

# STATE AID IN FOOTBALL: FALL-OUT FROM THE GENERAL COURT'S JUDGMENTS IN THE *VALENCIA* AND *ELCHE* APPEALS



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## I. INTRODUCTION

Having received the endorsement of the European Courts in support of its policy of treating sporting bodies as “undertakings” that are subject to the EU competition rules,<sup>2</sup> the European Commission has adopted an increasingly aggressive stance since 2007 against various forms of State aid granted by national or regional authorities which support football clubs.<sup>3</sup> Given the enormous financial rewards associated with professional football at the highest level, it is not surprising that football clubs have become a focal point for the enforcement of State aid rules, especially considering the very wide discretion afforded to the Commission in determining that any material benefit can amount to “aid.”<sup>4</sup> However, two very recent judgments of the General Court delivered in March 2020, which build upon a judgment of 2019 covering aid dispensed in very similar circumstances, cast doubt upon the methodology relied upon by the Commission to measure economic value in the world of football.

In its 2016 Decision,<sup>5</sup> the Commission found that the Spanish Instituto Valenciano de Finanzas (“IVF”) had granted unlawful State aid to three football clubs, namely, Valencia FC, Hércules FC and Elche FC. The aid took the form of bank loan guarantees. All the affected football clubs appealed the Commission’s Decision to the General Court in Luxembourg. Following its Ruling of March 20, 2019 in Case T-766/16, *Hércules Club de Fútbol v. Commission*, the General Court also delivered judgments in Cases T-732/16, *Valencia Club de Fútbol v. Commission* and T-901/16, *Elche Club de Fútbol v. Commission* on March 12, 2020. As in the *Hercules Case*, the General Court ruled in favor of the football clubs and annulled the Commission’s Decision. The judgments confirm the increased appetite of the General Court to delve more deeply into the economic logic underpinning the Commission’s analysis of State aid measures, rather than deferring to the Commission’s discretion in interpreting ambiguous economic evidence and focusing narrowly on procedural faults in the Commission’s investigatory process.

2 See, for example, Case T-679/16 *Athletic Club v. Commission*, Case T-865/16 *Fútbol Club Barcelona v. Commission* and Case T-791/16 *Real Madrid Club de Fútbol v. Commission*.

3 See, for example, Commission Decision of July 4, 2016 on the State aid SA.41617 - 2015/C implemented by the Netherlands in favor of the professional football club NEC in Nijmegen, C(2016) 4048 final and Commission Decision of July 4, 2016 on the State aid SA.29769 (2013/C) implemented by Spain for certain football clubs, C(2016) 4046 final.

4 According to Article 107(1) TFEU, any form of support granted to an undertaking will constitute State aid within the meaning of that provision where it is imputable to a Member State and granted through State resources, confers a selective advantage, distorts competition and affects trade between Member States. For the notion of “aid”, refer to the Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ C 262/1, 19.7.2016. Consistent with the breadth of this notion, the Commission’s Decisions have found that State aid to football clubs can, *inter alia*, take the form of waiver of claims, bank loan guarantees, purchase of a club’s stadium and land swap deals.

5 Commission Decision (EU) 2017/365 of July 4, 2016 on the State aid SA.36387 (2013/C), OJ L 55/12, 2.3.2017.

## II. THE 2016 COMMISSION DECISION

In its decision, the Commission identified a total of four measures constituting unlawful State aid to the football clubs in question. Two of those measures concerned a leading club in Spain's Primera División, Valencia FC. The first measure consisted of IVF providing a guarantee for a bank loan given to Fundación Valencia by the Spanish bank, Bankia, to finance the acquisition of the shares in Valencia FC, thereby in effect providing a capital injection to the football club. The benefit included a guarantee which covered 100 percent of the loan, together with the interest generated by the transaction and the transaction fees. By way of a counter-guarantee, IVF received a second-rank pledge on the shares of Valencia FC owned by Fundación Valencia, thereby following Bankia in terms of priority. In 2010 and 2013, IVF increased its guarantee to Fundación Valencia by 6 million and 4.9 million respectively, in order to increase the value of Bankia's initial loan. A counter-guarantee was then again granted to IVF in the form of pledged shares in Valencia FC.

