EUROPEAN BASKETBALL ADVISORY GROUP

Critical Review of Euroleague Basketball's Financial Stability and Fair Play (FSFP) Regulations

Can the stated objectives be achieved?

2nd Report

Author - Cem C Karamürsel

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- Current Situation & Relevant Facts
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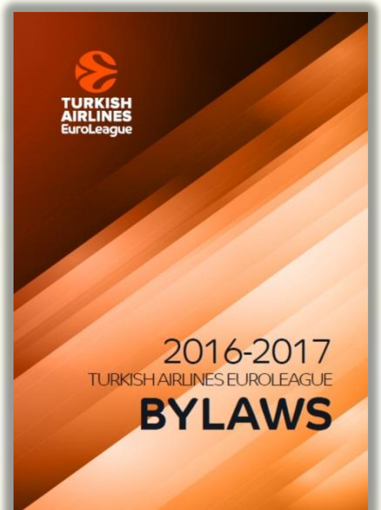
Introduction

Since the beginning of 1990s, European basketball has gone through a quite **turbulent period** experiencing major structural and economic challenges, mainly caused by (i) **deficit of demand** (especially compared to football), (ii) certain **governance issues** (e.g. FIBA vs ULEB/Euroleague), and (iii) lack of a **rational and sustainable economic model**. Failure in creating and establishing such a model led to the situation that some traditional teams with a very successful history (such as Limoges, Benetton Basket, Kinder Bologna and more recently Montepaschi Siena and so on) have disappeared from the top-level European competition.



Without any doubt, since its inception, **Euroleauge Basketball** has achieved quite a **remarkable progress** in enhancing the commercial value of the top-level European basketball league and significantly increasing the competition's revenues. However, it still cannot be argued that the operating model of European basketball is now based on economically sound and rational principles & practices. In an effort to strengthen the **financial stability** of its clubs and to improve its financial **governance model**, Euroleague Basketball enacted its Financial Stability and Fair Play Regulations (FSFP).

In this study, we perform a critical review of the financial criteria as set out in the FSFP rules (as stated in 2016-2017 Bylaws), both from an economic and legal perspective, also considering the "*current reality*" in European Basketball. We intend to provide the decision-makers with **objective feedback** on the regulations as well as suggestions for a more **effective regulatory framework**.

Content

- Introduction
- Current Situation & Relevant Facts
- Critical Assessment of the FSFP Criteria
- Key Conclusions & Comments
- Suggestions for Improvement

Current Situation & Relevant Facts

Background

- In 2012, it was announced that **Euroleague Commercial Assets Board** approved a framework to establish principles of **greater financial stability and fair play** in its competition by unifying the criteria used by and applied to participating clubs. Starting from the 2015/16 season, all participating clubs are required to follow specific FSFP rules.
- In essence, FSFP regulations aim at **optimizing management methods and budgetary control** to be applied by the clubs participating the competitions.
- Besides **solvency** related rules (no overdue payables and no bankruptcy/ insolvency proceedings) as well as the formal **documentation and audit requirements**, the central element of the FSFP rules relates to achieving a **fair play result** supported by some **budget restrictions**, specifically for **player salaries** as well as the **shareholder/ related party contributions**.
- Conceptually, these regulations show some important similarities with the **UEFA Financial Fair Play and Club Licensing** criteria which were introduced in 2010 and came into full force with the 2013/14 season.
- Given the fact that UEFA regulations have been in the center of public interest well before (and after) their effective date, they have been the subject of several **scientific papers** both focusing on theoretical and, more recently, also on empirical aspects. Thus, it would be beneficial to take a brief look at the UEFA rules and their impact so far.

Current Situation & Relevant Facts

Financial Fair Play Regulations of the UEFA

- UEFA's Club Licensing and Financial Fair Play (FFP) Regulations were introduced in **May 2010** and came into full effect with the **2013/14 football season** in Europe. Most recently the regulations have been **updated in 2015**.
- These regulations are intended to "fix" the **unhealthy** and **instable financial situation** of the football clubs by (i) addressing the "*soft-budget constraint*" that lead to "*irrational bailout expectations*" (moral hazard) by the club managers and (ii) preventing "*financial doping*" (i.e. large, unsustainable money injections from – private - shareholders/investors who act as purely success seeking benefactors (i.e. sugar daddies). By doing so, the ultimate goal is to ensure a **viable and sustainable competition**.
- Although not called out as an explicit objective, UEFA seeks to achieve this goal by forcing the clubs to "**keep their wage bill under control**" by "**lowering salary costs and/or limiting the number of players under contract**".
- The two main criteria of UEFA Club Licensing and FFP are:
  - **No overdue payables:** A club must be fully up to date with payments to its creditors.
  - **Break-even requirement:** A club must be able to demonstrate that relevant income balances with relevant expenditure with an acceptable deviation amount.
- While the "*no overdue payables*" rule relates to issues of **payment behavior** and **solvency**, the "*break-even requirement*" interferes with the **investment behavior** of the clubs.

Current Situation & Relevant Facts

UEFA vs Euroleague - *Similar Formal Objectives*

Article 2 (2) - UEFA Club Licensing and Financial Fair Play Regulations (Edition 2015)

a) to improve the economic and financial capability of the clubs, increasing their **transparency** and **credibility**;

b) to place the necessary importance on the protection of creditors and to ensure that **clubs settle their liabilities** with employees, social/tax authorities and other clubs punctually;

c) to introduce more **discipline and rationality** in club football finances;

d) to encourage clubs to operate on the **basis of their own revenues**;

e) to encourage responsible spending for the long-term benefit of football;

f) to protect the **long-term viability and sustainability** of European club football.

Article 1 – Turkish Airlines Euroleague Bylaws / Appendix I Financial Stability and Fair Play Regulations (2016-2017)

a) Ensure good financial practice in the Euroleague Basketball competitions.

b) Guarantee the **transparency** and **credibility** in the finances of the participating clubs.

c) Ensure the financial stability of the clubs and the Euroleague Basketball competitions through a **balanced budget and a consolidated equity**, protecting the **long-term viability and sustainability** of the Euroleague Basketball competitions.

d) Guarantee the **fulfilment of the economic commitments** adopted by the clubs.

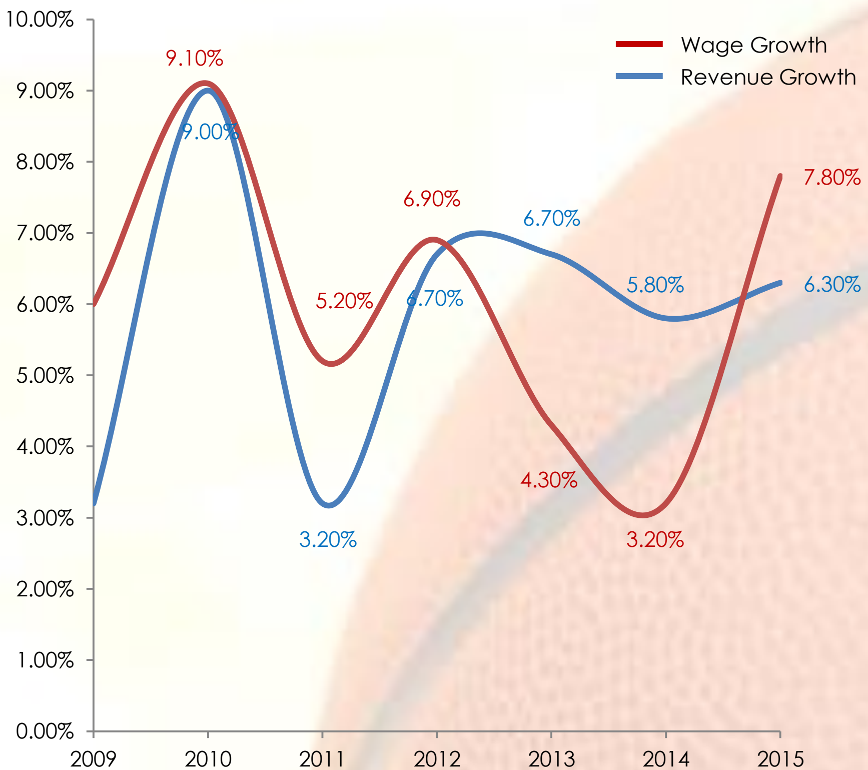
e) Define the role and tasks of the Management Control Commission and the external auditing firm, the minimum procedures to be followed in their assessment of the requirements [...]

