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# 11 - June 2019



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Major Football Competitions: Key Legal Challenges & Ongoing Reforms

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# EDITORIAL

**T**he Women's World Cup, UEFA Champions League Final, Copa America, Gold Cup, African Cup of Nations... the month of June 2019 is rich for football fans.

On the sidelines, the situation is no calmer. From rumours of a European “*Super League*” to advanced discussions on a revamped FIFA Club World Cup and a reform of the UEFA Champions League, the last few months have been dominated by intense discussions on the format of existing competitions and the emergence of new ones.

As we know, these great competitions create incredible moments of passion and enthusiasm. They also represent unique opportunities for organizers, host countries or cities, teams, clubs, players and sponsors.

It goes without saying that, quite logically, this complex environment raises many legal and governance issues.

It is in this changing and exciting context that *Football Legal* dedicates this issue's Special Report to Major Football Competitions: Key Legal Challenges & Ongoing Reforms.

It also seemed important to propose a Focus on recent developments in Third-Party Influence and Third-Party Ownership. Finally, as usual, this issue offers a comprehensive overview of the latest developments in football law around the world, both nationally and internationally.

**Alexandre DURAND**

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## Sports M&A – Investments in Brazilian Football Clubs

By André SICA & Graciema ALMEIDA<sup>1</sup>  
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### → Brazilian Football Confederation (CBF)

*The Brazilian football market has recently drawn the attention of major global investors. Though, from a legal perspective, such investments involve complex challenges, arising mainly from the particularities of the Brazilian football regulatory framework and usual market practices.*

### **Introduction: Recent Market Developments'**

On 23 April 2019, the *Red Bull Group*, which owns Brazilian team "*Red Bull Brasil*", announced investments for the 2019 season into another football club in Brazil: *Clube Atlético Bragantino*, a traditional sports association established in 1928, with quite a successful history in Brazilian championships and which currently plays in *Serie B* of the Brazilian National Football League.

Less than ten days later, on 2 May 2019, *Centro Sportivo Alagoano (CSA)*, a 105-year-old club currently playing in *Serie A* of the Brazilian National Football League, disclosed ongoing negotiations with a pool of Chinese investors for a potential acquisition of the club. Finally, on the very same date, another centennial club, *América Futebol Clube*, also known as *América Mineiro*, playing

in *Serie B* in 2019 but which on occasion reaches *Serie A*, admitted preliminary discussions with possible investors.

This sudden boom of prospective deals appears to indicate that the Brazilian football market has drawn the attention of major global investors, interested in participating in the world's largest athlete-maker market, responsible for handling 1,753 international transfers in 2018, involving the substantial amount of USD 1.1 billion (approx. EUR 966 million).<sup>2</sup>

The logic behind the appetite for the acquisition of Brazilian football clubs by foreign investors is quite straightforward: it is much less expensive to participate in the formation of Brazilian athletes from the beginning - by investing in their clubs of origin and subsequently transferring them to other markets, especially to Europe - than paying the increased resale price of these athletes, which comprises the stakes of their training football clubs of origin.

Notwithstanding the evident economic *rationale* behind the aforementioned Brazilian football club acquisition trend, from a legal perspective, such an investment involves complex challenges, arising mainly from the particularities of the Brazilian football regulatory framework and usual market practices.

### **Brazilian Football Clubs – Organizational and Regulatory Contexts**

#### **Organization of Football Clubs as Non-Profit Civil Associations**

Football was introduced in Brazil in 1894 by *Charles MILLER*, a São Paulo-born upper-class Brazilian citizen of British descent who, after a period studying in England, returned to Brazil bringing the rules of the game that would soon become the most popular sport played in the country.

<sup>1</sup> André SICA (LL.M. Kings College, London, 2007) and Graciema ALMEIDA (LL.M. Humboldt University, Berlin, 2010) are, respectively, partners with the Sports and Corporate/M&A practices of *CSMV Advogados*, a Brazilian full-service law firm established in São Paulo ([www.csmv.com.br](http://www.csmv.com.br)).

