



HARE COURT

Insolvent FC

What Happens When Your Club Goes into Administration? The Framework for Survival and the Football Creditor Rule

'Some people believe football is a matter of life and death. I am very disappointed with that attitude. I can assure you it is much, much more important than that.'

Clubs in Danger

That Bill Shankly's celebrated witticism was never at all as serious as contemporary motivational posters might have you believe is something which is presently being thrown into sharp relief by the Covid-19 pandemic. But football, that most important of unimportant things, will at some stage return. Except that is, for those clubs which might not. Insolvency hurdles too stand in the way of your place on the terraces.

Football insolvencies are different than others. In their community impact, yes, but, to some extent at least, legally as well. They may also be becoming more common.

In its Football Distress Report published just last year, insolvency specialists Begbies Traynor found an 8% increase in English Football League clubs showing serious signs of financial trouble.¹ With many clubs deriving significant amounts of their income from gate receipts (and this is not to mention the manifold other financial problems arising from lockdown) it does not take a soothsayer to forecast that this figure may go higher still. Pair that to the warning of Fausto Zanetton, CEO of Tifosy Capital & Advisory, leaders in advisory and capital solutions in the sports industry, that some clubs 'will really struggle' on account of the pandemic² and sensible football fans ought to be chilled.

The Football League

So, what is the process when your team becomes Insolvent FC?

This piece addresses the situation in the Football League (that is, in England and Wales, the Championship, League 1, and League 2) but there are similarly motivated mechanisms in play in the Premier League, albeit they are not the same.

¹ Begbies Traynor, 'Red Flag Alert Football Financial Distress Report' May 2019, https://www.begbies-traynorgroup.com/assets/uploads/pdfs/5303_ENGLAND%20Football%20Report.pdf accessed on 29 April 2020

² Sport Business, 'Some clubs will really struggle' | Tifosy CEO Fausto Zanetton on surviving the shutdown , <https://www.sportbusiness.com/2020/04/tifosy-ceo-fausto-zanetton-on-football-clubs-surviving-the-shutdown/> accessed on 29 April 2020

The Football League has been spotlighted for two reasons. First because it provides a good illustration of industry wide issues and, secondly, because a 2011 High Court challenge by HMRC against its version of the controversial Football Creditor Rule is central to where we find ourselves today in analysing footballing insolvencies.

For its part, the focus is on administration not only due to the processes' special resonance in the footballing lexicon but also due to its particular – and perhaps surprising – relationship with the *pari passu* principle as established in the leading High Court decision.³

Framework and Consequences

The Football League is a limited company with a share capital of £5 divided into 100 shares. 72 of these have been issued and are known as 'Golden Shares'. It is having this share which makes Insolvent FC a member and allows it to play.

Accordingly, Insolvent FC is subject to the League's rules and policies. One of these policies is the 2015 Insolvency Policy which sets out a number of the consequences of going into administration such as:

- (i) The possible imposition of a 12 point deduction known as a 'sporting sanction' to be applied in the current or following season, depending on whether administration occurs before or after 5pm on the fourth Thursday in March;
- (ii) Further, even upon successfully exiting administration fresh sporting sanctions are available to bite. Insolvent FC must pay its creditors a minimum of 35 pence in the pound over 3 years (or 25 pence on transfer of share) in default of which it faces a fresh 15 point deduction at the start of the season following administration;
- (iii) Perhaps more happily (but perhaps not) the fans must also be given the opportunity to buy the club, with the administrator being required to market the club for at least 21 days during which time she must meet the club's supporters' trust for this purpose;

Even a vague familiarity with league tables makes plain that the sporting sanctions are punchy. But still greater risks lie in the administration route for Insolvent FC.

The Quirk of the Golden Share

Upon entering administration Insolvent FC's Golden Share – and with it its status as a Football League club – is thrown into jeopardy. This is because clause 4 of the Football League's Articles of Association vests ultimate control of the ownership of its Golden Share in the Football League and administration begins the process of notice by which Insolvent FC's Golden Share can be transferred from it.

In other words, Insolvent FC stands to crash out of the league and, with it, very possibly, out of business.

³ It is to be noted that the same rules (as adjusted to the particular insolvency proceeding at issue) apply to various other 'insolvency events' as defined in the Football League's Articles of Association, including the entering into a Company Voluntary Arrangement pursuant to the Insolvency Act 1986.

The Football Creditor Rule

But dire fates can be avoided. By clause 4.8 of the Articles of Association the Football League Board may suspend the notice transferring Insolvent FC's Golden Share on condition that a body of creditors known as 'Football Creditors' are paid the totality of whatever the club owes them. This is the Football Creditor Rule, or 'FCR.'

Football Creditors are defined by the Articles of Association and include the Football League itself, others member clubs, players, and management teams. Critically, the relevant rule makes no provision for other unsecured creditors who would, absent the clause, rank the same in priority in insolvency as the Football Creditors.

Such a situation, one might think, may be lamented as being contrary public policy, and perhaps even public morals. After all, the league imposes as a condition of continued participation that your elite, often well remunerated striker is to be paid in full, even if that means St John Ambulance is not. Which brings us to a big question.

Surely the FCR Breaches the *Pari Passu* Principle?

The administration of football clubs is, as with other industries, controlled by the Insolvency Act 1986. As is well known, this regime and its supporting case law broadly require that all equivalent creditors are treated equally, bringing into play the familiar spectres of the anti-deprivation rule and the *pari passu* principle. It is by these mechanisms that unsecured creditors receive *pro rata* shares of what they are owed. And, of course, these are things parties cannot contract out of.

Now on its face the Football Creditor Rule, in preferring some unsecured creditors ahead of others purely on the basis of self-determined associations with football, breaches the *pari passu* principle. And, in fact, this was the view of HMRC in its challenge to the FCR in the 2011 case *The Commissioners for Her Majesty's Revenue and Customs v The Football League Ltd and The Football Association Premier League Ltd* [2012] EWHC 1372 (Ch). By contrast, the Football League contended that FCR was required to ensure the integrity of competition as well as to avoid unfair competitive advantage being gained.

After 5 days of argument, the FCR survived. What was key for David Richards J in reaching his conclusion was that administration seeks to save a company. Its purpose, unlike liquidation, is not to provide distributions for creditors (albeit that is a power an administrator possesses). Rather:

'so 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, the application of the pari passu principle so as to render void some of its contracts could be very damaging.'

On this basis, the Court held that it is only when an administrator gives formal notice of a proposed distribution that the *pari passu* principle applies in administrations. Consequently, because, in a typical case, the payment of Football Creditors will take place at a point in time before any such notice is given, then the FCR was found not to be contrary to English law.

A Sting in the Tail?

So, having paid its Football Creditors (and complied with the Insolvency Policy) Insolvent FC has survived. But there's a sting in the tail for the Football League.

The High Court was plainly unimpressed by the FCR. It was equally unimpressed by the Football League's justifications for it. Now, here in 2020, and possibly on the cusp of a considerable number of footballing insolvencies, the final paragraph of the judgment, it seems, repays further reflection:

'The [Football League] 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.'

Perhaps it may yet be game on.

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