of a business disappearing altogether, it is not a sufficient condition for such. Of the various potential outcomes of formal insolvency proceedings, only liquidation terminates an entity. The introduction of the Insolvency Act 1986 (IA 1986) saw a liberalisation of the insolvency regime and a paradigm shift towards corporate rescue, with the introduction of CVAs (IA 1986 Part I) and administrations (IA 1986 Part II) in particular aimed at maintaining businesses as a going concern.[14] The administration process was further amended and liberalised by the Enterprise Act 2002.

Administration involves the appointment of an insolvency practitioner, under whom 'the affairs of the company are placed' (Sealy and Hooley 2009), enabling the insolvency practitioner to run, sell or restructure the business. Administration 'is designed primarily as a rescue procedure aimed at facilitating the survival of the company's business' (Birds et al. 2011). The insolvency practitioner will negotiate with creditors, and his proposal can be accepted by a majority of creditors by value of debt (Insolvency Rules 1986, r2.43). The administration will continue until one of several criteria is met, such as the insolvency practitioner completing the object of the administration (e.g. resuscitating the company); the insolvency practitioner dissolving the company if it is not possible to repay creditors; or the elapsing of statutory timescales (IA 1986, Schedule B1). Administrations also occur in 'pre-pack' form, whereby a company is placed into administration and the business is immediately sold in whole or in part.

Like administrations, CVAs are intended as business rescue mechanisms. CVAs are formalised, legally binding, repayment arrangements 'approved by the majority of creditors and the members of a company' (Birds et al. 2011: 863). CVAs generally consist of an agreement by creditors to accept the part-payment of debts and revision to the repayment timetable, thus enabling a company to adjust its debt obligations to a more sustainable level so that it may continue trading; the benefit to creditors being a preferable debt recovery than otherwise would have been achieved had the insolvent company gone into liquidation. The payment to creditors is effected under the supervision of 'a qualified insolvency practitioner' (Sealy and Hooley 2009).

Conversely to administration and CVAs, liquidation, also known as 'winding up', is a terminal process involving 'the cessation of [a company's] business, the realisation of its assets, the payment of its debts and liabilities' (Birds et al. 2011). Liquidation can be commenced on a voluntary basis, instigated by the directors of the company (either by creditors' voluntary liquidation in the case of insolvent companies, or by members' voluntary liquidation in the case of solvent companies) or it can be a coercive process, instigated by a company's creditors, against the company's wishes, if a creditor is able to prove at least one of the statutory grounds found at section 122 of the Insolvency Act 1986.[15]

Accordingly, care must be taken not to conflate all insolvency proceedings with the formal conclusion of business activities. English football insolvencies are predominantly restructures under the aegis of an insolvency practitioner. Of the 88 clubs competing in the FL in 1923, 97% (i.e. 85 clubs) still existed in some iteration in the 2007–08 season (Kuper and Szymanski 2012: 81),[16] despite having weathered the Great Depression, World War II, the 1973–75 recession, the contraction of football attendances throughout the 1980s and a further recession in the 1990s.[17]

It is clear the liquidation of professional football clubs is comparatively rare. Whereas liquidation, entailing the extinction of a club, is clearly injurious to the game and its fans, it is less obvious that administrations and CVAs are similarly baleful. The extension of the insolvency regime has furnished clubs with various means of defeating adverse financial circumstances. This raises a normative question as to whether CVAs and administrations inhabit a separate theoretical genus from liquidations when considering the regulation of football insolvencies.

Scales of severity

It is uncontroversial to suggest that, notwithstanding their rarity, liquidations are the most egregious outcome of football clubs becoming insolvent. Whereas CVAs and administrations are designed to rescue businesses,[18] liquidations are intended to be terminal and as such challenge clubs' very existence. However, to draw *ex post* distinctions implies volition, whereas the reality is that when football clubs – or any businesses – become insolvent, they have diminished (if any) control over the outcome; they are under the coercive control of their creditors. As Goode (2011: 7) states: 'the creditor is entitled to avail himself of all the rights and remedies given to him by his contract and by law'.

For example, whilst CVA proposals can emanate from company directors (IA 1986, s.1 (1)), they will not take effect without the approval of 75% of creditors (by value) (Insolvency Rules 1986, Rule 1.19). Administrations do not require such aggregated creditor approval,[19] but it should be borne in mind that an administrator has a duty to perform his functions with regard to the interest of creditors (as a whole) and that creditors may establish a creditors' committee in order to 'assist the administrator in discharging his functions' (Insolvency Rules 1986 Part 2 Section B Chapter 7 2.52(1)).

