SPORT RESOLUTIONS

SR/206/2020

BEFORE THE LEAGUE ARBITRATION PANEL IN THE MATTER OF A DISCIPLINARY APPEAL FROM AN EFL DISCIPLINARY COMMISSION (SR/017/2020) UNDER SECTION 8 OF THE EFL REGULATIONS

Before:

Charles Hollander QC (Chair)
Rt. Hon. Lord Dyson
David Phillips QC

BETWEEN:

THE FOOTBALL LEAGUE LIMITED ("The EFL")

Appellant

and

DERBY COUNTY FOOTBALL CLUB LIMITED ("DCFC")

Respondent

DECISION: FRESH EVIDENCE APPLICATION

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1. This ruling relates to EFL's appeal from the decision of the Disciplinary Commission ("DC") dated 24 August 2020 in relation to what is referred to as the second charge, which concerned the amortisation of the capitalised cost of player registrations ("amortisation" or "amortisation treatment") in Derby County FC ("Derby")'s accounts for the years ending in 2016, 2017 and 2018 (accounts are referred to here by the year of end date).

2. By application dated 15 December 2020 EFL seek to put in new evidence on this appeal not reasonably available before the DC. The application relates to a witness statement from Mr Jim Karran, EFL's Finance Director.

3. The second charge concerned the manner in which Derby amortised the capital cost of player registrations. In summary the DC found:

   a. Derby said it changed its amortisation treatment with effect from the 2016 accounts. Prior thereto, it had amortised in the same way as other clubs [45].

   b. It was not obvious from the written materials that there had been such a change in amortisation treatment [50]; the notes to the 2016, 2017 and 2018 accounts did not make clear that such a change had occurred and EFL had not until a late stage of proceedings understood there to have been such a change [51]-[52]. EFL believed that the method which Derby said it had used from 2016 was not in accordance with FRS 102 [53].

   c. However, the DC accepted Derby's case that there had been such a change and the treatment adopted from 2016 onwards was as Derby said, and the change occurred after discussions with their auditors [60]-[64].

   d. The DC then went on to consider whether the 2016, 2017 and 2018 treatment was contrary to FRS 102 in circumstances where they regarded the treatment as novel and potentially unique [239]-[240].

   e. There was an issue as to whether there was a pleaded criticism that the treatment was not "systematic" and whether that criticism could of itself involve a breach of FRS 102, but it was not necessary for the DC to rule on that, given the DC's other findings [243]-[245]. However the DC did consider Derby's approach was systematic: [249].

   f. Derby was able to determine the pattern of its consumption of future economic benefits from its ownership of player registrations 'reliably', and the DC was satisfied that Derby was able to do so in the financial years in question [257].

g. Given their findings that i) Derby allocated the depreciable amount of the capitalised costs of player registrations over their useful lives on a systematic basis, ii) Derby's amortisation policy reflected the pattern in which it expected to consume the future economic benefits of those players registrations, and iii) Derby was able to determine that pattern reliably, the DC held Derby's amortisation policy was not contrary to FRS 102 [258].

h. Derby did not fairly disclose the change in accounting treatment in the accounts and to that limited extent failed to comply with FRS 102 [260].

4. EFL Regulation 94.6 permits new evidence to be adduced in support of an appeal if the League Arbitration Panel ("the Panel") determines that:

> *"94.6.1 the evidence was not available at the time of the hearing before notwithstanding the exercise of reasonable diligence by the person seeking to introduce it;*
>
> *94.6.2 the evidence is credible; and*
>
> *94.6.3 the evidence is relevant."*

The application

5. Mr Karran's new evidence concerns events which occurred from 25 August 2020 onwards, after the DC decision was delivered. EFL submit it casts serious doubt upon the reliability of the "expected recoverable values" employed by Derby. They say those events concern matters that appear to have been within the knowledge of Derby in advance of the hearing before the DC, but which were not disclosed to the DC:

a. On 25 August 2020, the day after the issue of the Decision, Derby lodged with the EFL draft audited annual accounts for the 2019 year end for both the Club itself and Gellaw Newco 203 Limited ("Gellaw") (the new parent company of Derby's Group which Derby proposes as the new P&S Reporting entity). Those drafts had been, according to their text, prepared a considerable period previously.

b. In those drafts, Derby included an "impairment" charge of £22.2 million in respect of the value of its squad and Gellaw included a "goodwill impairment" of £32.1million. Derby has since refused to explain these impairment charges unless the EFL undertakes not to draw them to the attention of the Panel.

