SPORT RESOLUTIONS (UK)

SPECIALIST INDEPENDENT DISPUTE SERVICE

SR/Adhocsport/199/2018

IN THE MATTER OF AN EFL DISCIPLINARY COMMISSION

Before:

Charles Flint QC
Arthur Harverd
Dr. Neil Hudgell

BETWEEN: -

THE ENGLISH FOOTBALL LEAGUE (the EFL)

Claimant

-and-

BIRMINGHAM CITY FOOTBALL CLUB (the Club)

Respondent

DECISION

James Segan, instructed by Solesbury Gay and Nick Craig (Governance and Legal Director) for the EFL

Daniel Bayfield QC and Tom Richards, instructed by Mishcon de Reya for the Club

1. By a letter dated 14 August 2018 the EFL gave notice that the Club was referred to a Disciplinary Commission in connection with breaches of the Championship Profitability and Sustainability Rules (**P&S Rules**). The members of the Disciplinary Commission were appointed and on 18 October 2018 directions were made for the preparation of the case with a view to a hearing fixed to commence on 26 February 2019. The directions recorded that the Club had already accepted

the charge, and that the matter would proceed for determination of the appropriate sanction.

2. The Club has filed a Response to the charge dated 21 November 2018, to which the EFL served a Reply on 20 December 2018, subsequently amended by agreement on 28 January 2019. On 8 February 2019 witness statements were exchanged.

Jurisdiction

3. On 19 February the member of the Commission who had been appointed by the Club resigned. The consequences of that resignation, including the need to adjourn the hearing to a date subsequently fixed for 18 March, were dealt with in directions made by the chairman on 22 February. The Club was required to appoint a replacement member as soon as reasonably practicable under paragraph 3.3 of the Procedural Rules, and given the urgency of convening a hearing the Club was directed to make that appointment by Monday 4 March. A copy of the decision making those directions is included in this decision at Annex A.

4. The Club did appoint a replacement member on 27 February, but her appointment was challenged by the EFL and she subsequently resigned on 28 February. In view of the urgency the chairman had given notice that he proposed to exercise the power to make an appointment under paragraph 3.1 of the Procedural Rules, and by a written decision made on 11 March he appointed Dr. Neil Hudgell as a member of the Commission. A copy of the reasoned decision making that appointment is included in this decision at Annex B.

5. The Club, by letter dated 12 March, has challenged the power of the chairman to have made that appointment and objects under section 31 of the Arbitration Act 1996 (**the Act**) that the Commission is not properly constituted, and is thus exceeding its jurisdiction. The Club requested the Commission to rule on this objection under section 30 of the Act either in a separate award or as part of this decision, or to stay the proceedings to allow an application to be made to the court under section 32. The Club has made clear that it is not waiving its objection to jurisdiction by continuing to participate in the proceedings. At the hearing the Club made clear that the grounds of objection are only those set out in its letter dated 8

March, namely (i) the power of the chairman to make an appointment under paragraph 3.1 of the Procedural Rules does not apply where a member resigns and requires to be replaced (ii) the Club had not failed to make an appointment and (iii) the necessary notice under paragraph 3.1 was not given.

6. The Commission has considered this objection and decided to deal with it in this decision. The reasons for the chairman's decision to make the appointment are as set out in Annex B. In addition to those reasons the chairman had power under paragraph 4.1 (i) of the Procedural Rules to abbreviate any time limits provided by "this section of the Regulations". That is a reference back to Regulation 90.4 which applies the Procedural Rules, and in its context that phrase includes any time limits in the Procedural Rules, in particular under paragraph 3.1. In addition the chairman had power under paragraph 4.1 (k) to give such other lawful directions necessary to ensure the just, expeditious, economical and final determination of the dispute. Those rules empowered the chairman, in the exceptional and unfortunate circumstances of this case, to give directions as to the period within which the Club should appoint a replacement member and, if necessary, to abbreviate the time limit of 3 days set out in paragraph 3.1.