<sup>2</sup> FIFA TMS Global Transfer Market Report 2018 : [www.fifatms.com](http://www.fifatms.com)

In view of this, football was originally a hobby of the Brazilian elite, played during the weekends at upscale sports clubs legally organized as non-profit civil associations. In time, football grew in relevance within sports clubs, leading some of these occasional players to participate in their management and to become amateur football team directors during their spare time.

Possibly due to its characteristics of not requiring highly specialized skills or expensive gear, football eventually spread beyond the walls of the sports associations and became extremely popular throughout Brazil, whilst continuing to consist mostly of teams organized as non-profit civil associations, a model which is still in place to this date and which poses challenges from an M&A perspective.

Under Brazilian Law, non-profit civil associations do not have corporate capital, issue stocks or have shareholders - but are rather legal entities incorporated to pursue not-for-profit (sports, religious, political, artistic) purposes of a certain group of members with a common interest, and which revenues, if any, cannot be distributed to such members, being reinvested in the pursuit of its objectives. It is usually not regulated in detail by governmental laws, allowing a considerable leeway for self-regulation *via* by-laws and other rules enacted by its management bodies. Unsurprisingly, it is not the type of legal entity best suited for a high yield business model which requires modern corporate governance, compliance practices and return on investment.

### ***Brazilian Football Regulatory Framework***

As it did in Brazil, football also grew exponentially around the world, leading to its substantial professionalization and consequently to the enactment of modern sports regulations in many jurisdictions. This, however, was not the case in Brazil, where the lack of modernization of the legal framework contributed to preserve the *status quo* by maintaining the majority of the clubs organized as non-profit civil associations, privileging traditional amateur management and cultivating a poorly regulated business environment.

Notwithstanding the foregoing, it should be noted that there have been legislative attempts in the last three decades to introduce corporate alternatives for the organization of football clubs, so as to replace civil associations, enhance transparency and improve governance.

The first attempt was brought by Law no. 8.672/1993 - nicknamed the "*ZICO Law*" to pay homage to former national team player *Arthur Antunes Coimbra*, known as *ZICO* -, which granted professional sports entities the right to be incorporated as or to be transformed into corporate (for profit) entities.<sup>3</sup> In fact, prior to 1993 it was not possible to explore professional football activities under corporate entities, a legacy from the centralized and interventionist Federal Government in place at the time of enactment of the original sports regulations.<sup>4</sup>

Law no. 9.615/1998 (known as the "*PELÉ Law*"), in turn, made it mandatory for sports entities to

be organized as corporate entities, also imposing the obligation of transformation of the clubs from civil associations into corporations by March 2000, under penalty of suspension of their sports activities.

Following strong opposition to such terms by the football club managers at the time, Law no. 9.981, of 14 July 2000, was enacted to amend provisions of the *PELÉ Law* - including to reinstate as optional the conversion of sports clubs into corporate entities. The Federal Government then attempted, *via* Provisional Measure no. 39/2002, to once again amend *PELÉ Law* to reintroduce the obligation of organization of sports entities, which Provisional Measure was however not converted into law by the Legislative within the legal term and expired. Finally, Law no. 10.672/2003 reiterated the adoption of the corporate model entities to be discretionary.

Concurrently with the above back-and-forth, a number of legislative attempts to grant favorable tax treatment to sports clubs organized as corporate entities comparable to the exemptions granted to those organized as non-profit civil associations were also unsuccessful, rendering the corporate model less attractive than the not-for-profit alternative.

Therefore, after more than two decades of legislative uncertainty - which is far from reaching an end, as there are legislative bills concerning this matter under discussion by the Legislative (as shown below) -, investors interested in joining Brazilian football clubs must be prepared to deal with non-profit civil associations as a part of their business model.

<sup>3</sup> Bruno Galvão S.P. DE REZENDE & Wagner NASCIMENTO, "*Curso de Direito Desportivo Sistemico*", Volume II, São Paulo: Quartier Latin, 2010. p. 699.

<sup>4</sup> Fábio LILLA, "*Curso de Direito Desportivo*". São Paulo: Ícone Editora, 2003. p.115.