In the case of Elche, a football team in Spain's Second Division, IVF provided two bank loan guarantees for a total of 14 million euros to Fundación Elche. The purpose of the loans was to finance the acquisition of shares in Elche FC by Fundación Elche, which was therefore also characterized as the grant of a capital injection into that football club. As a counter-guarantee, Fundación Elche offered to IVF an annual guarantee premium of 1 percent and a pledge on the shares of Elche FC owned by Fundación Elche.

Both Fundación Valencia and Fundación Elche were non-profit organizations whose purpose was to promote the sporting, cultural and social activities of their respective football clubs. In assessing whether the loan guarantees constituted State aid within the meaning of Article 107 TFEU, the Commission found that the beneficiaries of the loan guarantees were in practice not Fundación Valencia and Fundación Elche but the respective football clubs in which they sought to buy a controlling interest, given that the two organizations were merely being used as financial vehicles to increase the capital of the two clubs.<sup>6</sup>

In addition, the Commission found that both Valencia and Elche should be considered as "firms in difficulty" at the time of receiving the guarantees, due to their increasing losses and diminishing turnover.<sup>7</sup> Nevertheless, this situation did not amount to a situation of "extreme difficulty" within the meaning of points 2.2 and 4.1 (a) of the 2008 Guarantee Notice,<sup>8</sup> because the clubs had recently reduced their losses.

Following a cursory analysis of the Guarantee Notice, the Commission considered that the respective measures conferred economic advantages to Valencia and Elche since the two football clubs would not have otherwise been able to obtain the same advantages on the same market terms. The Commission then went on to analyze the compatibility of the loan guarantees under the *Rescue and Restructuring Guidelines*,<sup>9</sup> reaching the conclusion that they constituted incompatible State aid because not all of the criteria set forth in the *Guidelines* had been fulfilled.<sup>10</sup>

## III. THE GENERAL COURT'S JUDGMENTS

### A. Valencia FC Ruling

On appeal, the General Court analyzed whether Valencia FC was indeed a "firm in difficulty" at the time the State guarantees had been granted. Valencia claimed that the Commission had not taken into account the "specific business model of football clubs" in its assessment, by having ignored relevant factors such as the market value of the club's football players, the number of season ticket holders, and the likely commercial price of the club in the case of a resale.<sup>11</sup> The Commission, for its part, argued that the rather high sales price of certain football players did not necessarily mean that the team, as an undertaking, was not "in difficulty." To support its position, the Commission concluded that in case of a

<sup>6</sup> See Paragraph 68 of the Decision, OJ L 55/12, 2.3.2017.

<sup>7</sup> Paragraphs 77-79 of the Decision, OJ L 55/12, 2.3.2017.

<sup>8</sup> Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C 155/10, June 20, 2008.

<sup>9</sup> Community Guidelines on State aid for Rescuing and Restructuring Firms in Difficulty, OJ C 244/2, 1.10.2004.

<sup>10</sup> The key criteria set forth under the Guidelines are: (i) the beneficiary must be a "firm in difficulty"; (ii) the grant of aid must be conditional on the implementation of a restructuring plan, which must restore the long-term viability of the company; (iii) compensatory measures to ensure that the positive effects of the aid outweigh the adverse ones must be imposed; (iv) the aid must be limited to the minimum, meaning that the plan must also involve "own contributions"; and (v) the "one time, last time" principle must be respected, meaning that aid can be granted only once every ten years.

<sup>11</sup> Case T-732/16, paragraph 51.



so-called “fire sale” of the club’s most valuable players, other teams would be likely to take advantage of its financial situation in order to obtain lower prices for those players. Furthermore, injuries can reduce the market price of a player.<sup>12</sup> The Court sided with the Commission in this respect and held that no manifest errors had been committed with respect to this part of its assessment.