Source: UEFA, Euroleague

Current Situation & Relevant Facts

UEFA FFP Regulations - Initial Results & Observations

- According to the UEFA, in a very short period of time after the implementation of the FFP regulations club finances have already improved significantly. Thus, UEFA's conclusion so far is that FFP rules are working effectively.
- *Revenue-Wage-Growth (in % YoY)*



"The last edition of this report highlighted the facts that wage growth had reached low and revenues had recently grown faster than wages for the first time on record. To reiterate, the 4.3% wage growth in FY2013 and 32.% growth in FY2014 were significantly below both the FY2015 growth rate and the long-term average of more than 10%.

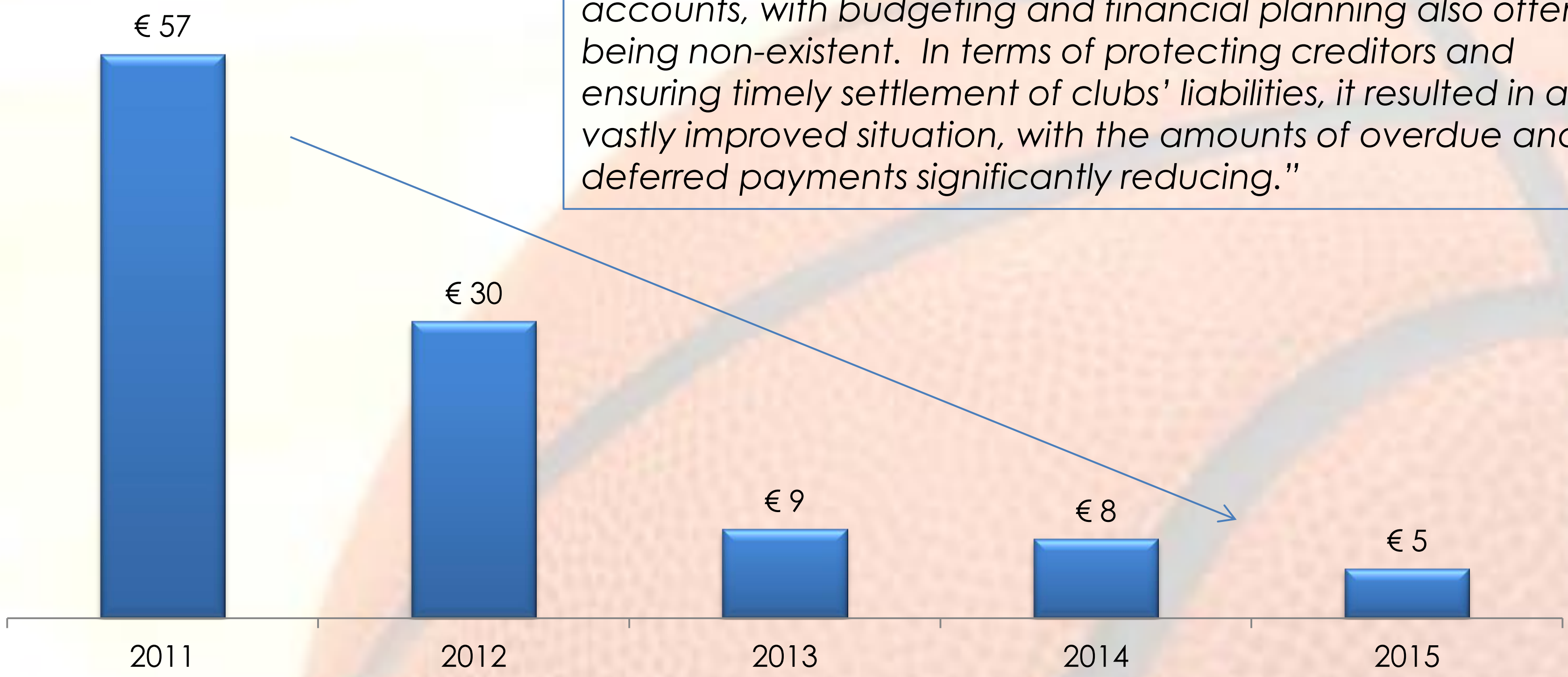
The FY2015 results indicate that wage growth picked up in FY2015 and once again outstripped revenue growth. At 7.8%, wage growth has reached its fastest rate since FY2010."

Source: UEFA

Current Situation & Relevant Facts

UEFA FFP Regulations - Initial Results & Observations

- *Overdue Payables (in million EUR)*



"The impact of the financial criteria of the club licensing system has been overwhelming. Prior to the introduction […] many clubs in Europe did not have standard financial accounts, with budgeting and financial planning also often being non-existent. In terms of protecting creditors and ensuring timely settlement of clubs' liabilities, it resulted in a vastly improved situation, with the amounts of overdue and deferred payments significantly reducing."

