

# Agenda

## Advancing economics in business

### The charity league: state aid investigations in European club football

**The European Commission is becoming increasingly interested in investigating whether European football clubs are accessing state aid, and whether this funding is compliant with state aid rules. A judgment in the UK courts in June 2014 relates to whether Coventry City Council's assistance to the stadium of Coventry City Football Club meets the market economy operator (MEO) test**

The financial operations of football clubs have come under increased scrutiny since UEFA (the Union of European Football Associations) released its Financial Fair Play (FFP) Regulations in 2010.<sup>1</sup> Since then, questions about the compatibility with state aid rules of dealings between football clubs and local authorities have gained prominence. The European Commission and UEFA had previously issued a joint statement setting out their intention to work collaboratively in order to ensure that FFP was not undermined by weak state aid compliance.<sup>2</sup>

In late 2013, the Commission announced the launch of state aid investigations into Spanish football clubs, including Real Madrid, Valencia and Barcelona.<sup>3</sup> The announcement followed the launch of investigations into clubs in the Netherlands.<sup>4</sup> More recently, the Commission has looked into football clubs in the UK.<sup>5</sup>

#### Case study: applying the MEO test in judicial review

A judgment<sup>6</sup> in the English Courts in June 2014 involved a state aid<sup>7</sup> allegation relating to financial assistance offered by Coventry City Council (the Council) to its portfolio company, Arena Coventry Limited (ACL). ACL owned the Ricoh Arena, the home of Coventry City Football Club (CCFC).<sup>8</sup> Although several grounds for judicial review were advanced, the case centred on the allegation of state aid, and whether the Council was acting in accordance with the MEO test.<sup>9</sup>

This case provides guidance on the following aspects of domestic state aid litigation:

- the test applied by the judge (as part of judicial review proceedings) in determining whether the action by the member state is consistent with the MEO test;

- the evidence and economic analysis admissible in Court as part of judicial review.

The case is similar to some of the current investigations against football clubs being pursued by the Commission, to the extent that it involves the alleged granting of aid by a local public authority to a football club/stadium. In this case, the Council had a 50% stake in the stadium (the remaining 50% was owned by The Alan Edward Higgs Charity). However, it is also unique because the claimant, Sky Blue Sports (SISU, a hedge fund), owns CCFC, which was the anchor tenant at the stadium.

#### Background to the case

The origins of this dispute appear to be in the fixed £1m+ annual licence payment made by CCFC to ACL for occupying the stadium. At the time when this licence payment was set in 2006, and until 2012, the club played in the second-tier Football League Championship. In April 2012, CCFC was relegated to Division One. At the same time, the Football League introduced FFP rules. It would appear that the combination of relegation in April 2012 and the adoption of FFP rules meant that the £1m+ licence payment became highly unattractive for CCFC. It appears that SISU, in order to realise returns from its investment in CCFC, had been negotiating a restructuring of the deal between ACL and CCFC. As part of these efforts, SISU sought to acquire a stake in ACL as it regarded the revenues from the stadium as crucial. As no satisfactory agreement was arrived at, CCFC withheld rent payment from ACL from April 2012 onwards.<sup>10</sup> Without the rent being paid regularly, SISU knew that ACL would not be able to continue to service its debt.<sup>11</sup> As noted in the judgment, SISU's strategy of distressing ACL's financial position in this way was deliberate and designed to put SISU into the optimal commercial position to broker a deal most advantageous

to it.<sup>12</sup> It considered this strategy to be necessary if it was to recover its investment in the club.<sup>13</sup> This meant that ACL's creditor (Yorkshire Bank) was likely to put ACL into administration, leading to the distressed sale of ACL's assets (i.e. the lease on the stadium) and write-off of the Council's equity value in ACL.

A logical solution would have been to renegotiate the rent paid by CCFC such that it would adjust with the club's fortunes, but this was rendered difficult by the level of ACL's indebtedness to the Bank. In order to reduce the rent to be paid by CCFC, ACL would first require financial restructuring to reduce its outgoing debt payments. This could have occurred in a variety of ways. Among the available options, SISU offered to conduct a transaction whereby it would take ownership of ACL's entire bank loan, provided it could acquire the charity's 50% stake in ACL. In exchange, it sought an extension to the existing lease on the stadium. This deal never materialised, and the Council subsequently negotiated, refinanced and restructured ACL's bank loan to protect its equity stake in the stadium.<sup>14</sup> Subsequently, for the 2013/14 season, CCFC shifted base to Northampton and played its home games at the Sixfields stadium.