As regards the first bank loan guarantee granted to Fundación Valencia, however, the Court held that the Commission had committed a manifest error of assessment precisely because it had wrongfully assumed that, since Valencia FC was a firm in difficulty at the time the guarantees were received by the club, no equivalent guarantee premium or corresponding guarantee premium benchmark could have been identified on market terms.<sup>13</sup> Furthermore, the Commission had not carried out a sufficient assessment of whether there was a market price for a similar non-guaranteed loan. Instead, it had merely concluded that “*not enough operations of similar nature can be found for a significant comparison.*” Thus, by not calculating the market price consistent with the reference rates of point 4.2 set out in the 2008 Guarantee Notice, the Commission had committed a manifest error of assessment.

With respect to the second bank loan guarantee of 6 million euros, Valencia argued that the Commission had wrongly calculated the value of the pledged shares of the club that Fundación Valencia had granted to IVF in the form of a counter-guarantee. In its Decision, the Commission concluded that the value of the shares was “close to zero,” since the club has been operating at a loss and had negative equity.<sup>14</sup> Following a detailed analysis, the Court held that the Commission had not taken into account the positive impact of the 2009 recapitalization process, which had increased the registered capital of the club from 9.2 to 101.7 million euros, and its own equity from -59.2 to 17.9 million euros.<sup>15</sup> Instead, in its valuation of the counter-guarantee, the Commission had used as its reference point the financial situation of Valencia FC *prior* to the first measure of 2009. In doing so, the Commission had committed manifest errors in its analysis, with the Court even expressing doubts as to whether or not the measure conferred an economic advantage to the football club.<sup>16</sup>

## **B. Elche FC Ruling**

In its second judgment, the General Court also held that the Commission had committed manifest errors in its assessment of whether an economic advantage had been conferred upon Elche FC.

Even though the Court reaffirmed the Commission’s finding that the beneficiary of the aid was Elche FC and not Fundación Elche, it held that the Commission should nevertheless also have taken into account the economic and financial situation of Fundación Elche in its assessment.<sup>17</sup> This was a relevant factor that needed to be taken into account when evaluating the risks assumed by the State guarantor, since it was Fundación Elche that was benefiting from the loan guarantees and was responsible under its contractual obligation with IVF.<sup>18</sup>

Furthermore, the Commission had committed a manifest error in its assessment by failing to take due account of the recapitalization of the football club when assessing the valuation of the counter-guarantees offered by Fundación Elche to IVF. As a counter-guarantee, Fundación Elche had pledged its shares of Elche FC to IVF, the value of which the Commission again had found to be “close to zero.” According to the Court, a private market investor in the same situation as IVF would have taken into account the recapitalization of the club when assessing the value of the pledged shares. Moreover, as an additional counter-guarantee, Fundación Elche had granted to IVF a mortgage on a six-hectare block of land valued at around 600 million euros.<sup>19</sup> Accordingly, the Court held that by failing to take into account the mortgaged land, the Commission had committed a manifest error in its assessment.<sup>20</sup>

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<sup>12</sup> Case T-732/16, paragraph 87. A dramatic high-profile case in point is Panathinaikos F.C., one of Greece’s most famous football clubs, which has found itself in financial difficulties for a number of years, thereby obliging it to sell many of its players under “fire sale” conditions (and thereby perpetuating its financial crisis).

<sup>13</sup> Case T-732/16, paragraph 125.

<sup>14</sup> Case T-732/16, paragraph 198.

<sup>15</sup> Case T-732/16, paragraph 197.

<sup>16</sup> Case T-732/16, paragraph 205.

<sup>17</sup> Case T-901/16, paragraph 93.

<sup>18</sup> Case T-901/16, paragraph 84. Note also that the Fundación Elche held its own equity of 1.4 million euros at the time; refer also to paragraph 22 of the Decision.

<sup>19</sup> Case T-901/16, paragraph 71.

<sup>20</sup> Case T-901/16, paragraph 120.