Put simply, insolvent companies cannot readily escape the convictions of their creditors, even under the auspices of an insolvency practitioner. Any football club that becomes insolvent could find itself forced out of existence; the operative difference between liquidation, administration and CVAs can be no more than the caprices of the creditors in question. As Finch (2009) states in her description of the legal economics view of corporate insolvency, 'Keeping firms in operation is thus not seen as an independent goal of insolvency law'.[20]

From a sporting regulatory perspective, both the FL Regulations (the Football League 2015) and the PL Rules (The Premier League 2016) proscribe the gamut of insolvency events and do not delineate between liquidations and other forms of insolvency from a sanctions perspective. All insolvency events are punishable.

Of course, the distinction between liquidations and other forms of insolvency is arguably somewhat trivial, since after liquidation, there is in theory no entity left on whom to levy a sanction.

Do football clubs still exist after liquidation?

Whether football clubs – as distinguished from holding companies running football clubs – exist beyond liquidation is a complex and nuanced question worthy of greater enquiry than can be dedicated to it here; however, it is important to consider that some commentators contend that a football club can survive the holding company by which it was run: 'the bankrupt club [is] ditched, but the immortal club inside it salvaged' (Kuper and Szymanski 2012: 86; Szymanski 2013).

In this respect, a football 'club' could be considered an item of goodwill, owned by and severable from the company responsible for its operation. However, whilst this construction might be of some comfort to fans from a cultural identity perspective, its effect on insolvency policy is less significant. Even allowing for the demarcation of the 'club' from the company, it is the latter that enters into contracts of employment with players,[21] owns or rents a stadium, or, crucially in respect of the FL and the FCR, holds the 'Golden Share' in the company running the FL requisite to participate in the league and for eligibility to its revenue.

Much of the debate in *HM Revenue and Customs* centred on the ownership of the 'Golden Share' and the benefits arising thereunder; ergo, even if we accept that 'clubs' are capable of surviving liquidation, this does not have much legal application for present purposes. Whether 'clubs' still exist after liquidation is open for debate, but that question should not impinge on the FL or the PL's insolvency policies since the 'club' itself is not the conduit of its legal personality; the company is.

Conclusions on the economics of football in England and Wales

For football clubs, there is a strong correlational link between spending money and playing success. This has encouraged clubs to risk financial vulnerability in pursuit of improved match results, despite the mathematical impossibility of all clubs being able to improve their fortunes on the field. This innate instability has resulted in persistent insolvencies despite the remarkable growth in turnover seen in the professional game. Regrettably, when balance sheets weaken, the risk of insolvency increases; and once a club becomes insolvent, its survival is subject to the predilections of its creditors. The game's governing bodies should aim to militate against any rule that perpetuates this volatility.

What Money Can't Buy

In *What Money Can't Buy: The Moral Limit of Markets* (2013), Michael J. Sandel conducts an in-depth exploration of the role money and market forces have come to play in modern society. The focus of his disquisition is not on markets in the traditional sense, i.e. financial or consumer goods markets, but on a kind of economic mission creep, whereby market forces have come to impact traditionally non-market transactions and norms. The consequence of this, Sandel (2013: 9) argues, is that 'Sometimes, market values crowd out non-market values worth caring about'. *Much of What Money Can't Buy* focuses on delimiting 'what money should – and should not – be able to buy' (2013: 9) in response to the developed world evolving from '*having* a market economy to *being* a market society' (2013: 10).

Sandel approaches his work in two ways. Firstly, he conducts a descriptive discourse on the myriad ways in which 'markets now reach into almost every aspect of our private and collective lives' (Saprai 2013). In doing so, Sandel takes in key economic theories, considerations and empirical evidence.

Secondly, he uses the descriptive platform created to espouse a normative position on the influence markets *should* (or *should not*) have; or, to put it in Sandel's more succinct titular term, he creates a framework to assess *the moral limit of markets*.

The descriptive element of Sandel's work is broad in its scope, taking in examples such as:

> '[The] erosion of that fine old institution, the queue, as a result of ticket touting and 'fast-track' options for wealthy customers… on to weightier matters: the use of economic incentives in education and social policy; the commercialisation of sport; and the invasion of advertising into schools and hospitals' (Skidelsky 2013).