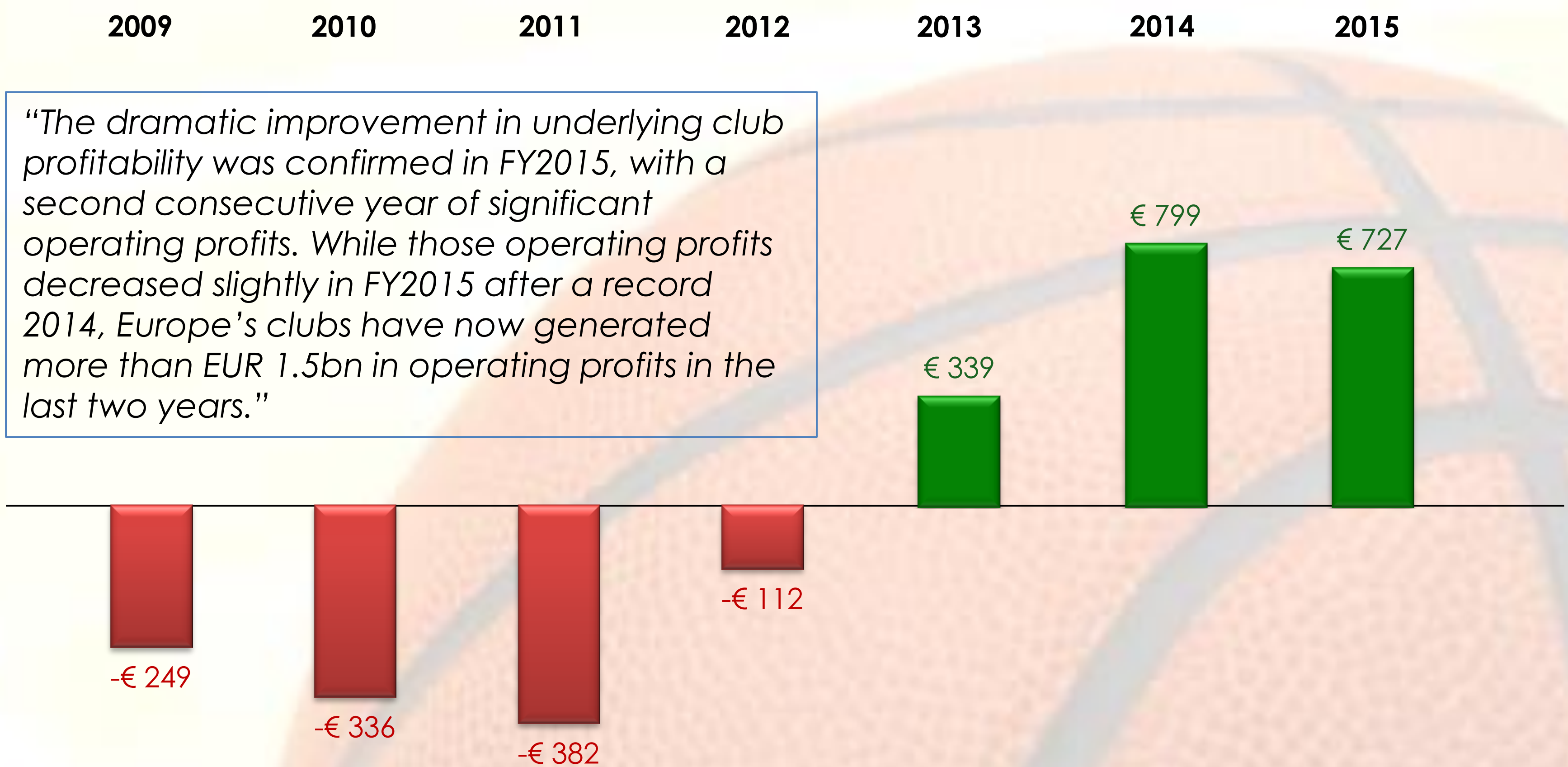
Source: UEFA

Current Situation & Relevant Facts

UEFA FFP Regulations - Initial Results & Observations

- *Aggregate Operating Losses (in million EUR)*

> *"The dramatic improvement in underlying club profitability was confirmed in FY2015, with a second consecutive year of significant operating profits. While those operating profits decreased slightly in FY2015 after a record 2014, Europe's clubs have now generated more than EUR 1.5bn in operating profits in the last two years."*



Source: UEFA

Current Situation & Relevant Facts

UEFA FFP Regulations - Criticism

- As shown in the figures above, the **overall trend** in key measures appears to be moving into the **right direction** (except for wage increase in 2015), especially in terms of ensuring going concern and solvency of the clubs.
- However, on the other hand, some **critical voices** have been raised against the UEFA FFP regulations with regard to its (anticipated) **adverse impact on competitive balance**. This criticism is mainly based on the argument that the break-even rule will distort competition by giving rise to an "*ossification*" of the market structure, i.e. it might **cement, freeze, congeal the clubs' existing financial positions**. Since clubs need to adjust their investment to the level of their revenues, **"big" clubs** who enjoy high revenues right now can **maintain their competitive advantage** by high investments while restricting **"small" clubs**' investments and "forcing" them to maintain their **lower competition level**.
- Some **(empirical) studies** indeed demonstrate that FFP rules have further amplified the **competitive imbalance** in European football by causing additional **entrance barriers** for new (potential) investors. Furthermore, it is also argued that FFP supports the former season's winner in terms of budget shares in the upcoming season.
- Some other studies point out that the changes in clubs' finances as a result of applying FFP regulations are in line with the intended effects, however these changes are rather **weak** and **vary substantially across national leagues**.

Current Situation & Relevant Facts

UEFA FFP Regulations - Criticism

- As explained above, due to its (deemed) restrictive impact on the competitive balance, it is also **questionable** whether the UEFA FFP regulations are **compatible with the EU competition law**, even though the EC made a statement that it supports the FFP regulations.
- Without going into too many (technical) details of the EU competition law, it can be subsumed that the FFP regulations could, due to its publicly declared aim to decrease pressure on salaries and transfer fees, be interpreted as a **price-fixing scheme** between undertakings (or as a decision of an association of undertakings) that would be significantly affecting the trade between EU member states. In other words, FFP regulations might be **in breach of the EU competition rules** as set out in **Article 101** and **102** of the **Treaty on the Functioning of the European Union** (TFEU).
- In 2013, a Belgian football agent named **Daniel Striani** has made a **formal complaint** to the European Commission contending, among other things, that the FFP rules are incompatible with EU competition law, especially focusing on the break-even requirement. On 24 October 2014, the Commission **dismissed** the complaint on **procedural** grounds, whilst on 29 June 2015 the **Brussels Court** declared itself **incompetent** for lack of international jurisdiction and made a reference to the **European Court of Justice** (ECJ) for a preliminary ruling. On 16 July 2015 the ECJ declared the reference manifestly **inadmissible**. As such, the **first attempt** to challenge UEFA's FFP regulations has been **defeated on procedural grounds**.

Current Situation & Relevant Facts

UEFA FFP Regulations - Criticism

- Also, in one of its recent decisions issued in October 2016, **Court of Arbitration for Sport** (CAS) concludes that **no violation of EU competition law has been established** *(CAS 2016/A/4492 – Galatasaray v. UEFA)* while also stating the fact that the appellant (i.e. Galatasaray) did not provide any economic analysis or empirical evidence of the impact of FFP on competition and market, and as such did not meet its burden of proof to demonstrate the illegality of the FFP rules.
- Given the fact that there is **recent empirical research** showing some strong indications of market restriction as discussed above, it can be argued that the legal case has not been permanently and conclusively closed yet.
- In light of all these legal discussions, it needs to be pointed out that, compared to the UEFA FFP, **Euroleague FSFP** concept stipulates **some more restrictive rules**, e.g.
    - Relative acceptable deviation from the Fair Play result (10% of the budget)
    - Explicit cap for Player Salaries
    - Additional (relative) limitation of Shareholder Contributions
- As such, it might be **more challenging** to defend the **legality** of these regulations on the grounds of EU competition law, also considering the current competitive (im)balance in Euroleague as well as other structural differences such as the league governance, competition format and participation criteria.

Current Situation & Relevant Facts

<u>**Characteristics of European Top-Level Basketball vs Football Competitions**</u>

- The highest level club football competition in Europe, **UEFA Champions League** (UCL) represents the best football league in the world which is therefore seen as a very **attractive investment alternative** and a very important **platform for public exposure**, whereas Euroleague is clearly behind the NBA and facing more intense competition from other leagues such as Chinese Basketball League and FIBA Basketball Champions League. Top European football clubs are among the **most valuable clubs** in the entire world, as presented below.

<u>Average Team Values in Major Leagues*</u>

Sport / League	Average Team Value ($ bn)
NFL	$2.39
MAJOR LEAGUE BASEBALL	$1.54
Soccer (top 20 teams)	$1.47
NBA	$1.36
NHL	$0.52

<u>Most Valuable Clubs in the World* (Top 10)</u>

#	Team	League	Value ($ bn)
1	Dallas Cowboys	NFL	$4.20
2	New York Yankees	MLB	$3.70
3	Manchester United	UCL/PL	$3.69
4	FC Barcelona	UCL/LL	$3.64
5	Real Madrid	UCL/LL	$3.58
6	New England Patriots	NFL	$3.40
7	New York Knicks	NBA	$3.30
8	New York Giants	NFL	$3.10
9	Los Angeles Lakers	NBA	$3.00
10	San Francisco 49ers	NFL	$3.00

Source: Forbes

Current Situation & Relevant Facts

Characteristics of European Top-Level Basketball vs Football Competitions

- **UCL** generates **significant revenue sources** for participating clubs. For instance, in the 2015/16 season, Real Madrid and Manchester City received more than EUR 80m each from the UEFA for participating as well as their performance in the UCL during the 2015/16 season, whereas according to the explanations of the President of Fenerbahçe, Mr. Aziz Yıldırım, his team only received EUR 3.5m in total from Euroleague during the entire 2016/17 reason including the championship bonus.
- As a result, UCL represents an area of **high interest for many (professional/corporate) investors**, but also a major platform for pure "*success benefactors*" e.g. from the USA, Russia and Middle East investing in clubs located in Western European countries such as Manchester United, Liverpool, Chelsea, Monaco, Paris Saint Germain and Manchester City). In this context, fundamental discussions around the optimal governance model and ownership structures (e.g. 50+1 Rule in Germany) are currently ongoing.
- Although the problem of **increasing budgets** (primarily driven by higher salaries) and the related question as to their sustainability might also be deemed directly relevant for **Euroleague** (e.g. $42 million-budget of CSKA Moscow for the 2016/17 season and their recent offer to Miloš Teodosić amounting to $12 millions for three seasons), it does not necessarily indicate a **systematically dysfunctional/inefficient market** with "*sugar daddies*" attacking the (Western) European basketball seeking pure success and associated (personal) prestige gains (rather than sustainable investment).