7. Having considered these points the Commission has decided that it is properly constituted and has jurisdiction to determine this matter.

Procedure

8. A hearing was held on 18 March 2019. There was written evidence from six witnesses: for the EFL, Nicholas Craig (Governance and Legal Director), James Karran (Financial Controller) and Shaun Harvey (Chief Executive); and for the Club, Xuandong Ren (CEO since June 2017); Asif Khawaja (CFO since August 2018); and Ciara Gallagher (Club Secretary since August 2018). Only Mr Harvey and Mr Ren were cross-examined on their witness statements; the other statements were not disputed.

Issues

9. The Club has admitted that it was in breach of Rule 2.9 of the P&S Rules by incurring adjusted losses totalling £48.787 million over a monitoring period

comprising seasons 2015/16, 2016/17 and 2017/18. Such adjusted losses exceeded by £9.787 million the permitted upper loss threshold of £39 million over that period.

10. Under Regulation 91 of the EFL Regulations a Disciplinary Commission has a wide power to impose sanctions for breach which may include ordering a deduction of points or imposing a financial penalty.

11. The question to be decided is the fair and correct sanction to be imposed on the Club on the facts of this case. In the course of the hearing it became clear that the parties were agreed that the proper sanction is a points deduction to be applied in the current season. The issues raised are:

    (1) whether the contravention was aggravated by the conduct of the Club in proceeding to sign a player after it had been informed that it was under an embargo on registering new players;

    (2) whether the Club gained an actual sporting advantage by exceeding the limits on permissible expenditure;

    (3) the relevance of the guidelines on sanctioning which were approved by the board of the EFL on 17 September 2018;

    (4) whether there is any substantial mitigation as argued by the Club.

The facts

12. In October 2016 control of the Club passed to Trillion Trophy Asia Limited, the ultimate owner of which was Paul Suen, who was chairman of the immediate holding company of the Club, Birmingham Sports Holdings Limited. Xuandong Ren was appointed as CEO of the Club in June 2017. He had experience of running a football club in China, but had not previously managed a club subject to EFL P&S Rules.

13. There is no dispute as to the losses incurred by the Club during the relevant monitoring period. Those losses, shown in the table below, are taken from the audited financial statements for each of the 3 years of the relevant monitoring period, appropriately adjusted pursuant to the P&S Rules:

Season 2015/16 **T-2**	Season 2016/17 **T-1**	Season 2017/18 **T**
Loss £1.982m	Loss £12.944m	Loss £33.861m

The aggregate loss for the monitoring period was £48.787 million, exceeding the upper loss threshold of £39 million by £9.787 million. The loss in 2016/17 was only just below the annual upper loss threshold of £13 million, and the loss in 2017/18 was £20.86 million above the annual threshold.

14. The trend of increasing losses during the monitoring period appears from the evidence of Mr Ren to have been mainly accounted for by the expensive acquisition of players in the January 2017 and summer 2017 transfer windows. In January 2017 the manager Gianfranco Zola signed four new players at a total cost of £7.45 million. In the summer 2017 transfer window the new manager Harry Redknapp made 9 permanent signings and brought in 5 loan players at a total cost of £23.75 million. From the evidence of Mr Khawaja, the CFO of the Club since August 2018, the player expenses of £11.3 million in 2016/17 nearly doubled to £22.45 million in 2017/18. Mr Ren accepts that the main cause of the breach of the P&S Rules in the 2017/18 season was the cost of signing new players and the cost of hiring and firing the two managers.

15. The analysis by Mr Karran, the financial controller of the EFL, was that in the period from 6 July 2017 to the end of the summer 2017 transfer window the transfers, less the sale and loan of players, resulted in the Club's liability for salary costs increasing by £8 million in the 2017/18 season alone. Wages as a percentage of turnover increased from 120% in 2016/17 to 195% in 2017/18. Over the same period net debt increased from £31.7 million to £71.1 million.