Last but not least, the Court was critical of the Commission's wrong assumption that no private market operator would have been willing to act as a guarantor in this case, simply based on the fact that Elche FC was a "firm in difficulty." Instead, according to the terms of its own Guarantee Notice, the Commission should have sought to identify a corresponding guarantee premium benchmark.<sup>21</sup> In the absence of such a benchmark, it should have drawn a comparison with a similar non-guaranteed loan. As occurred in the *Valencia* ruling, the Commission was found to have failed to conduct an in-depth analysis and had merely asserted that not enough operations of a similar nature could be identified in order to draw a meaningful comparison.<sup>22</sup>

## IV. LEGAL IMPLICATIONS OF THE RULINGS

The Rulings of the General Court provide clarity on a number of important issues that often arise in State aid disputes involving indirect support for football clubs. For example, it is now clear that, when aid is delivered through a financial vehicle, as occurred in the cases of Fundación Valencia and Fundación Elche respectively, the financial situation of the vehicle must also be taken into account when assessing the financial risk being incurred under the bank loan guarantees. This is because it is the financial vehicle, and *not* the actual beneficiary football club, that is responsible for the repayment of the loans.

Furthermore, in those situations where counter-guarantees are offered in the form of shares in a football club, the Commission must take into account the impact of the loan on the financial situation of the club when assessing the value of the shares. This is particularly important since the greater amounts of money injected into the club will, more often than not, give rise to a chain reaction which means the acquisition of better players, which should lead to better performances on the football field and ultimately to a better overall financial performance by the club.

Another important clarification of principle made by the Court, this time in agreement with the position espoused by the Commission, is that when assessing whether a football club can be characterized as being "in difficulty" under the Rescue and Restructuring Guidelines, the Commission must rely upon the book value of the club's players and not on their current market value, which might significantly drop in the case of injuries to the players or where the club is forced to sell them under "fire sale" conditions.

When analyzing the existence and the amount of the aid, the Commission must also determine whether a reference price can be found on the market, or at least identify a corresponding guarantee premium benchmark. Where such figures are not available, the Commission must then seek to compare the price with that of a similar non-guaranteed loan. In any event, the Commission must demonstrate that it has conducted a thorough review of the market before concluding that the club would not have obtained a loan on the market on as favorable terms. In practice, this will mean that the Commission must conduct market studies before adopting a decision as to whether an advantage had been conferred on the football club in question.

Although it may appear to many that the Commission has lost the battle before the Court, it has not necessarily lost the war. In both judgments, the Court did not rule on the overall merits of the Commission's decision-making in terms of the final result, but simply held that the Commission committed manifest errors in its method of assessment. The Commission therefore has the possibility of re-opening a formal investigation procedure in each case, in order to rectify its own mistakes. We should therefore not be too surprised if the results of the new investigation again support the view that the two football clubs have received incompatible aid, although we can also expect that the amounts of aid that would need to be paid back will be lower than originally estimated. The two rulings are similar to that of the General Court in *Hércules v. Commission*, where the Commission had also failed to take into account counter-guarantees offered to IVF by one of the main shareholders of the club and had not explained why it had failed to do so. The Court annulled the decision on the ground that the Commission had failed to state reasons, which might again mean that the Commission has not had its last word in this matter.

In arriving at its conclusions, the Court has raised the metaphorical bar for the Commission to substantiate its case that a football club has benefited inappropriately from the grant of State aid:

- *First*, by obliging the Commission to take into account the financial position of the vehicle through which a loan is granted to a football club, the level of financial risk incurred under the loan might in fact be underestimated. This is especially the case if the financial vehicle through which the loan is granted is itself supported directly or indirectly through some other form of government funding or other indirect

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<sup>21</sup> Case T-901/16, paragraph 132.

<sup>22</sup> Case T-901/16, paragraph 133.

support. It will not come as a surprise to many football fans that intermediary financial vehicles are often designed to act as “straw men” in order to support clubs in their ambitious re-financing plans. In the real world, banks, politicians and even national leagues are well aware of the “straw man” nature of such vehicles. This is tolerated widely in the sector, because, unlike many other fields of State aid practice, competitors do not derive any great benefit from the demise of their famous competitors because that fame fuels fan rivalries and fills stadiums with season ticket holders.