Current Situation & Relevant Facts

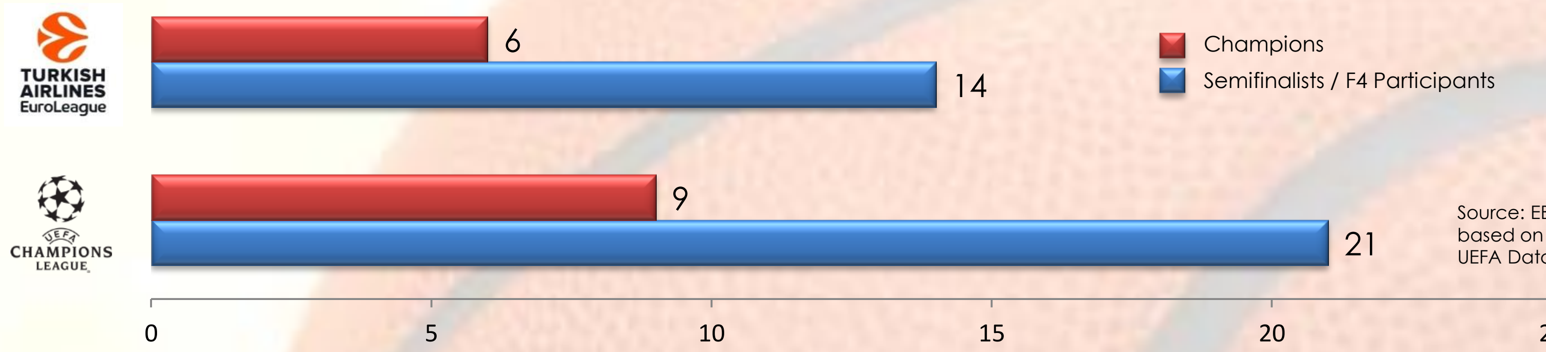
Characteristics of European Top-Level Basketball vs Football Competitions

- Compared to the (European) football in general, **types of investors in European basketball** and their **motivations** might be quite different (mainly due to much lower or even non-existent financial incentives), as listed below. This is not necessarily a recent phenomenon, instead has been the case for quite a long period.
  - **Being part of a sports club:** Engagement in basketball might mainly be as a result of being part of a sports club led by a powerful football team, also fueled by the investments made by the clubs' rivals (e.g. FC Barcelona, Real Madrid, Fenerbahçe, Galatasaray, Panathinakos, Olympiacos etc.).
  - Investments might be seen as part of a **quasi-CSR program** rather than an economic investment or a professionally managed sponsoring deal.
  - **Passion for basketball**, e.g. senior managers of a sponsor/shareholder with basketball background and/or have great passion for this sport.
  - Other reasons such as **(national) prestige**, **tradition**, **rich history**, certain **synergy effects**, or other expected **benefits**.
- The **importance/relevance of these factors might vary** from country to country. For instance, basketball investments in a country like Lithuania or Serbia might be deemed as a much more prestigious and major act, compared to some other countries where basketball is almost non-existent.

Current Situation & Relevant Facts

Characteristics of European Top-Level Basketball vs Football Competitions

- **Euroleague**, especially after the radical format change last season, represents a **semi-closed league** with (virtually) **no risk of relegation** for the leading clubs, whereas UCL represents a fully open league with participation totally based on sportive criteria. Thus, it can be argued that in the case of UCL there is a **higher risk of (inefficient) overinvestments** due to the so-called "*rat race*" phenomenon (which might justify FPP).
- Another difference relevant for this assessment is related to the **competitive balance** in Euroleague vs UCL. Below chart shows the total number of semi-finalists and different champions over the last 15 seasons (between 2002-2016) indicating an already **weaker competitive balance in Euroleague** than in UCL.



Source: EBAG Analysis based on Euroleague & UEFA Data

- In assessing the FSFP rules' effectiveness, their (possible) **impact on future growth** and the competitive balance need to be studied carefully since "*the regulations […] seek to ensure a greater balance in the clubs' budgets in order to help them and the league build consistent and sustainable growth over years*".

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Critical Assessment of the FSFP Criteria

No Overdue Payables / Solvency requirements

Not having any overdue payables with players, coaches, employees, any other club participating in the Euroleague Basketball competitions, Euroleague Properties S.A. (hereinafter "EP") and/or the company designated by EP to manage the Euroleague Basketball competitions (hereinafter the "Company"), and/or any tax or social authorities.

Not having been formally declared bankrupt or insolvent by a competent body in its home country, not having entered into liquidation or dissolution or any similar proceeding affecting the ordinary course of its activity, or not being in a situation in which it is obliged under law to file an insolvency proceeding or be entered into liquidation or dissolution, winding up or any similar proceeding in its jurisdiction. In the event that a club has undergone any of the aforementioned situations prior to participating in the Euroleague Basketball competitions, a period of one year after having exited that situation must have passed prior to applying for a licence to participate. The club will provide the corresponding certificate from the competent official body.

- Clubs are clearly engaged in **economic activity**, therefore, from a legal perspective, are deemed to be "*undertakings*" in the context of the TFEU and EU competition law. As such, meeting **payment obligations/commitments** and ensuring **going concern** are pre-requisites for the continuation of their (economic) activities.
- These criteria are directly related to ensuring the **viability and sustainability** of the club competition. From a competition standpoint, these two criteria do **not** seem to be **imposing any restrictive impact** on the club completion, thus not deemed critical. Further, similar rules have already existed in the local league club licensing procedures since several years (mostly in Western European leagues) which proved to be effective.

Critical Assessment of the FSFP Criteria

No Overdue Payables / Solvency requirements

- However there seem to be some **practical issues** which need further clarification:
- **Definition of overdue payables:** Although the definition of an overdue payable might seem straightforward, in practice, it is of critical importance as to whether the concept of an overdue payable should be determined by the applicable **national law** or whether it represents an **autonomous concept under the Euroleague FSFP** regulations. CAS decision *2013/A/3067 Malaga CF SAD v. UEFA* provides further insights into this issue. Given the possible relevance of the discussion point for the Euroleague competition, **Management Control Commission** (MCC) would be required to provide **further guidance** and clarification on this matter.
- When assessing compliance with both "*no overdue payables*" and "*solvency*" requirements, it is also important to clarify as to whether a **standalone or a more holistic approach** needs to be applied. For instance, do any overdue payables, that a club's **women basketball division** might have, need to be taken into account for the purposes of assessing this requirement (considering the fact that in most cases it can be part of the same management unit)?
- Similarly, if a club's (leading) **football division** demonstrates serious **difficulties in terms of solvency**, does that condition have any impact on the assessment under Euroleague FSFP regulations?