16. In the Club's Response at paragraph 9 (5) it was asserted:

> "This is a case of a Club which employed the wrong managers in the sense that:
>
> (a) The managers overspent on transfer fees, loan fees, signing on fees and player wages, having no or no adequate regard to the P&S Rules or the Club's financial health generally;

(b) The managers and their support staff largely failed but were, in many cases, entitled to substantial termination payments when their services were dispensed with."

However it is accepted in Mr Ren's evidence that it was the owner, Mr Suen, who personally took the decision to change the manager in December 2016 and to agree transfer budgets of £10 million for Mr Zola and after he was sacked £22 million for Mr Redknapp, with no controls imposed on the salary terms which could be offered to new players. At paragraph 14 of Mr Ren's witness statement he states:

> "We ought to have ensured that we did not sign any new player if doing so would put us in breach of the P&S rules or create a serious risk of a breach. We failed to do that. The Club accepts responsibility for that failure, and for the breach."

17. The internal forecasts prepared by the Club in June 2017, before most of the acquisitions had been made by Mr Redknapp, showed that although the finances of the Club would by a small margin not exceed the upper loss threshold in 2017/18, it would do so in the following two years. Presented with those figures in cross-examination Mr Ren accepted that it was virtually certain from June 2017 that the Club would not be able to comply with the P&S Rules.

18. It is clear that the spending decisions made by the Club in 2017 in recruiting managers and players were made without regard to the restraints imposed by the P&S Rules, and without any reasonable basis for an assumption that such spending would not result in the Club exceeding the upper loss thresholds in 2017/18.

<u>The transfer of Kristian Pedersen</u>

19. On 2 May 2018 Mr Lloyd, the then senior finance officer of the Club, received an email from the financial controller of the EFL raising a number of further queries on the P&S submission the Club had made on 29 March. At the end of that email it was stated:

> "As discussed on the phone, as the Club is reliant on future player transfers in order to fulfil the P&S requirement, the Club will be placed under a registration

> embargo until the Club's year end so that the final P&S result following any transfer profits can be confirmed."

Mr Lloyd replied to that email on 11 May, but made no reference to the registration embargo.

20. On 8 June 2018 the Club entered into a transfer contract with FC Union Berlin and Kristian Pedersen. On 29 June the then Club Secretary, Julia Shelton, applied to the EFL for registration of the transfer, enclosing the relevant documents. On 3 July Mr Karran emailed Mr Lloyd and Mr Moore referring to a discussion the previous day with Ms Shelton in relation to the embargo which had been placed on the Club by email of 2 May. On 13 July the Club was informed that the registration embargo would remain in force. On 1 August the Club was informed that it would, subject to certain conditions, be permitted to register Kristian Pedersen, notwithstanding the view of the EFL that the application had been lodged whilst the Club was under an embargo and was required to meet the requirements of the P&S Rules. In its letter dated 14 August the EFL made clear that when the registration application was submitted it was reasonably foreseeable to the Club that the final P&S result would confirm a result in excess of the permitted threshold.

21. Shaun Harvey, the chief executive, explained in his evidence why he took the view that the EFL should register the transfer despite its view that the Club had deliberately ignored the registration embargo in place. In 6 years he had not seen a case in which a club had ignored a registration embargo, but the actions of the Club had placed the EFL in a very difficult position.

22. The Club submits that the argument for EFL that the signing of Kristian Pedersen should be treated as an aggravating factor in considering sanction is misconceived and unfair. The asserted misconception arises under the relevant rule 4.3 which reads:

> 'Without prejudice to the right of The League to refer any breach of rules to the Disciplinary Commission in accordance with section 8 of the Regulations, where any Club is in breach of any requirement of these Rules relating to the provision of information, the Executive may refuse any application by that Club to register any Player or any new contract of an existing Player of that Club.'