6. EFL submit the evidence is relevant for two reasons:

a. The 2019 impairment charge may cast serious doubt upon the DC's finding that Derby's amortisation approach was reliable. The impairment of £22.2 million accounts for nearly 44% of what was previously the net book value of Derby's squad and was therefore highly significant. The only explanation of the £22.2million impairment is that "the book values of certain players exceeded their recoverable amounts". This indicates that, contrary to the DC's findings, the "expected recoverable values" deployed by Derby were not reliable at all. In view of the manner in which the DC approached the issue of reliability given the "relatively little evidence" it had, (comparing the outturn against the assumptions (see [257])) it is difficult to see how their finding could have been the same had they known this vital fact.

b. The DC appears to have been under the impression that the only relevance of the amortisation approach was how to ensure that clubs record the correct "profit on disposal" [56], whereas the 2019 impairment charges suggest that the policy is not merely about delaying amortisation charges, but rather avoiding them altogether. The EFL is currently unclear exactly what has happened to generate the £32 million "goodwill impairment" in the new reporting entity, because Derby refuses to explain. But Derby's approach of delaying the amortisation charges into future reporting periods appears, at least potentially, to be part of a strategy designed, in conjunction with a change in reporting entity, to ensure that the relevant losses are never taken into account for the purposes of the P&S Rules at all.

Derby's response

7. Derby opposes the application and rely on a witness statement from CEO Stephen Pearce. They submit as follows:

    a. Much of the new evidence goes beyond the purpose for which EFL seeks to admit it. Further a portion of Mr Karran's witness evidence consists of commentary and argument.

    b. Derby accepts that the draft 2019 accounts recording player impairments for that year and Mr Karran's commentary thereon at Karran3 [21]-[25], are in a different category, to the extent that it was the EFL's case before the DC that impairments in the year 2018/19 were material. However:

        i. The Charge was confined to the years 2016, 2017 and 2018. All that evidence of subsequent financial years could show would be the materiality of the alleged non-compliance with FRS 102. But on EFL's own case, materiality was irrelevant (see [215(a)]).

        ii. The EFL's application proceeds upon the basis of an assumption that it can be inferred from the 2019 impairments that Derby's prior approach to amortisation was unreliable. That is not the case for the reasons explained at Pearce2 [28]-[41].

    c. The EFL received the draft unaudited accounts for Gellaw on 6 March 2020. These showed a large impairment to goodwill of £32.1 million. Any reasonable accountant with Mr Karran's knowledge and experience should have appreciated that the goodwill impairment in those accounts related wholly or in large part to player registrations, as Mr Pearce explains. In any event, the audit findings report for Derby and other group companies for the 2019 year was disclosed in the course of the proceedings before the DC. This made reference to very substantial impairments on player registrations for that year, and Mr Phillips QC for EFL cross-examined Mr Delve, Derby's former auditor, to the effect that these impairments showed Derby's amortisation policy to be unreliable. The EFL was thus well aware prior to the hearing before DC: (i) that Derby's auditors had

suggested that between £11.7 million (re [redacted]) and £19 million (adding [redacted]) of player-related impairments needed to be made in Derby's 2019 accounts; and (ii) of the significance of such impairments, on the EFL's case, to the issue of the reliability of the Club's approach to amortisation. If the EFL had wished to explore the significance of 2019 impairments more fully at the hearing before the DC, the EFL could very simply have requested disclosure of the 2019 Draft Accounts or chosen to cross-examine Mr Pearce, rather than Mr Delve, in relation to the impairments.

d. If the Panel is persuaded that the 2019 Draft Accounts (or any other documents exhibited to Karran3) meet the threshold conditions in Regulation 94.6, the appropriate response is to admit those documents but not Mr Karran's witness evidence.

EFL Reply

8. In reply, EFL point out that the Draft 2019 Accounts were only supplied to it on 25 August 2020 notwithstanding (i) an order by the DC for standard disclosure (ii) Derby being ordered on 16 June 2020 to serve a witness statement confirming "*that all correspondence (to the extent that it exists) between the Club and its accountant, Smith Cooper Audit Limited has been reviewed and any relevant correspondence has been disclosed*", and

   "all documents (including but not limited to internal Club correspondence) relating to the basis on which the Club decided to amortise player costs from 1 January 2015 to date;

   all documents (including but not limited to internal Club correspondence) relating to the residual values assigned by the Club to players from 1 January 2015 to 16 January 2020; and... any other document identified as relevant to the charges."