Critical Assessment of the FSFP Criteria

No Overdue Payables / Solvency requirements

- For example, in the case of **Fenerbahçe**, **Galatasaray** and **Beşiktaş**, all three clubs' publicly trading football divisions are deemed to be "*overindebted*" according to the **Article 376** of the **Turkish Commercial Code** which is clearly stated in the audit opinions issued by their independent auditors. As per the relevant law, this conclusion triggers a fair value valuation of all of clubs' assets and liabilities in order to determine whether **going concern** is in jeopardy (i.e. whether the (fair) value of their assets would be sufficient to meet all their financial obligations). Would this situation represent an important "*relevant fact*" in evaluating these clubs' **financial health**, especially considering the fact that in many cases football divisions are cross-funding other "*amateur*" divisions including basketball?
- Further related to this, what happens in case **a football club is being excluded from UEFA competition** due to **non-compliance** with UEFA FFP regulations? Can the MCC conclude that this would **not be relevant for the assessment** of the financial health of the same club's basketball division and just ignore that fact?
- **If yes**, would this be **prudent and/or sufficient** in terms of protecting the competition's financial stability? Would a club which is heavily dependent on football operations be really free of any concerns whatsoever with regard to its solvency?
- **If no** (i.e. not ignore, instead take into account), then **on what legal basis?** Further MCC guidance seems to be necessary also in this case.

Critical Assessment of the FSFP Criteria

No Overdue Payables / Solvency requirements

- The **Galatasaray** case proves that the example discussed above is definitely not an unrealistic scenario. Here are the relevant facts:
  - Exclusion of Galatasaray (Football Team) from the UEFA competitions for one year (executed in 2016/17 season) due to non-compliance with the UEFA FFP rules and breaching the Settlement Agreement with UEFA.
  - Basketball team won the Eurocup in 2015/16 leading to a direct qualification for the Euroleague in the following season.
- An analysis of the **BAT cases** published since July 2016 onwards reveals that the club had (at least) **nine cases of (disputed) overdue payables** to players and/or their agents, all of which were pending as of the date of club's (associate) license application. Euroleague Bylaws clarify that payables are not considered overdue (also) in case of open proceedings with national/ international authorities and/or arbitration tribunal. However, the unusually high number of pending cases might (or should) have triggered some "*red flags*". But ultimately, Galatasaray Odeabank was deemed **eligible for Euroleague 2016/17 season** which, in retrospect, seems to be a questionable decision.
- After being let go by the club in June 2017, **Coach Ergin Ataman** stated that the club would still owe him **salary payments** that are overdue by more than a year now. Furthermore, it was also announced by the club that the 2017/18 **budget will be significantly reduced to only EUR 4m**, both indicating major issues with club's solvency.

Critical Assessment of the FSFP Criteria

Acceptable "Fair Play Result"

> Not presenting an aggregate deficit from the three immediately previous seasons (T-1, T-2 and T-3) that exceeds 10% of the club's budget average from those same seasons (T-1, T-2 and T-3). Depreciations, write-offs, investments in the club's facilities, and expenses related to the youth programmes will not be taken into account for the deficit calculation.

- This represents a **slightly modified version** of UEFA's **break-even rule** which has been the most **controversial** element of this concept, both from economic as well as legal perspectives. It is a relatively **complex** approach requiring the clubs to determine the acceptable income and expense items which is not in line with basic accounting rules. Unlike UEFA rules, **acceptable (aggregate) deficit** is not an absolute amount, rather a % of the respective club budget.
- It also stipulates that all **revenue transactions with shareholders/related parties** (primarily sponsoring agreements) need to be stated at their **Fair Value** which is defined as "*the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction*".
- Fair Value (FV) has a pretty "*powerful*" definition, such that nobody would have any objections to the underlying principle and the associated intention thereto. However, **determining the Fair Value** represents one of the **most complex** and **difficult** concepts of accounting theory and practice. Unless there is a regular (and efficient) market for regular trade, the **reliability** of any fair (!) value is (almost) always problematic.

Critical Assessment of the FSFP Criteria

Acceptable "Fair Play Result"

- Although the term FV had found its way in several key accounting standards, up until recently there was **no unified FV definition** or, more importantly, **no standard approach** as to its measurement.
- After debating over it for almost nine years, international accounting standard bodies (IASB and FASB) issued a separate **accounting standard** dedicated to FV measurements which became into effect in 2014 (IFRS 13, ASC 820). However this accounting standard is **not relevant/applicable** for the purposes of determining FV for FFP purposes (at least not according to the UEFA regulations, to be clarified by MCC of Euroleague). Currently, **FV definition** as mentioned above represents the only guidance available in Euroleague Bylaws.
- In addition to this, it is assumed that in most of the relevant cases the FV of the sponsorships arranged/provided by shareholders/related parties need to be measured. However, obviously **sponsorship evaluation** is another real challenge for the sports (marketing) industry (as well as the academic world) in terms of reliably determining its effectiveness and Return on Investment (ROI).
- In practice, **media exposure** can somehow be measured however serious challenges do exist with regard to reasonably measuring/quantifying the **transferred image** and thus the total ROI for the sponsors.

Critical Assessment of the FSFP Criteria

<u>Acceptable "Fair Play Result"</u>

- It is obvious that the value needs to be fair, but it is **not always clear** according to whom (i.e. who exactly are the knowledgeable parties) and under what circumstances?
- For instance, is **investing $ 42m** by **CSKA** Basketball's shareholder Nordisk Nickel not **fair**? Compared to many other team budgets this might be the logical conclusion however one could ask the following (fair) question: **Would all star players be willing to join CSKA** in case they receive exactly the same offer from Real Madrid or Barcelona? Or wouldn't it be fairer to assume that **attracting best talent** to cities like Moscow, Istanbul, Krasnodar, Kazan etc. (due to many different reasons) would require a **(much) higher investment** than attracting players to cities like Barcelona, Madrid or Milan? In this case it could be argued that all knowledgeable parties would be aware of the fact that there is an additional "*risk premium*" expected by the players in order for them to be transferred to certain teams in certain countries.
- As such, there is always a **strong subjective element** in determining FV which needs to take into account all (specific) conditions of potential buyers in a given market. Based on this fact, and especially in the case of sponsoring agreements, creating the **impression** that a Fair Price could be determined (implying an overall valid value in any condition and for all involved parties) might lead to a **spurious precision** (*Scheingenauigkeit*, as the Germans would put it). Following two examples clearly illustrate the challenges in measuring FV and the related ambiguity.

Critical Assessment of the FSFP Criteria

<u>Acceptable "Fair Play Result"</u>

- <u>Deutsche Telekom – FC Bayern Munich</u>

  Deutsche Telekom AG, leading international telecommunication service provider and the main sponsor of the club since 2002, engaged **two independent market research companies** to appraise the value of its sponsoring deal with the leading German Football club, FC Bayern Munich.

- One of the valuation reports showed a "fair" value of approx. **EUR 50m** whereas the other one came up with (another) "fair (!)" value amounting to **EUR 115m***.
- This example clearly shows that, depending on which report and/or valuation methodology and assumptions are used, the calculated FV can be significantly different.
- However, the key question here is: **which value is "fair"?**

*) Strauß, M.: Fußball Unternehmen in Europa – Konzernrechnugslegung, Lizenzierung und finanzielles Fairplay im deutschen und europäaischen Profifußball, 2014, P. 320.

Critical Assessment of the FSFP Criteria

Acceptable "Fair Play Result"

- Volkswagen – VfL Wolfsburg

  According to a recently published study, **Volkswagen AG**'s sponsorship for the football club **VfL Wolfsburg** (in the form of a shareholder, i.e. Wolfsburg is a fully owned subsidiary of VW) is among the **most expensive** deals in the Bundesliga whereas it seems to bring the **lowest Return on Investment (RoI)**.