This rule gives a discretion to the EFL to refuse an application by the Club to register a particular player in certain circumstances. It does not impose any prohibition on a club entering into contracts for the transfer of a player. It is argued that in its letter dated 1 August 2018 the EFL did not suggest that to proceed with the registration application was impermissible. In all these circumstances it is unfair for the signing or registration of Mr Pedersen to be relied upon as a factor aggravating the Club's breach.

23. It is correct that rule 4.3, if it applied, did not impose any restriction on the Club entering into transfer contracts, but only reserved the power to the EFL to refuse registration. However that subtlety was not a factor in the Club's decision making. In his statement Mr Ren stated:

> "…I did not believe that I was breaching any embargo in doing the transfer deal with FC Union Berlin or signing a contract with the player. The terms of the embargo were never fully set out in any document from the EFL before the interim breach letter dated 13 July 2018, but I had understood it to be a provisional embargo on registering players to play at the Club. If the EFL had refused to register Pedersen as our own player, I would have looked to release him to another club."

Mr Ren's statement did not explain the basis of his understanding, but in his oral evidence he accepted that Mr Lloyd had informed him by email that the Club could not sign new players. Mr Lloyd had dealt with a number of registration embargos in his time at the Club, so he would have fully understood the importance of an embargo and ensured that notice was communicated to those responsible for the signing of new players. However the internal management emails relating to this issue have not been produced by the Club, so it is not in a position to dispute the clear inference that the Club had been advised by Mr Lloyd that new players could not be signed. The Club did not take any steps to communicate its intentions to the EFL, despite knowing that the EFL would probably raise an objection to any further signings whilst the Club was likely to breach the upper loss threshold. Mr Ren's evidence was that the signing of Pedersen was important for the Club and it was hoped that the Club could get the embargo lifted.

24. It is clear from Mr Ren's evidence and the documents that the Club knew that in entering into the transfer contracts it was running the risk that registration would be refused for the reason which had been given in the email of 2 May. It had been unable to make the forecasted player sales profits of £8.3 million, although it continued to assure the EFL that it would do so. Those profits were highly material to the P&S calculation which had been submitted on 29 March. It was on 10 July that the Club submitted a revised forecast from which it became clear that the aggregated loss would exceed the aggregate threshold in 2017/18 by at least £7 million.

Objectives of the P&S Rules

25. The Financial Fair Play Rules introduced by the EFL in 2012 were modelled on the Financial Fair Play Regulations of UEFA. Although there are some differences between those rules their objectives are broadly similar. Those objectives include the introduction of more discipline and rationality in club football finances, the encouragement of clubs to operate on the basis of their own revenues, and protecting the long-term viability and sustainability of club football. Those objectives continue to apply to the P&S Rules which came into effect from 2014. The 2014/15 season was the first season to be reported under those rules, but they only came into effect from 2016/17.

26. In the many UEFA cases which have been decided since 2012 the general aim of achieving financial fair play has been made clear. For example in *CJSC Football Club Dynamo Moscow* (AC-02/2015) it was stated at paragraphs 79 and 80:

> "… the CL&FFP Regulations are underpinned by the principle that all of the clubs that compete in UEFA's club competitions must be treated equally … It would be unfair for one club to be allowed to compete when it is in serious breach of the monitoring requirements which apply to all.
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> This principle has even greater force in relation to the Break-even Requirement because a breach of this requirement (for example, because of excessive spending on player acquisitions and employee benefits expenses in order to attract 'star players') may directly affect the competitive position of a club, to the detriment of the vast majority of clubs who comply with the

> CL&FFP Regulations. So, in general, it would be unfair to allow a club which is in serious breach of the Break-even Requirement to compete in a UEFA club competition. The power to impose disciplinary measures exists not just to encourage compliance with the rules by deterring breaches of the monitoring requirements, but also to protect the integrity of UEFA's club competitions by ensuring that all of the clubs that compete are subject to the same requirements."