The restructured loan from the Council to ACL ensured that annual debt service obligations were reduced by almost half.<sup>15</sup> The difference in annual payments arose from a substantial increase in the term of the loan. This long-term finance allowed ACL to restructure its business operations, and matched its main liability to its main asset (i.e. to the term of the lease on the stadium). It did not require any significant change in the interest rate on the loan, which remained similar to the bank loan.

SISU's primary grievance was that the terms under which the Council refinanced ACL's bank loan amounted to unlawful state aid. The judge, Mr Justice Hickinbottom, rejected SISU's claim on all grounds, and concluded that the loan extended by the Council did not constitute state aid.<sup>16</sup>

## Approach to assessing the MEO test in a judicial review

The judge set out up-front that the Court was concerned only with whether the transaction represented state aid, and was not concerned with answering the question of whether that state aid was justified.<sup>17</sup>

First, in setting the threshold for the MEO test, the judge recognised that the hypothetical private investor needed to have similar economic interests to the Council—i.e. that the Council was also a 50% shareholder in ACL. If the transaction had been scrutinised in isolation from the Council's shareholding position in ACL, it is unlikely that it would have passed the MEO test.

Second, although the judge acknowledged that the MEO test needed to be carried out on the basis of the ex ante data that was available, he discounted some contemporaneous

evidence relating to ACL's valuation by the Council in its negotiations with the Bank. In doing so, he stated the following:

when discussing a loan buy-out with the Bank, it was of course in the interests of the Council (as well as those of ACL and SISU) to talk down the value of ACL and thus the value of the loan the Bank held.<sup>18</sup>

He also referred to a court judgment made after the loan action had been completed in assessing the evidence concerning the state of the negotiations between SISU and the charity for the sale of the latter's stake in ACL.<sup>19</sup>

The Court also focused on the Council's decision to grant the loan, and the evidence informing that decision. The extent of evidence that was allowed to be submitted and reviewed by the judge was limited to the key facts of the case.

Lastly, in the methodology adopted by the Court in assessing whether the terms of the loan were market-conforming, the judge accorded considerable weight to the Commission's standardised reference and discount rates for member states.

## Key implications

One inference from this ruling is that, for defendants, it is not essential to show that every private investor would have offered the same deal. The burden of proof appears to rest with the claimant to show that no rational private investor would have entered the transaction. In particular, the case distinguishes between a private creditor and a private investor test—the creditor is primarily concerned with the most effective means of recovering their debt, whereas the investor's commercial interests may well include ensuring that the undertaking concerned avoids going into liquidation because, in the investor's view, profitability might reasonably return in the future. As stated by the judge:

the very nature of the issue of whether a private investor would enter into a transaction implies a wide margin of judgment on the part of the investor and consequently a wide margin in discretion when any decision falls into the hands of the state with regard to whether a matter is state aid or not.<sup>20</sup>

Another development has been the non-acceptance of expert evidence by the judge as part of judicial review. In contrast, the Commission has tended to conduct a more detailed review of the financial analysis. Also, litigation cases involving competition law routinely include cross-examination of experts. Nevertheless, although the claimant's application to submit extended witness statements and expert evidence as part of the formal judicial proceedings was not accepted (partly due to the lateness of the submission),<sup>21</sup> the arguments of both the claimants and defence were informed by financial and economic advice from experts.

The outcome of the case hinged on financial analysis relating to the future profitability of ACL's activities, the current valuation of its assets, and the terms under which the loan was granted. In all circumstances, the judge agreed with the analysis presented by the defence.<sup>22</sup>

Furthermore, the judge was not persuaded by arguments that the Council had taken into account wider public benefits that a private investor is unlikely to have considered. He noted that, as a public body, the Council was duty-bound to act in the public interest, but this fact in itself did not violate the MEO test. As long as a private investor (without objectives of public duty) could have arrived at the same decision as the Council, the MEO test was satisfied.<sup>23</sup>

Lastly, the case has highlighted the importance for public bodies to obtain independent advice and prepare credible business plans to inform their decisions regarding deals involving public funds or publicly owned assets. In this case, the fact that the Council had done so was helpful to its defence.