According to this analysis performed by FACIT Research, for VW the **cost of sponsoring per fan amounts to EUR 300**. In comparison, **Evonik**, the main sponsor of **Borussia Dortmund** pays only **EUR 6.40/fan** demonstrating the most effective **target-audience-fit**. As per this analysis, it could be argued that **VW is not paying a "fair" value** for its Wolfsburg sponsoring since no knowledgeable party would be willing to pay this price. VfL Wolfsburg played in 2015/16 season in the UCL without any discussions around the FV of its sponsoring.

Source: FACIT Research

Critical Assessment of the FSFP Criteria

Acceptable "Fair Play Result"

- In summary, FV measurement represents one of the **most challenging accounting concepts**, even for (public) corporations which are required to prepare and publish detailed financial statements in compliance with all applicable accounting rules. Sports clubs are **not necessarily known** for their **strong governance models**, **accounting infrastructure** and their **expertise in asset valuation**. Being confronted with this almost impossible task can be seen analogous to the case of a U11 basketball team trying to flawlessly play all 100+ offensive sets of Coach Zeljko Obradovic.
- Another more conceptual argument against the break-even rule relates to the fact that break even is **not necessarily an indicator of solvency**. In a given year or monitoring period, club budgets might be in balance, which however can, by no means, be seen as a guarantee for the financial health of the clubs in the following year(s). Additionally, **items that are not included** into this calculation as relevant expenses might bear the **risks of inefficient and unprofessional management** of club finances, thus jeopardizing the overall solvency of the clubs.
- Lastly, we would like to point out to some **conceptual ambiguities** of the Euroleague Bylaws in determining the Fair Play Result (FPR). As per its definition, FPR is the difference between total revenues and total expenses. In accounting theory and practice, there is an important difference between the terms "revenue" and "income" (and "gain"). If generally accepted accounting principles are applied strictly, third-party contributions (including club contributions to the basketball department) must be excluded from the FPR calculation in their entirety since they do not represent revenues (Exhibit B).

Critical Assessment of the FSFP Criteria

Budget Cap for Player Salaries

> Having a budget allocated to player salaries (gross salary) that does not exceed 65% of the total budgeted expenses of the club.

- This criterion represents an additional, **more restrictive requirement** than the UEFA FFP regulations with regard to limiting expenses on **player (gross) salaries** including all social contributions and taxes as well as fees paid by the clubs to players' agents.
- **Is this goal realistic?** Does the imposed salary limit present an achievable target? Taking a look at the budgets of Euroleague's two leading clubs, FC Barcelona and Real Madrid could provide further insights for this assessment:

2016/17 Budget
(in million EUR)

	Realmadrid Baloncesto	FCBARCELONA LASSA
Basketball Revenues	(11.803)	(9.774)
Operating Expenses (excl Depreciation/Amortization)	34.280	32.603
Sports Personnel Expenses (incl staff)	25.947*	23.421
in % of Total Budgeted Expenses	**76%**	**72%**

- Depending on the staff salaries, this might mean a reduction or at least freezing of salary levels.

	RM	**FCB**
Necessary Decrease in Salary Expenses to comply with this requirement (incl staff)	EUR 3.7m (14%)	EUR 2.2m (9.5%)

- Conceptually, it is not clear as why the salaries of the coaches and staff are not taken into consideration for the salary restriction.

Source: Annual Raports of Real Madrid and FC Barcelona, 2014/15 and 2015/16 seasons

Critical Assessment of the FSFP Criteria

Budget Cap for Player Salaries

- **Is this goal effective and in line with strategic objectives of the Euroleague competitions?** Unlike UCL, Euroleague is not the world's # 1 competition. As such, it does not automatically **attract the best talent**. But also in economic terms, best players are more keen on playing in the NBA due to the much higher level of salaries, including NBA Development League which is currently going through a remarkable change, significantly improving its image as well as the financial conditions with support from a strategically powerful sponsor. Additionally, Chinese Basketball League also seems to be emerging by offering more and more lucrative contracts to the best talent.
- In light of all these current challenges from Euroleagues's perspective, it would be somehow **questionable as to how lowering (or at least freezing) the salary levels** would be contributing to the **growth of the league**, both in sportive and financial terms. If the **player quality** drops, it is inevitable that the image of the competition will also be suffering from it, ultimately leading to **loss of demand**.
- Another (more practical) issue with regard to the **efficiency** of this requirement is again related to the fact that it is a **relative** (rather than an absolute) **limitation**. In case of the clubs with higher budgets, the difference between the player salaries and the full budget will also be higher. These clubs will then be prevented from **investing the residual** into the strategically most important item (i.e. for good players), and instead be forced to find other ways of spending those funds which does not seem to be a fully efficient approach.

Critical Assessment of the FSFP Criteria

Budget Cap for Player Salaries

- As explained in detail above, UEFA break-even rule's **compliance with the EU competition law** seems to be **questionable**. This is mainly supported by the argument that UEFA FFP regulations (implicitly) aim at reducing the salary levels of players (essentially imposing a "relative" salary cap) which is against the interests of players and their agents but in favor of UEFA and the clubs (i.e. the so-called rent-shifting argument).
- In this context, it is interesting to read the following statements in one of the recent **CAS decisions**: "[T]he Panel notes that CL & FFP Regulations do not appear to prevent the clubs from competing among themselves on the pitch or in the acquisition of football players. […] Further they **do not limit the amount of salaries** for the players: clubs are free to pay as much as they wish, **provided those salaries are covered by revenues**."
- In the case of **Euroleague regulations** though, this objective is **not even implicit**, and that there is an **additional limit on** the amount of **salaries** (in addition to the revenues and contrary to the argument used in the CAS decision) clearly stated in this requirement. As such, and also considering the fact that it is a relative cap, it might have further consequences when assessing its compliance with the EU competition law.

Critical Assessment of the FSFP Criteria

Limited Shareholder Contributions

> Not having direct or indirect contributions from the shareholders/related parties of each club representing more than the following percentages of the budgeted expenses: 70% in the 2016–17 season, and 65% from the 2017–18 season onwards.

- Unlike UEFA FFP, Euroleague rules stipulate an **explicit limit for receiving contributions from shareholders/related parties**, essentially discriminating a certain group of investors from the rest, especially sponsors vs investors/benefactors. In other words, this limitation only applies to shareholders (and related parties), but is not applicable in case of a sponsor.
- For the effectiveness of this requirement, it is critical to assess the **role and influence of sponsors** (vs shareholders) in European basketball. Mainly due to its smaller economic scale, and less important role compared to football, it would not be completely wrong to argue that **sponsoring engagements in European basketball** are not always driven by rational economic decisions and not always executed in a professional manner.
- In many cases, sponsors (even if they have no ownership interest) do have a **significant influence** over key decisions of basketball clubs. In several cases, clubs are also significantly dependent on one or a few sponsors, especially in financial terms, mainly because unlike UCL, top European club competition does not provide significant source of revenues to the clubs nor the (local) TV broadcasting agreements, combined with the relatively low demand for game attendance in basketball leagues.

Critical Assessment of the FSFP Criteria

Limited Shareholder Contributions

- As such, the **lines between shareholders and sponsors are getting even blurrier** from European basketball's perspective. For instance, taking **CSKA** as an example. **Norilsk Nickel is currently the owner of PBC CSKA Moscow**, thus subject to both to the limitations of shareholder contributions as well as Fair Value requirement. However, we argue that its influence over the club would not have been less, in case it would be acting as the main sponsor, which however would not make them subject to these restrictions. To further continue, would **Brose Baskets Bamberg**'s budget contribution from Brose deemed as a sponsoring only and not be subject to any FV restrictions although the dependency is obvious (despite a very high number of other sponsors)? How should the situation of **FC Bayern Munich** be assessed in case of a sponsoring deal with Adidas which has a more than 10% ownership interest in the FC Bayern Muenchen AG which makes the selection of another sponsor practically impossible (i.e. no other realistic options for jersey/equipment sponsoring other than Adidas)
- Other relevant examples would be the cases of **Ülker** and **Doğuş**. Both have in common that they first competed in Euroleague with teams that were directly owned by them and then became **main sponsors of Fenerbahçe**. One could argue that Fenerbahçe is an independent club, thus the sponsoring relationship would always be established at fair market conditions, however Ülker family members took key roles in club management, not necessarily applying full control over the entire club, but (in substance, but not necessarily in form) were able to apply significant influence on basketball decisions (e.g. in the first year of Mr. Zeljko Obradovic as Head Coach).