27. Under that approach financial fair play rules operate by reference to the failure to comply with financial restrictions, not by any analysis of the degree to which any overspending by clubs has had the effect of improving the performance of an offending club in competition. Excessive spending on players is clearly designed to achieve an enhancement of sporting performance, but whether in practice it does enable a particular club at a particular point in time to achieve better results than it would have achieved if it had complied with the rules is practically impossible to assess. Even more difficult to assess would be the other counter-factual, namely whether competitor clubs would have performed better if they too had been permitted to overspend to the same degree. The principle of fairness and equal treatment can only be applied in this context by measuring the degree of overspending, recognising that any substantial breach may directly affect the competitive position of the offending club, to the detriment of other clubs in the same competition. Given that the UEFA and EFL financial fair play rules have the same objectives these principles must apply equally to the P&S Rules.

28. For those reasons the Commission cannot accept the Club's argument that for the EFL to justify a sporting sanction it is necessary to prove a "measurable sporting advantage" caused by the overspending. That argument does not meet the point that any substantial overspending is in principle detrimental to the interests of other clubs which comply with the rules, because it gives the overspending club a direct advantage in bidding for players during the transfer window. Any such advantage gained from breach of the rules, in the acquisition of players or in the fielding of a stronger team in competition, is in principle unfair.

Sanctioning Guidelines

29. On 17 September 2018 the board of the EFL approved sanctioning guidelines for P&S cases. It is clear from the accompanying paper and the guidelines that these constitute instructions given by the board to the executive as to sanctions to be sought in proceedings before the Commission. They do not have any legal force and are not binding on the Commission, which retains its general power to impose any sanction falling within Regulation 91.2. It also needs to be noted that these guidelines were agreed and promulgated after the charge had been brought against the Club.

30. However in the course of argument each party invited the Commission to have regard to these guidelines, although for different reasons. The EFL argues that the guidelines are at least an indication that the EFL and clubs regard a sporting sanction as the most appropriate response. But the Club accepts that a sporting sanction by way of a points deduction is appropriate. The Club also accepts that the guidelines properly reflect the policy of the P&S Rules. Its argument is that the sanction should not exceed that required under the guidelines. The Commission accepts that it would clearly be unfair for a points deduction to be imposed which exceeded the deductions specified in the guidelines, but the corollary is that the guidelines are a relevant indication of the appropriate deduction. So in effect each party invites the Commission to have regard to these guidelines in deciding what sanction should be applied under Regulation 91.2.

31. There is considerable merit for both the EFL and all the clubs in the Championship in having clear guidelines which provide some measure of predictability as to the severity of sanction which may be imposed in the event of breach of the P&S Rules. Under the guidelines the points deduction to be imposed is 12 points, which is to be reduced by reference to the amount of overspending above the upper loss threshold. The applicable reduction is by reference to bands of excess expenditure, from less than £2 million, where there is a reduction of 9 points, to £15 million or more, where there is no reduction. The band applicable to this case is £8 – 10 million, giving a reduction of 5 points, so that the net points deduction starts at 7 points. The trend in spending, if diminishing, is then taken into account, as showing an intent to comply. The guidelines then provide for an additional points deduction of up to 9 points for “any aggravating factors”, which are not defined. It

is clear from the Championship Clubs meeting on 20 September 2019 that it was understood that mitigating factors could also be taken into account.

32. The points deduction is to be applied in the season following the conclusion of the relevant 3 year monitoring period. It is only at the end of that period that any loss in excess of the aggregated threshold can be finally determined, so that the following season is the earliest point at which a points deduction can be applied. However it is clearly desirable that any points deduction should be decided and imposed as early as possible in the relevant season, so that all clubs participating in the Championship understand where they stand in the league. For relegation or promotion outcomes potentially to be affected by a points deduction only announced in the last few weeks of the season is far from ideal. That requires a Disciplinary Commission to be appointed early and a hearing date fixed promptly. Under the procedural rules the chairman does have a power, and a duty, to secure an expeditious hearing, but it is regrettable that in this case, for a number of different reasons, it was not possible for the hearing to be held until 7 months after the charge was brought.