### **Possible Structures for Direct / “M&A-Like” Investment in Brazilian Football Clubs under the Current Legal Framework**

There are two possible gateways for making a direct investment or an “M&A-like” investment in a team in the Brazilian football market: establishing a new club, which may be organized as most of the types of profit and non-profit legal entities set forth in Brazilian Law, or structuring a transaction involving an already established club.

#### ***Incorporation of a New Club vs. Joining an Existing Club***

Although allowing a high level of flexibility in the corporate structuring of the investment, the incorporation of new clubs is generally not the preferred alternative for investors, in view of the high association fees charged from new clubs by the State Football Federations<sup>5</sup> as well as of the substantial bottlenecks to access and be promoted to the main leagues of the Brazilian national championships.

In other words, apart from requiring a high volume of investment to become part of a State Federation, the path to participate in the main leagues in Brazil is very long and competitive. For this reason, investors normally seek to invest in clubs that are already established and affiliated, playing national championships - noted that, as a rule, the higher the level of the championship played by the club, the more expensive the investment will be.

### **Precautions upon Joining an Existing Club**

When looking for targets, investors will most likely find clubs established as non-profit civil associations and bearing considerable indebtedness and liability issues. In general, the greater the history and fan base of a club, the higher the number of associate members that will need to be involved in the negotiations, and the amount of the club’s indebtedness. It should be noted that, although in the smaller circle of clubs organized as corporate entities the investor will not have to deal with a myriad of associates, the probability of facing indebtedness and liability issues is also high.

Therefore, when considering the acquisition of a club in Brazil, it is essential to conduct an in-depth, full-scale legal, financial and compliance due diligence to ascertain, on one hand, the governance structure, approvals and other requirements and restrictions to the intended investment set forth in the constituent documents and other instruments binding the club, and, on the other hand, the club’s contingent and non-contingent liabilities, particularly relating to labor, tax, real estate (should the club own or have the right of use of a third-party-owned stadium) and contractual matters.

Another aspect to be considered by players contemplating entering the Brazilian market *via* investment in previously incorporated entities is the culture of informality of the Brazilian football business environment. As a rule, investors should be prepared to deal with lack of transparency, absence of trustworthy records, inaccurate bookkeeping, off-the-book transactions and the hiring, compensation and transfer of

players in violation of employment and regulatory laws.

Albeit not necessarily of a legal nature, this aspect may pose several difficulties, particularly when the investor is a legal entity with sophisticated governance and reporting levels - the cultural shock being the most evident repercussion of the clash of these two entirely different worlds. This aspect may also potentially lead to legal implications, such as liabilities and compliance concerns, reinforcing the need for a high-quality, detailed due diligence of the target.

### **“M&A-Like” Investment Structures Involving Sports Associations**

This section shall focus on the legal structuring of deals involving non-profit civil associations, as this is the type of organization of the significant majority of clubs in Brazil and given the challenges of carrying out an essentially equity-based transaction involving a non-equity entity.

In Brazil, unless expressly authorized by law, non-profit civil associations cannot be transformed into corporate entities. The few legal authorizations for transformation are usually based on the objectives of the association and set forth specific conditions for the transformation. This is the case, *e.g.*, of educational entities pursuant to Law no.11.906/2005, and was the case of professional sports entities (including football clubs) during the period from enactment of the *PELÉ* Law (which Article 27 authorized transformation), in 1998, until enactment of Law no.10.672, in 2003 (which amended Article 27 of the *PELÉ* Law to suppress the provision authorizing transformation).

<sup>5</sup> In Brazil, the sports system is comprised of clubs affiliated to state federations which, in turn, are affiliated to the national confederation.

In view of the current impossibility of transformation, direct investments in football clubs established as non-profit civil associations may be effected in two ways: (i) by the investor becoming a member of the civil association; or (ii) *via* the implementation of a dropdown of assets from the civil association to a corporate entity incorporated as a subsidiary of the civil association, and subsequently having the investor join as a shareholder of the subsidiary of the civil association.

#### Acquisition of Associate Membership Status

This first alternative is the only one that in principle does not require any kind of regulatory clearance by the Brazilian Football Confederation (*Confederação Brasileira de Futebol* - CBF), as (i) it does not trigger a change of the legal entity which holds spots in professional championships, and (ii) there are no regulatory restrictions to the admission of new members or to the replacement of members of a legal entity holding such spots.