Critical Assessment of the FSFP Criteria

Limited Shareholder Contributions

- Another key topic which is directly relevant for European basketball is the **role of the state**. How should the contributions from state/government organizations and authorities be interpreted, especially considering the fact that state aid can take several forms?
- For instance, **Istanbul Büyükşehir Belediyesi** (IBB) is a club directly managed by Spor A.Ş. (a venture 100% owned by the Municipality of Istanbul, besides many other facilities, also the owner of **Sinan Erdem Dome**, two time hosting venue for Euroleague Final Four). Its basketball division has been competing in the **Turkish Basketball Super League** since 2014/15 season. Main sponsors of the club are some other ventures of the Municipality of Istanbul. According to the Turkish laws, municipalities are not allowed to provide any (cash) contributions to (non-amateur) sports clubs, nor can actively be involved in any club's management. Thus, from a **formal perspective** the relationship between the club and the Municipality is **not based on ownership**.
- How should this requirement be applied in this case? It is not a remote possibility that, at some point, IBB might be competing at the highest competition level, as demonstrated by the fact that their sister team, **Medipol Başakşehir**, finished the **Turkish Football League** in the second place in 2016/17, thus will play qualification round games for the UCL. Considering their economic potential combined with their remarkable basketball investments in recent years (e.g. hiring players like Sasha Vujačić) this case can become **relevant for the Euroleague sooner than expected**.

Critical Assessment of the FSFP Criteria

Limited Shareholder Contributions

- Besides this (probably unique set-up) in the Turkish system, there are **several other instances** where the state's role and its compliance with this requirement should be analyzed and clarified in more detail, such as in the case of **Lokomotive Kuban Krasnodar** (main sponsor being the state-owned Russian Railways), or **Rostelecom** (CSKA Moscow) etc. etc. And last but not least the support obtained from some **(Western) European states such as Spain and France** in terms of **direct contributions or tax amnesty**. It is also extremely important that the role of state aids should be assessed from a transparency as well as fair competition point of view.
- Similarly, the **role of football clubs**, especially in terms of allocating a budget to their basketball divisions requires further clarification and guidance. It is also not clear, as to why the FV requirement is not applicable for allocating sponsorship revenues to basketball divisions. In practice, football divisions provide cross-funding to basketball by simply "plugging" whatever the budget deficit is.
- In this context, it is very important to call out that **corporate sponsors** (in the form of shareholders) played a **unique role for the development of Turkish basketball**. Currently, clubs like **Anadolu Efes, Doğuş, Tofaş, Banvit and Türk Telekom** etc. are deemed to be the locomotive of Turkish basketball. Formerly, clubs like **Eczacıbaşı, Ülker, Paşabahçe, Nasaş and Çukurova**, all very robust, professional companies with long-term investments, played an extremely important role in developing Turkish basketball. Simply put, without these investments (based on a shareholder model) the Turkish basketball would definitely not have been where it is today.

Critical Assessment of the FSFP Criteria

Limited Shareholder Contributions

- Even if some of these companies closed their basketball operations, their **investments** have been **long-term** and **strategic** in nature, **not necessarily always driven by economic reasons and decisions**, but in many cases were seen as **CSR projects**. To put the success of this model in context: **Fenerbahçe**, by winning the Turkish League championship in the current 2016/17 season has just reached the same number of championships as **Eczacıbaşı** did already before closing down their basketball operations back in 1993. Anadolu Efes was the very first Turkish sponsor of a Final Four organization (1992 Istanbul organized by FIBA) and the first Turkish team ever to win a European title. Possibly even more important was the fact that **Anadolu Efes** and Eczacıbaşı were the biggest two rivals in all Youth Championships which produced many players, coaches as well as basketball managers some of which are still in key positions of Turkish Basketball. Similarly, **Ülker** had created another new basketball école in Turkey with great success, even leading to developing NBA players like Ersan Ilyasova, Zaza Pachulia and Ömer Aşık. Furthermore, it was both Anadolu Efes' and Ülker's great vision to be part of the **Euroleague** organization.
- This FSFP requirement however, in our view, clearly represents an **additional entrance barrier for new investors** like the ones mentioned above and thus an obvious disadvantage for the continuation of this very successful (and sustainable) growth model. Restricting money injections can be particularly **welfare-reducing and contra-productive to ensure a more balanced competition as well as sustainable future growth of European Basketball**.

Critical Assessment of the FSFP Criteria

Minimum Revenue

> Presenting a revenue budget of a minimum of 4,000,000 euros.

- **Similar regulations** already exist in the club licensing requirements of some of the domestic leagues which seem to be a **proven measure** in strengthening the financial health and sustainability of the clubs.
- This requirement does not seem to represent a decisive factor due to other existing regulations, as such, should **not have any significant restrictive effect on competition**, at least at this level (EUR 4m). However, unless supported by future growth and additional payments to the clubs, increase in future years might be problematic.
- **Minimum revenue limit** should be determined carefully just to ensure that clubs with relatively limited means are still given the chance to have sportive success..

Standard Financial Year

> Having a financial year from 1 July to 30 June in order to be analysed and compared in terms of annual accounts coinciding with the official basketball season.

- In our view, this represents a **good practice** especially to ensure comparability in a more efficient manner. It needs to be **harmonized** with the regulations of the domestic leagues, e.g. ACB.

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Key Conclusions & Comments

- Euroleague's FSFP regulations show some **significant conceptual similarities** with the UEFA FFP rules while imposing some more restrictive and detailed criteria. As explained above, it is not unlikely that the FSFP rules will lead to some **direct limitations for new investors** who want to invest in European Basketball and reach the top-competition in Europe.
- **Critical points** raised against the UEFA FFP rules could be even **more relevant** to the European basketball due to the following:
  - Lack of real "*sugar daddies*"
  - Different types of investors
  - Small economic scale
  - Not being the leading basketball league in the world
  - (Semi-) Closed League format
  - Competitive Balance issues
- **Euroleague**, especially after the radical format change last season, represents a **semi-closed league** with (virtually) **no risk of relegation** for the leading clubs, whereas UCL represents a fully open league with participation totally based on sportive criteria. Thus, it can be argued that in the case of UCL there is a **higher risk of (inefficient) overinvestments** due to the so-called "*rat race*" phenomenon
- It can be argued that in European basketball the **lines between sponsors and shareholders are blurry** and not always completely different, sponsors having a quite significant influence on clubs' key decisions.

Key Conclusions & Comments

- Furthermore, there is a **significant difference** between European basketball and football in terms of **economic dimensions**. UEFA also considers the effects of so-called **structurally inefficient markets** while assessing the consequences of non-compliance. Transferring this concept to European basketball, it can definitely be argued that at least some countries can be categorized as structurally inefficient which needs to be taken into consideration by the MCC.
- **UEFA softened its rules** amid criticism as to limitation of real entrepreneurs by introducing the concept of **Voluntary Agreements** enabling investors, under certain conditions, to enter into a voluntary agreement with UEFA receiving an additional year for being non-compliant. Directionally, this might also be the right decision to take for the Euroleague as well (please refer to Suggestions for Improvement section).
- Most probable impact of these regulations, in addition to being an entrance barrier for new investors, is expected to be a **downward trend in salaries**. However, this will reduce the **attractiveness of Euroleague** for best talent, especially as a result of more increasing gap between NBA and Euroleague, but also some other developments such as the G-League and Chinese Basketball League. Also, FIBA Basketball Champions League might benefit from such a salary trend.
- **Determinig the Fair Value is not an easy task**. It is influenced by several (subjective) factors, thus making its reliability quite questionable unless there is a regular and efficient market for the assets for which FV needs to be determined. Complexities and difficulties in measuring the effectiveness of the sponsoring deals are making this task, especially for sports clubs with relatively poor accounting infrastructure and expertise, almost impossible.