33. The Commission is satisfied that a sporting sanction by points deduction is required. The sanctioning guidelines properly reflect the objectives of the P&S Rules, and should be taken into account as guidance in deciding what points deduction should be applied in the current season. Under the guidelines the level of excess expenditure by the Club falls within the bracket £8 – 10 million, which would indicate a deduction of 7 points, subject to any mitigation or aggravating factors.

Mitigating and aggravating factors

34. The Club puts forward as grounds of mitigation that this is a first offence, the Club deeply regrets its breach and has taken steps to avoid a repeat. Those points are to some extent accepted, but they do not carry much weight. The Commission also notes the change of position as to whether the fault lay with the former managers or the owner and current management of the Club, and the failure to disclose relevant documents which had been requested. The Club also asserts that the owners were not seeking to gain a competitive advantage, but seeking to restore

to health a club in a parlous state with investments in the squad and across the board. There is no distinction in principle between overspending with a view to gaining promotion and overspending with a view to avoiding relegation. The purpose of the overspending is to gain some enhancement in competitive position.

35. However it is fair to note that the Club did very promptly admit the breach and, as set out in its letter dated 2 August, agreed to all the terms and restrictions which had been imposed by the EFL. The evidence from the chief executive of the EFL is that the Club has substantially complied with those conditions. The Club is entitled to an allowance of 1 point for mitigation.

36. Such mitigation as there is does not affect the seriousness of the breach. As set out above the aggregate loss for the monitoring period ending in 2017/18 was £48.787 million, exceeding the upper loss threshold of £39 million by nearly £10 million. The loss in 2016/17 was only just below the annual upper loss threshold of £13 million, and the loss in 2017/18 was over £20 million in excess of that threshold. Those figures, and the trend in expenditure, are adequately taken into account by the guidelines, but the conduct which gave rise to the breach, in particular the spending on new managers and players in 2017, demonstrates a deliberate disregard of the rules. As set out at paragraph 16 above it is clear that the spending decisions made by the Club in 2017, which were personally directed by the owner, in recruiting managers and allocating a budget to cover the acquisition of new players, were made without any regard to the restraints imposed by the P&S Rules, and without any reasonable basis for an assumption that such spending would not result in the Club exceeding the upper loss thresholds in 2017/18. The seriousness of an intentional breach is an aggravating factor which requires the deduction of at least 3 additional points.

37. The Commission is not persuaded that the signing of Pedersen was actually a breach of the applicable rule and this conduct will not be treated as an aggravating factor in this case. However the EFL was correct to state in its letter dated 1 August that the Club's conduct had not fully embraced the objectives of the P&S Rules. It is evident from the correspondence that the officials of the EFL had been extremely helpful in providing clear guidance as to the effect of the rules on the Club's finances and transactions, and it is regrettable that the Club did not consult the EFL before signing contracts and proceeded despite the increasingly obvious

fact that the Club would fail to keep its expenditure below the permissible limits in the period ending 30 June 2018. The EFL is entitled to assume that a Club will fully comply with any notice given under the rules, but to avoid any lack of clarity in future cases it would be desirable for notice of a decision to refuse registration of players until a club has complied with certain conditions to clearly identify the relevant rule and the effect of the decision.

Sanction

38. The Commission reiterates that it is not bound by the sanctioning guidelines, but as set out above each party accepts that they should be taken into account. Considering all the circumstances of the case, including the mitigating and aggravating factors discussed in the previous section, the Commission imposes a points deduction on the Club in the 2018-19 season of 9 points. In the view of the Commission a points deduction equivalent to 3 wins in competition is entirely fair on the facts of this case.

For these reasons the Commission decides:

(1) 9 points are to be deducted from the points earned in the Championship by the Club in the current season 2018-19;

(2) The costs of the tribunal and the legal costs of the EFL are to paid by the Club, to be assessed under rule 14 of the Procedural Rules if not agreed.

Charles Flint QC, Chairman
For the Disciplinary Commission
22 March 2019

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