As Skidelsky highlights, Sandel's work encompasses the application of economics to sport. Sandel considers a duality of purposes of modern sports clubs: i) as business; and ii) as a source of civic identity. He raises concern that 'the money in sports has been crowding out the community' (2013: 172).

There is a self-evident relevance to Sandel's (2013: 164) critique of 'market mania' displacing community-focussed ideals in sport that is inherent to the nature of the FCR. For example, Stoner (2012) describes scenarios whereby football creditors are paid in full whereas, 'local trades & organisations who supply the club with everyday services, including the standard example of the St John's Ambulance, are left to fight for whatever pennies in the pound may be available'.

However, there are more fundamental aspects of Sandel's work that are applicable to the FCR. In describing what money 'should and should not buy', Sandel (2013: 110) sets out 'two objections to markets': the fairness argument and the corruption argument. If one were to set these as tests for good sports governance policy (if not for legal standards), the FCR would fail both.

The fairness argument

Sandel (2013: 111) says that the fairness argument is typified by 'the injustice that can arise when people buy or sell things under conditions of inequality'; this can have the effect of rendering a market exchange 'not always as voluntary as market enthusiasts suggest'. The parties to a bargain do not always enter that bargain on an equal footing; market transactions cannot be divorced from their context.

This imbalance in bargaining positions is a clear consequence of the FCR. Businesses of non-football provenance are left with two choices if they want to trade with a football club: either accept that if the club with whom they wish to do business becomes insolvent, their prospect of being repaid commensurate with football creditors is remote; or decline to deal with football clubs. The power lies with the football industry.

We have seen that non-football creditors to football clubs who become insolvent invariably receive only a small proportion of the debt to them repaid. In the case of Portsmouth FC's insolvency, Conn (2010) describes 'schools, hospitals, the local ambulance service, HM Revenue and Customs and scores of small businesses' as receiving 'a fraction of what they are owed'. Serby (2014) concludes that the FCR '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'. Under no ordinary use of the word can this be considered fair.

The FCR deprives non-football creditors of the opportunity to deal on fair terms; it is inherently and quite deliberately unfair insofar as it values football creditors above non-football creditors. This may not entail a breach of the *pari passu* or anti-deprivation principle but that makes it no less unconscionable.

There are potential refutations to the accusation of inherent unfairness. Firstly, there is an argument of necessity. In evidence given for the Report of the Parliamentary Select Committee on Football Governance, Shaun Harvey, then Chief Executive of Leeds United Football Club and now Chief Executive of the FL, propounded the notion that the FCR allows clubs to trade with confidence (Culture, Media and Sport Committee 2012, para. 101), as they know that financial defaults by one club will not adversely affect another.[22] The FL itself submitted to the Committee that the FCR was necessary to prevent a 'domino' effect of financial distress (para. 99). This, however, seems like a peculiar way of exonerating clubs from responsibility for managing their own finances effectively.[23] We have seen that there are strong incentives for clubs to spend speculatively and beyond their means because of the strong correlational links between spending and success; however, the FL would be better served addressing this situation – which they have moved towards with the adoption of Financial Fair Play rules – rather than legitimising unsustainable spending by instituting a self-serving *ex post* mechanism for financial failures.

A more compelling argument is that administrations in particular are not zero-sum equations; it is notionally possible that the FCR simply serves to increase the available money for football creditors without having a detrimental effect on the sums paid to non-football creditors in the way hypothesised above. However, this does not obviate the unfairness of a selected class of creditor being paid in preference to another. That the FCR may potentially attract additional funds into an insolvent estate for the benefit of football creditors in particular does not make the FCR egalitarian nor does it diminish the unpalatability of the outcome for non-football creditors; a *fair* rule would attempt to improve the position of all creditors to an insolvent football club equally. (Although it should be noted that the 2015 update to the FCR does offer non-football creditors a stronger platform, they remain disadvantaged when positioned against football creditors.) The possibility that the FCR may have a neutral impact on payments to non-football creditors does not affect the unfairness attendant to a rule that sees the majority of available resources diverted away from them.

The FCR fails the 'fairness argument' test. It creates an intrinsically unfair instrument for dealing with insolvent football clubs; it arbitrarily subjugates non-football creditors, when their importance to football or society is no less significant than that of football creditors. This is not the only one of Sandel's arguments for which the FCR fails to meet a minimum standard.