## Conclusions

The Commission's launch of investigations into dealings between public authorities and football clubs conveys the message that its approach to applying Article 107 (1) TFEU to football will be consistent with that for any other sector, and that the need for advance notification is essential. It also suggests that sports businesses, in accessing government assistance, need to be compliant with state aid rules, as is the case in other sectors.

Although football clubs may argue that available exemptions are applicable in their particular cases, the benchmark for this appears to be quite high.<sup>24</sup>

In light of this, it is clear that football clubs and local authorities need to monitor their financial relationships to ensure that their dealings do not amount to state aid.

Following the conclusion of this case, in September 2014 CCFC returned to the Ricoh Arena in Coventry to play its home matches.

<sup>1</sup> See UEFA (2011), 'Fair play and Respect', 13 January.

<sup>2</sup> European Commission and UEFA (2012), 'Joint Statement by Vice-President Joaquín Almunia and President Michel Platini', 21 March. See also Petit, N. (2014), "'Financial fair play" or an "oligopoleague" of football clubs?', *Agenda*, July.

<sup>3</sup> European Commission (2013), 'State aid: Commission opens in-depth investigation into public funding of certain Spanish professional football clubs', press release IP/13/1287, 18 December.

<sup>4</sup> European Commission (2013), 'State aid: Commission opens in-depth investigation into public funding of five Dutch professional football clubs', press release IP/13/192, 6 March.

<sup>5</sup> See European Commission (2014), 'Question for written answer E-014403/13 to the Commission. Diane Dodds (NI) (20 December 2013)', *Official Journal of the European Union*, C 288/110, 28 August.

<sup>6</sup> *Sky Blue Sports & Leisure Limited, Arvo Master Fund Limited and Coventry City Football Club (Holdings) Limited v Coventry City Council*, [2014] EWHC 2089 (Admin) ('the judgment').

<sup>7</sup> State aid is defined as any aid granted by a member state or through state resources in any form which distorts, or threatens to distort, competition by favouring certain undertakings.

<sup>8</sup> Over the period of the dispute, CCFC played its home matches in Northampton. In October 2014, the Council sold its stake in the Ricoh Arena to rugby team, London Wasps.

<sup>9</sup> The MEO test is also referred to as the Private Investor Test (PIT) or the Market Economy Investor Principle (MEIP). It aims to determine whether a rational private investor, creditor or vendor might have entered into the transaction in question on the same terms, taking into account the foreseeability of obtaining a return and leaving aside all social and policy considerations.

<sup>10</sup> Details of the case provided in this section are taken from the judgment. See the judgment, paras 9 to 25.

<sup>11</sup> See the judgment, para. 19.

<sup>12</sup> See the judgment, para. 32.

<sup>13</sup> See the judgment, para. 38.

<sup>14</sup> See the judgment, paras 16 and 17.

<sup>15</sup> See the judgment, para. 67.

<sup>16</sup> See the judgment.

<sup>17</sup> The judgment, para. 88.

<sup>18</sup> The judgment, para. 95.

<sup>19</sup> The judgment, paras 40–43.

<sup>20</sup> UK State Aid Law Association (2014), 'Applying the Private Investor Test in Judicial Review: R (Sky Blue Sports & Leisure Limited & Ors) v Coventry City Council [2014] EWHC 1747'.

<sup>21</sup> The witness statement relates to that of Ms Joy Seppala, founder and CEO of SISU. The defendants did not forward any expert evidence as part of their submissions.

<sup>22</sup> SISU was supported by valuation and corporate finance advisers, Duff & Phelps, whereas the Council drew on financial and economic advice provided by Oxera.

<sup>23</sup> See the judgment, para. 88.

<sup>24</sup> See Craven, R. (2014), 'How State Aid Rules Are Being Applied to European Football: PART 2 – The Availability Of Exemptions', *LawInSport*, 7 July. One example of the Commission approving public funding for the construction of an arena is the public co-financing of the Uppsala Arena in Sweden. In this case, the Commission found that the public funding was both proportional to the objective pursued, and limited to the minimum necessary to attain that objective. See European Commission (2013), 'IP/13/394– State aid: Commission authorises public co-financing of Uppsala arena in Sweden', press release, 2 May.