- *Second*, by insisting that players’ book values, rather than current market values, are the relevant criterion in determining whether the football club is “in difficulty,” the Court is arguably elevating legal certainty above market realities. The world of football is awash with players who are either bargains or a luxury at certain times in their careers, and book value arguably only tells one something about the value of a player at one particular narrow window of their career. Moreover, the reference to book values might have very little to do with the relative success of a club in any given season and its potential to access large prize money and media rights in subsequent seasons, based on performances in the current season. Book values can also be deceptive indicators of “value,” as can be seen by the often-deployed business model of buying a player in League A (e.g. Belgium) for X million Euros and selling them for 4X million Euros two years later to a wealthier League B (e.g. England).
- *Third*, the Court has been clear insofar as it expects the Commission, when determining a reference price, to conduct a thorough market review. In the eyes of the Court, the failure of the Commission to identify the real value of bank loans or guarantees in similar circumstances constituted a major gap in its analysis.

The net result is that the Commission’s forensic analysis will now need to be more painstaking, yet will arguably be nevertheless just as vulnerable to legal challenge in light of the uncertain nature of the commercial balancing exercises now expected to be performed by the Commission in its analysis.

## V. IMPLICATIONS OF THE RULINGS UNDER THE CURRENT COVID-19 STATE AID TEMPORARY FRAMEWORK

The implications of the two appeals might be more widely relevant in the immediate future since, due to the current COVID-19 pandemic, football clubs across all leagues are taking immediate and heavy hits to their budgets. Football clubs across Europe are currently not playing any matches and therefore not receiving any revenues from broadcasters and match-day ticket sales.<sup>23</sup> Thus, financial support which may take many forms, including bank loan guarantees, can be expected in the very near future. The European Commission has already classified the pandemic as an “*exceptional occurrence*” under Article 107(2)(b) TFEU.<sup>24</sup> However, in order for State aid to be authorized under Article 107(2)(b) TFEU, a causal link must be identified between the scheme and the “exceptional occurrence” which is being funded. It remains to be seen whether potential drops in the number of season ticket holders, the continuing high prices of players and reduced money received from TV contracts due to the poor economic prospects being faced will be capable of being causally linked to the COVID-19 outbreak under the logic of the General Court’s analysis.

On March 19, 2020, the Commission adopted a Temporary Framework<sup>25</sup> for State aid measures to support the economy, valid until December 31, 2020. This also includes State guarantees for loans taken by companies from banks and direct grants of up to 800,000 euros. These measures will no doubt provide some comfort to SMEs, but will probably fall far short of plugging even some holes in the bank balances of most European football clubs, in what has been for some time the most expensive and lucrative team sports environment in the world.

At the time of writing, it is fair to say that the financial damage that many football clubs will suffer will go well beyond the immediate impact of the pandemic and is likely to have long-term repercussions. Thus, despite the crumbs of comfort offered to the Valencia and Elche football clubs by the General Court judgments, the long arm of EU State aids law is likely to continue to rein in the excesses of European football clubs. However, in so doing, it arguably threatens to undermine the bedrock of the sport as much as pruning the excesses of its elite clubs.

<sup>23</sup> The economic implications of the pandemic can already be seen. Barnet FC, which plays in the UK’s 5th tier, has already made all its non-playing staff redundant, while leading European football clubs such as Barcelona, Juventus and Tottenham Hotspur have decided to temporarily reduce the salaries of their players.

<sup>24</sup> See State Aid SA.56685 (2020/N) – DK – Compensation scheme for cancellation of events related to COVID-19 C(2020) 1698 final. In its Decision, the Commission has approved an aid scheme compensating private legal entities organising events understood to account for more than 1000 people for the lack of attendance due to the legal restrictions imposed by the government. For those small clubs living “hand to mouth” with gate takings of less than 1,000 spectators, the future looks grim.

<sup>25</sup> Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, C(2020) 1863 final.

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