The corruption argument

There are credible reasons why football clubs would consider it a strategic benefit to spend as much money as possible on wages. The FCR attenuates the collective risk to football clubs of doing so and thus propagates speculative spending. Clubs are insulated from the downside risks of systemic overspending and the risk is instead borne by ordinary creditors.

The corruption argument, as set out by Sandel, does not focus on the parity of the participants in a transaction. Rather, it examines the impact that submission to market forces has on the goods in question. An example given by Sandel is that of college admissions: it is quite possible to amend or replace attainment-based college admission criteria for a financial criterion (i.e. college places would be sold to the highest bidder). In order to determine whether this would be valid, one must consider what norms govern the market in question – in this case college admissions – and then consider whether submitting to market forces undermines those norms. In the case of selling college admissions, it is argued that this would undermine the value of prestigious college places. Whilst allocating college places based on price would be efficient from a market perspective, it would corrupt the meaning of the goods in question: a place at college (Sandel 2013: 110).

In the case of the FCR, the norm that has been corrupted is the obligation to repay debts. The impact this has had on the market is to engender an environment where financial recklessness is acceptable amongst football clubs. The

impecuniosity of one club does not adversely affect the solvency of another, regardless of any actual creditor-debtor arrangements between them. Pressure to remain solvent and pay debts from within the football industry is dampened because the parties have no exposure; the detriment is borne by the rest of society. The economics of football rewards clubs for increasing outlay; the governance of the game debases the need to act with prudence, protecting clubs from the consequences of universal overspending.

Crowding out non-market norms

The moral impetus to act prudently enough to pay back creditors has been eroded by the insulation offered to football clubs by the FCR. The norm that should prevail – acting with financial responsibility to ensure that obligations can be met – has been supplanted by a more cavalier norm. Sandel's work suggests that this should not be surprising. He argues that markets crowd out non-market norms. For many markets, this may not be an issue; for some, it is. In the case of the FCR, the governance of the market in question has had a hand in altering norms underpinning the nature of the market.

Sandel (2013: 202) concludes *What Money Can't Buy* as follows:

> '[Once] we see that markets and commerce change the character of the goods they touch, we have to ask where markets belong – and where they don't. And we can't answer this question without deliberating about the meaning and purpose of goods, and the values that should govern them'.

Indeed, much of Sandel's work negotiates the friction between the quantitative and the qualitative. The former should not eradicate the latter and this is no less true in the case of the FCR.

There can be little dispute that commodification has a place in sport; equally, it is difficult to object to market values affecting insolvency law and policy. However, even against the 'rampant capitalism' backdrop of English domestic football (Freedland 2011), instituting and defending a policy that has seen ordinary creditors receive negligible sums in comparison to football creditors, and maintaining a policy that protects football clubs from their own overspending, cannot be considered to be in line with the values of sporting endeavour generally or good governance (or, indeed, the ethos of the variant Financial Fair Play cost control mechanisms). The rule is unfair and encourages the wrong behaviours. To reiterate the quote from the Parliamentary Select Committee on Football Governance (2011) above:

> 'The moral argument against it—that it harms the communities that football is supposed to serve—is persuasive on its own. There is, though, also a compelling systemic argument against it, namely that it positively encourages excessive financial risk-taking, in a system that already offers other inducements to so do, by offering a safety net to those who seek to benefit from such practices. The Football Creditors Rule should be abolished.'

As we have seen, football has a predisposition to financial instability. The FCR amplifies this risk, and it is ordinary creditors, such as the taxpayer, who suffer the consequences. The football industry elects to put itself at the front of the queue for repayment when a club enters insolvency and its creditors in the community are left to divide whatever scraps remain, which, as the data presented above from the insolvencies of Crystal Palace, Plymouth Argyle and Portsmouth shows, can be an order of magnitude less than football creditors receive.

The report of the Select Committee (2011) concludes:

> 'If the football authorities do not take the initiative themselves, and Her Majesty's Revenue and Customs loses its legal challenge to the Football Creditors Rule, we recommend that the Government consider introducing legislation to abolish it'.

It is difficult to conclude otherwise.