Inbound financial investments may consist of loans or donations to the target entity, and the level of control that the investor shall have as a new associate member of the club will depend on the negotiations with the other associate members, to be implemented *via* the necessary adjustments to the governance and management structure of target and reflected in the target's constituent documents.

As previously mentioned, by not having corporate capital or issuing stocks, the civil association structure does not allow the acquisition of equity interest nor a return of investment to the associate members *via* distribution of profits.

#### Dropdown of Assets

This second alternative requires a reorganization of the structure of the association, and regulatory approval of such reorganization by the CBF, before the investment can be made.

In short, the association shall create one or two levels of subsidiaries controlled by it, transferring to the subsidiary which will ultimately encompass the professional football team all the sports assets (spots in the football championships originally held by the association, title to real estate and other assets, employment and other contracts) required for such subsidiary to carry on the football activities. The transfer of assets is made *via* corporate drop down (*i.e.* equity interest in the subsidiary is paid in with such assets), and, in case of a double layer of subsidiaries, the civil association will ultimately have an indirect stake in the subsidiary that will hold the sports assets.

Upon completion of such corporate reorganization and obtaining of the necessary approvals, the investor may then acquire equity interest directly in the subsidiary bearing the sports assets, in any proportion negotiated with the civil association.

#### **Prospects for the Future**

The recent market developments mentioned at the beginning of this article show that the appetite to invest in Brazilian football clubs is of such magnitude that it sometimes even bridges the difficulties posed by the current state of affairs.

There is, however, still good perspective for organizational challenges for direct investment in Brazilian clubs, as the establishment

of a regulatory framework capable of promoting Brazilian football to modern corporate reality continues to be sought.

Legislative Bill no.68/2017, which introduces a new General Sports Law designed to introduce fundamental changes to the sports environment (including from a corporate standpoint), is currently under review by Federal Senate.

Legislative Bill no.5.082/2016, in turn, creates two new types of corporate entities: the so-called "*Sociedade Anônima do Futebol*" (SAF) - aimed at organizing football entities -, and "*Sociedade Anônima Esportiva*" (SAE) - aimed at organizing other sports entities and hence outside the scope of this article. It also served as a basis for the chapter on corporate sports organizations in the aforementioned draft General Sports Law.

Pursuant to this latter Bill, the SAF (i) would bear similarities to conventional joint-stock companies, *i.e.* having a corporate capital divided in shares; limitation of liability of a shareholder to the price of the shares subscribed or acquired by such shareholder; comprising the following corporate bodies: General Meeting, Board of Directors, Fiscal Board and Executive Committee; and (ii) would be governed on a supplemental and subsidiary basis by Law no. 6.404/1976 ("*Brazilian Corporations Law*"), which is the law applicable to conventional joint-stock companies.

Notwithstanding the foregoing similarities, the SAF has distinctive characteristics that prioritize security and reliability. The SAF has specific classes of shares and incorporation conditions, which require the carrying out of, or having an actual relation with, football activities.

Finally, one of the biggest advantages of the SAF lies on its special tax regime: independent, optional, temporary and limited to tax assessment. More than the particularities of its capital and governance structures, it is the favorable tax treatment granted to the SAF under Legislative Bill no.5.082/2016 that may finally lead to the abandonment of the non-profit civil association model (which is very much based on the tax benefits granted to such entities).

Amidst such scenario, the CBF is also in the process of developing a specific regulation with the purpose of dealing with the transition of sports entities between the various corporate regimes available. The CBF's draft regulation aims at designing procedures that shall enable corporate type transformations and deal with the contribution of sports assets from one entity to another, particularly when involving transfers of athletes and of federative affiliations. These procedures shall be subject to compliance with formal requirements, under penalty of imposition of sports sanctions by the CBF, including the possibility of loss of the right to participate in championships.

The fact is that a paradigm shift in the organizational model of Brazilian sports clubs seems to be drawing closer by the hour. However, any successful change in this area seems to also be contingent upon the granting of a set of tax benefits to football entities organized as corporations which is more attractive than the one currently available only to civil associations.

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