Key Conclusions & Comments

- Some of the requirements, especially those related to budget restrictions do **not seem to be realistic**, at least in the current state. These rules' effectiveness will directly depend on their **consequent application** otherwise it can lead to the loose of credibility. In this context, setting achievable targets in the initial phase is extremely important.
- Compared to UEFA regulations, there appear to **be bigger concerns in terms of compliance with the EU competition laws** due to additional restrictions as discussed above. This argument gets even stronger, when the current Euroleague structure is analyzed in further detail. Namely, Euroleague FSFP regulations have been imposed by the Euroleague Organization whose majority shareholders are the eleven licensed clubs participating in the Euroleague competition. Looking at the situation from the perspective of the remaining five Associated Clubs, this would represent a **vertical restraint** imposed by a group of competitors (e.g. licensed clubs) **acting horizontally**.
- The **role of the state** and its contributions to (basketball) clubs is not sufficiently and clearly addressed in the current version of the FFP regulations.
- <u>Assessing the effectiveness of Euroleague FSFP rules - **The case of Montepaschi Siena**:</u>

  In addition to the comments regarding the effectiveness of these rules mentioned in the above sections, it might also be useful to analyze a real-life case to determine as to whether the FFP rules might have prevented an adverse outcome. One of the most recent and prominent cases of (financial) club failures is the one of Montepaschi Siena.

  Could the club have been saved if the Euroleague FSFP rules were in effect earlier?

Key Conclusions & Comments

The Case of Montepaschi Siena

- Background: In 2000, **Banca Monte dei Paschi di Siena** became the main sponsor of the basketball club **Mens Sana 1871 Basket** based in Siena which took the club to the next level and initiated a very successful era. Between 2000 and 2014, the club won the **Italian championship** eight times, Italian cup five times and the Italian **Supercup** seven times.

  At the European stage, they also demonstrated quite an impressive achievement by winning the **FIBA Saporta Cup in 2002** and appearing in **Euroleague Final Four for four times**.

- Financial Difficulties: Following the severe impacts of the global financial crisis on its main sponsor, Banca Monte dei Paschi di Siena, **club's budget was initially decreased for the 2012/13 season**, followed by a further contraction of its budget in the following season which led to the departure of key players from its roster. As a result, Montepaschi Siena found it harder to compete in the Euroleague during the 2013/14 season. Soon after, the club was declared **bankrupt** amidst debts of EUR 5.4m and the departure of its main sponsor.

- Additionally, an inquest had been started in 2012 after suspected **undeclared payments and tax evasion** by club officials for over 90 million Euro, including former president Ferdinando Minucci.

Key Conclusions & Comments

The Case of Montepaschi Siena

- On 7 October 2016, following an investigation for accounting and fiscal fraud, the Court of the **Italian Basketball Federation revoked all the domestic titles** won by the club during the 2011/12 and 2012/13 seasons. On 18 April 2017, **CONI annulled the decision of the Italian Basketball Federation**.
- Without having all the relevant details about the club's financial situation, we assume the following with regard to the possibility of Euroleague FSFP rules preventing the bankruptcy of the club, if the rules would have been in effect for the 2012/13 and 2013/14 seasons.
- Due to the **extensive documentation and audit requirements**, most likely it would have been **visible to the MCC that club finances go under stress** as a result of the initial budget cuts for the 2012/13 season. At that point, the club may not have had **any (significant) overdue payables**, nor **any indications of insolvency**. Even if there was a budget deficit for that specific season, the Euroleague FSFP requirements in terms of **Fair Play Result** might have still been met, since for that assessment the **aggregate deficit** for a period of three years matters.
- Furthermore, **neither the Fair Value requirement nor the limitation of shareholder contributions** would have been **applicable**, since Banca Monte dei Paschi di Siena appears to be the sponsor of the club, and not its shareholder*.

*) As per the Bank's 2012 Annual Report M.Siena was not a subsidiary.

Key Conclusions & Comments

The Case of Montepaschi Siena

- In summary, **downturn in club finances** would have been most likely visible also subsequent events requirements should have set off certain red flags and alarms, however **it is not certain** that the club would have been **denied license for the 2013/14 season**.
- As to the **accounting fraud** discovered later, it can be argued that, depending on its severity, the detailed analysis of its financials submitted to the MCC might have led to certain **red flags**, or at least **concerns**. However, due to the fact that financial statement audits are not primarily designed for discovering fraudulent accounting practices on a full basis, there is a **quite reasonable likelihood** that fraud may not have been discovered either.
- As such, it would not be entirely inappropriate to argue that the **Euroleague FSFP regulations** including club monitoring procedures **may have not prevented** the bankruptcy of Montepaschi Siena.
- In this case, the **key issue** does not seem to be the **budget deficit** (at least not initially) **nor the money injections from a shareholder** (since the bank was a sponsor and not a shareholder). Instead, the **trigger** for this financial disaster might primarily be seen in the very high **dependency on a single sponsor** as well as the **lack of key governance structures** especially in the accounting function which in our opinion still exist in European Basketball and are not being fully addressed by the FSFP rules.

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Suggestions for Improvement

- Allowing all investors making "***money injections***" **without any limitations** whatsoever in case there is a **long-term commitment** (e.g. guarantee for a minimum 3-year budget, youth program, training facilities and arena).
- By doing so, **benefiting from the entrance barriers** imposed upon (potential) investors by the **UEFA** and attracting them to European basketball seem to be a smart strategic move for the top-level basketball competition in Europe.
- **Full elimination of the Fair Value requirements** due to their limited objectivity and the complexities associated with their application.
- Focusing on increasing **transparency** and **quality of accounting** and **financial reporting rules**, as well as strengthening **solvency related regulations**, eliminating ambiguous/unclear rules, enhancing **application guidance** with practical aids/interpretations of all rules.
- Introducing **additional rules** for:
  - Publishing **Cash Flow** information
  - Performing **Risk assessments** for **concentration of sponsors**
  - Improving the **Governance structure** / professionalism of club management

Suggestions for Improvement

- Clarifying the **role of the state** as well as the principles as to how the state aids in any form should be treated.
- Providing support for applying professional methods/concepts for **growing the sponsoring base and measuring ROI** of sponsoring engagements.
- Developing and implementing effective rules for **regulating the role, duties and rights of players' agents** as a mitigation against unsustainable (and unsubstantiated) "skyrocketing" of player salaries.
- Focusing on efforts to further grow **league revenue** and offering more **revenue sharing** within the Euroleague. In that context, re-visiting the issue of **increasing the number of teams** in the Euroleague asap.
- Enforcing the **minimum attendance policy** in a more consequent manner.
- **Improving cooperation with FIBA**, **local federations** and **domestic leagues** (due to interdependencies of the European basketball system) – Fixing the financial health of the top-level competition only does not appear to be sufficient for a viable and sustainable European basketball system as a whole, in that case top level competition would not be immune to the broader systemic risks if it only targets its member clubs.

Suggestions for Improvement

- Other factors to consider: Introducing **additional rules to protect the competition's integrity and independence** (both in fact and appearance), e.g. Doğuş acting as one of the major sponsors of Turkish Airlines Euroleague, and at the same time the main sponsor of the defending champion, Fenerbahçe, as well as running a Joint Venture with the strategic marketing partner of Euroleague, IMG, might cause some concerns with regard to (possible) conflict of interests.

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