Conclusions: Towards a More Cogent Policy on Governing Insolvencies in Football

> 'If finance is allowed to dictate sporting practice, competitions and events, non-ethical behaviour is likely to spread to all sports.'
>
> — Wladimir Andreff, *Handbook on the Economics of Sport* (2006: 278)

Updates to the FCR

In June 2015, the FL's constituent clubs ratified an update to its Insolvency Policy. It was agreed that the sporting sanction for clubs entering into administration would increase from 10 points to 12 (The Football League 2015: The Football League Regulations, 12.3.1), and that the purchaser of a club in administration will be required to pay to non-football creditors a minimum of 35 pence in the pound over three years or 25 pence on transfer of share (notably close to the 30 pence in the pound proposed to and rejected by HMRC in *Wimbledon*). If this minimum sum is not paid, the club will be punished with a further 15 point penalty at the start of the season after the insolvency event. Administrators will

now be required to market clubs for 21 days, during which they must meet with the insolvent club's supporters' trust, offering the trust an opportunity to purchase the club. Clubs will no longer need to exit administration by way of CVA, as was previously required.

These changes are a positive step. They will go some way to eradicating the more extremely disparate outcomes for non-football and football creditors as seen, for example, in the Plymouth Argyle administration detailed above. However, despite being an improvement for ordinary creditors, these changes do not undo the essential normative tone created by the FCR: football creditors are still ensured payment in full, in contrast to non-football creditors. The arguments presented above in respect of the fairness argument and the corruption argument still stand.

Future legal challenges

The FCR has been criticised by various observers, including legal scholars, journalists, Parliament and the judiciary (*HM Revenue and Customs* para. 2); nevertheless, it survived HMRC's litigation. On the basis of its nebulous efficacy, manifest unfairness and inappropriate normative tone, there are compelling arguments for the discontinuation of the FCR, but these arguments are not the limit to the considerations in respect of the FCR, nor does the result of *HM Revenue and Customs* insulate the FL and the PL from further legal challenges. Richards J. made it clear that his judgment in *HM Revenue and Customs* was intended to address only the insolvency law questions at hand and not the broader legality of the FCR: 'a decision on a challenge brought on a particular legal basis' (para. 189). For example, given the market structure of professional sport, the FCR is susceptible to challenge on the basis of its compatibility with Chapters I and II of the Competition Act 1998.

In an environment in which taxpayer money being diverted to clubs has been determined to create unfair competition in contravention of European Union state aid law (see European Commission 2016a and European Commission 2016b), promulgating a system whereby football creditors are habitually repaid in full when the tax authorities are not is aberrant. The football industry is seeking to give itself a state-funded advantage, which, given the censure of clubs in Spain and the Netherlands for receiving state aid, is a stance appearing to lack co-ordination or coherence. A more joined-up, consistent approach should be targeted.

Given the intangible benefits of the FCR, its abolition should be preferred to further dispute on its legality.

The Financial Fair Play era

Controversy surrounding the implementation of Financial Fair Play (FFP) rules across domestic and European football may have distracted from the debate over the FCR. Rather than the two being discrete, the success of FFP, which has helped foster an environment in European football whereby there have been significant reductions in financial losses, significant reductions in overdue payables, and revenue growth outpacing wage growth for first time since UEFA started collecting and analysing pan-European data (UEFA 2014), should inform the residual debate around the FCR.

FFP is not without its own attendant legal challenges (Flanagan 2013), but the evidence suggests it is having a positive impact on financial stability (UEFA 2014). FFP also represents a more pro-active, *ex ante*, approach to solvency in comparison to the *ex post* FCR approach. It makes more sense to prevent insolvency insofar as is possible than it does to have a complicated mechanism for protecting the football industry from the fall out.[24]

FFP's pan-European reach also provides more extensive protection to clubs than is afforded by the FCR. Football is a global game, and the FCR does not protect clubs from insolvencies in other countries.

It is not unreasonable to contend that the FCR somewhat undermines FFP: whereas FFP looks to rationalise spending in football, the FCR tacitly endorses reckless spending in the pursuit of sporting success.

It could be suggested that the FCR and FFP are not mutually exclusive, and this is, of course, correct; however, given the moral issues associated with FCR and the fact that FFP seeks to address solvency issues, the necessity to persist with the FCR is questionable. There is no need for the two policies to coexist; the more coherent approach is for FFP to supplant the FCR.

The history, culture and economics of professional football in England and Wales are unlikely to enable the sort of fundamental reorganisation of the game that could eradicate the occurrence of insolvency; however, on the basis of the arguments set out in this paper, the abandonment of the FCR would be a good start – for the benefit of football itself and the communities football serves and represents.