9. EFL submit the Draft 2019 Accounts, by disclosing the Player Impairment, are of obvious relevance to the issues in the appeal:

   a. One of the four key issues in the appeal is the reliability or otherwise of the "expected recoverable values" used by Derby as part of its revised amortisation

policy. The existence of a Player Impairment amounting to what was 44% of the entire value of the playing squad, and the explanations included in the accounts, are squarely relevant to that issue of reliability. The Impairment indicates that the values employed by Derby were highly unreliable.

b. Derby's observation that the Player Impairment fell in the 2019 year whereas the charge related to the years 2016, 2017 and 2018 misses the point that the Player Impairment in 2019 casts doubt on the "expected recoverable values" that were used by Derby in the years 2016, 2017 and 2018.

c. Derby suggests that the inference which the EFL seeks to draw is not warranted but that is a submission in relation to the substantive merits of the appeal. On the contrary, Mr Pearce's evidence shows precisely the problem with Derby's approach, namely that Derby maintains high "expected recoverable values" for players throughout their contracts, thereby avoiding the appropriate amortisation charges, and then has to take very large impairment charges right at the end of the players' contracts.

10. Further, EFL say Karran3 itself, and the other documents in Exhibit JK3, meets the test in Regulation 94.6. These materials are concerned exclusively with, or comprise, documents which were not produced by Derby until 25 August 2020, and thus could not have been submitted to the DC.

Further submissions

11. Derby deny that they were in breach of any disclosure order and (i) the draft 2019 Accounts were not responsive to the disclosure orders made (ii) the DC refused EFL's application for documents relating to the 2018/19 season and (iii) the disclosure statement made clear that the search had been done to 16 January 2020.

12. EFL say in response the draft 2019 Accounts fell squarely within the orders of the DC and in particular *"relating to the residual values assigned by the Club to players from 1 January 2015 to 16 January 2020"*.

Discussion

13. We accept EFL's submission that the three prerequisites of Reg 94.6 are satisfied:

    a. The draft 2019 accounts were not available at the time of the hearing before notwithstanding the exercise of reasonable diligence by the person seeking to introduce it;

    b. The evidence is credible;

    c. The evidence is relevant.

14. The key issue relates to the 2019 draft accounts. If we admitted them, we would need to admit evidence which explained them.

15. It is not in dispute that, even if the three conditions stated in Reg 94.6 are satisfied, (i) Rules 6.1 and 6.2 of the Procedural Rules in Appendix 2 to the EFL Regulations give the Panel a discretion as to whether or not to admit the new evidence; and (ii) this discretion should be exercised in accordance with the overriding objective in Rule 9.1 of dealing with cases justly.

16. We have been referred to the cross-examination by Mr Phillips QC of Mr Delve, on the basis of the audit findings report for Derby and other group companies for the 2019 year, a document disclosed in the course of the proceedings. Mr Phillips QC cross-examined Mr Delve to the effect that the impairments referred to there showed Derby's amortisation policy to be unreliable. Although it would not have been apparent what the precise impairment in the 2019 accounts would be, it was apparent from the audit findings report, and the cross-examination, that the impairment was expected to be very substantial. It seems to us that the very point for which EFL rely on the draft 2019 accounts was made clear in this effective cross-examination. As Derby put it at para 16 of their submissions dated 8 January 2021:

    "The EFL was thus well aware prior to the hearing before the Disciplinary Commission: (i) that the Club's auditors had suggested that between £11.7 million (re. [redacted] *) and £19 million (adding* [redacted] *) of player-related impairments needed to be made in the Club's accounts for the 2018/19 year; and (ii) of the significance*

of such impairments, on the EFL's case, to the issue of the reliability of the Club's approach to amortisation."

17. EFL seek to rely on the 2019 draft accounts on the issue of the reliability of the amortisation treatment in the 2016, 2017 and 2018 accounts. In our view, the point for which EFL now seek to rely on the 2019 draft accounts was before the DC, EFL were very much on it, and were able to make submissions on the point to the DC based on the audit findings report and the cross-examination of Mr Delve. It was not necessary for EFL to know the precise extent of the Player impairments to be able to make these submissions to the DC.

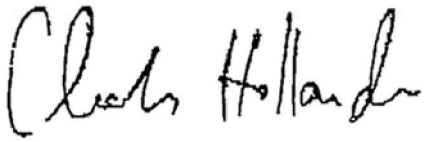
18. In the light of that, we do not consider that, in order to deal with the appeal justly, it is necessary to admit the fresh evidence and in the exercise of our discretion we refuse to do so. It is not necessary to have regard to the precise figures for the 2019 draft accounts in order to decide whether the way in which the amortisation was carried out in the accounts for the three previous years was reliable.

Disposition

19. We therefore dismiss this application.

The appeal

20. We invite the parties to consider directions for the appeal. Whilst we have encouraged brevity in oral submissions in hearings which have taken place to date, it seems to us that we will need quite a lot of assistance on the appeal itself, and wonder whether the estimate may be up to two days. We think sequential written submissions would be helpful. Please could the parties agree a time estimate and we will then need to fix a date and finalise directions.



Charles Hollander QC

For and on behalf of the League Arbitration Panel

London, England

22 January 2021

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