Notes

The views and opinions expressed herein are solely those of the author and do not reflect the views and opinions of the author's affiliated organisations.

1. A preferential creditor being an ordinary unsecured creditor elevated by the Insolvency Act 1986 s.175 and s.328 so as to be paid before other ordinary unsecured creditors.
2. At the material time, the FCR required clubs to exit administration by way of CVA. This is no longer the case. See 'Updates to the FCR above'.
3. Per the judgment in the HMRC case, para. 17:
   'Insolvency Event' is defined in Article 2.1 to mean any of the following:
   a) entering into a Company Voluntary Arrangement pursuant to Part 1 of the Insolvency Act, a Scheme of Arrangement with creditors under Part 26 of the 2006 Act, or any compromise agreement with its creditors as a whole;

b) the lodging of a Notice of Intention to Appoint an Administrator or Notice of Appointment of an Administrator at the Court in accordance with paragraph 26 or paragraph 29 of Schedule B1 to the Insolvency Act, an application to the Court for an Administration Order under paragraph 12 of Schedule B1 to the Insolvency Act or where an Administrator Order under paragraph 12 of Schedule B1 to the Insolvency Act or where an Administrator is appointed or an Administration Order is made ('Administrator' and 'Administration Order' having the meanings attributed to them respectively by paragraphs 1 and 10 of Schedule B1 to the Insolvency Act);
c) an Administrative Receiver (as defined by section 251 of the Insolvency Act), a Law of Property Act Receiver (appointed under section 109 of the Law of Property Act 1925) or any Receiver appointed by the Court under the Supreme Court Act 1981 or any other Receiver is appointed over any assets which, in the opinion of the Board is material to the Club's ability to fulfil its obligations as a Member Club;
d) shareholders passing a resolution pursuant to section 84(1) of the Insolvency Act to voluntarily wind up;
e) a meeting of creditors is convened pursuant to section 95 or section 98 of the Insolvency Act;
f) a winding up order is made by the Court under section 122 of the Insolvency Act or a provisional liquidator is appointed under section 135 of the Insolvency Act;
g) ceasing or forming an intention to cease wholly or substantially to carry on business save for the purpose of reconstruction or amalgamation or otherwise in accordance with a scheme of proposals which have previously been submitted to and approved in writing by the Board;
h) being subject to any insolvency regime in any jurisdiction outside England and Wales which is analogous to the insolvency regimes detailed in paragraphs (a) to (g) above; and/or
i) have any proceeding or step taken or any court order in any jurisdiction made which has a substantially similar effect to any of the foregoing.'

[4] 'except in so far as they may have priority as secured creditors or a statutory right to preference', see Commercial Law Texts, Cases, and Materials (Sealy & Hooley 2009: 1211).

[5] See Belmont Park Investments PTY Ltd. and others v BNY Corporate Trustee Services Ltd. and another [2011] UKSC 38; [2012] 1 A.C. 383 at para. 2 of Collins J's judgment.

[6] Whittaker (2012: 194) describes this as a 'murky distinction,' as 'it does not follow that simply because a limitation on the scope of ownership was included from the outset that it will necessarily be safe from the ADP.'

[7] Per Schedule 6, and sections 175 and 386 of the Insolvency Act 1986. Preferential creditors include particular employee claims and contributions to pension schemes.

[8] Together with 74 other airline operators.

[9] For the statutory purposes of administration, see Schedule B1 of the Insolvency Act 1986

[10] Comprising a Football League Loan of £281,380; a FL Pension Deficit of £50,909; an early termination of players' contracts liability £2,874,151; and liabilities to other clubs of £56,000
For full details see The P&A Partnership, 2012. at Appendix 3, Estimated Outcome Statement.

[11] The Scottish Premier League and the Scottish Football Association rules do contain certain offset provisions whereby prize money can be withheld and offset against monies owed to the Scottish Premier League, the Scottish Football Association, or their constituent members – see The Rangers Football Club PLC (In Administration) Joint Administrators' Report to Creditors and Statement of Proposals, 5 April 2012 at paragraph 14.35, Companies House 2012.

[12] The alternative model of club structure being the private membership club (unincorporated association), owned and run by its members, who bore unlimited personal liability for the obligations of the club, and whose 'objective was to promote the playing of the game, with no concern over the pursuit of financial gain' (Morris 2011); a position that became increasingly untenable with the growth in popularity of the game and thus the growth in legal risk to clubs' members.
The outlying anomaly was Nottingham Forest, who did not adopt limited liability status until 1983, when they became the last professional club to do so (Szymanski 2015).

[13] See, for example, the story of Real Oviedo in Spain, who, when on the verge of going out of business, were saved by investment from their own fans, former players, rival sides such as Spanish monolith Real Madrid and fans of other clubs the world over, rescuing the club and ensuring its short-term viability (Lowe 2012).

[14] There is an additional mechanism used by certain secured creditors in respect of companies in financial distress, being receivership (including administrative receivership) although insolvency reform instituted by the Enterprise Act 2002 making receivership a less attractive option meant 'administration is now the most popular insolvency procedure, displacing...receivership' (Sealey and Hooley 2009).

[15] The statutory grounds being service of a valid statutory demand; the existence of an unsatisfied judgment debt; or failure of either the 'cash flow' or 'balance sheet' tests for solvency.

[16] It should be noted, notwithstanding football clubs' propensity to survive in some iteration, that many clubs went through some form of restructure during the period highlighted by Kuper and Szymanski. For example, league clubs from 1923 such as Accrington Stanley FC and Newport County AFC went through liquidation and subsequent reformation; and some clubs went through consolidation and or merger with other local clubs, for example, Rotherham County FC, South Shields FC and Aberdare Athletic FC each merged with nearby local clubs.

[17] Kuper and Szymanski highlight the work of economic historian Les Hannah, whose research into the biggest 100 global companies between 1912 and 1995 reveals that, in contrast to the football industry, almost half of the organisations had ceased to exist by 1995 (Kuper and Szymanski 2012: 89). However, it should be noted that only five of those perished through insolvency, with the remainder of the 'disappearing' companies having merged with other companies or been nationalised, options that are less commonly available for football clubs. (Although merger between smaller clubs is not without precedent, particularly in the pre-World War II era, it is not a common feature of the post-war professional game.) So, perhaps football is more congruent with the broader economy than the headline statistics suggest.

[18] Paragraph 3 Schedule B1 of the Insolvency Act 1986 lists the statutory purposes of administration as being:
(a) rescuing the company as a going concern, or
(b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
(c) realising property in order to make a distribution to one or more secured or preferential creditors.

[19] Administrations can be invoked either by creditors, directors, the company itself or its insolvency practitioners, by way of application to the court; or by service of notice to the court with supporting documentation by a qualifying floating charge holder (if the floating charge meets the requirements of paragraph 14(2) of Schedule B1 to the Insolvency Act 1986).

[20] It should be highlighted that the analysis described by Finch is predominantly focussed on American legal economic scholars; however, the principles described – and the quote highlighted – are equally germane to UK corporate insolvencies.

[21] It is interesting to note, however, the recent Court of Arbitration for Sport adjudication 2012/A/2985 Racing Club v. Genoa Cricket and Football Club S.p.A., in which it was noted that 'only a club and not a private company can transfer the Player's federative rights and the proportion of economic rights it eventually holds' (see Court of Arbitration for Sport, 'CAS Bulletin 1/2014' (CAS-TAS 2014) Available at http://www.tas-cas.org/fileadmin/user_upload/Bulletin_1_2014.pdf at p.76 accessed 30 August 2014), which does suggest that certain rights are imputed to clubs rather than the companies that run those clubs. The particular facts of Racing Club v. Genoa are, however, perhaps too idiosyncratic to infer general principles.

[22] "If Leeds defaulted in this example on a payment to Crewe, which meant Crewe had to sell their players to keep in business, that cannot be a fair and rational position for Crewe to be put into", (Culture, Media and Sport Committee 2011 para.101).

[23] For example, if clubs were concerned about exposure to other clubs' future impecuniosity, it would be within their gift to request the payment of transfer fees up front rather than paid over a term. Such risk management is within clubs' individual discretion.

[24] To this end, it is perhaps disappointing to note the recent weakening of the Championship's FFP rules, which 'may struggle to reduce Championship clubs' losses in future seasons' (Deloitte 2016: 26), particularly given the high wage-to-turnover ratios observed in that league. This follows the '2015/16 season [being] the third consecutive season where there have been no insolvency events in the Football League' (Deloitte 2016: 27).

Competing Interests

The author has no competing interests to declare.

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