



EFL League One and League Two draft Salary Cap rules

Points for consideration

Introduction



The PFA has long supported the principles of cost control measures in their objective of ensuring the financial sustainability of EFL clubs. We recognise the need for a well defined and implemented set of regulations and we believe further consideration is required to meet the objectives of all stakeholders before proceeding with the implementation of the EFL's draft Salary Cap rules for Leagues One and Two



Following receipt by the PFA of the EFL's draft Salary Cap rules (the 'draft rules') dated 29th July 2020 for League One and League Two clubs, the PFA have reviewed the draft

rules and present this document for consideration and discussion. We understand that a vote is to take place on Friday 7th August, where the draft rules may become formalised regulations. **For the reasons set out in this document, we believe that further consideration is required, before proceeding with that vote.**

We are sure that many will consider this document an attempt by the PFA to simply block progress or evidence that we are too far removed from the financial realities of English football. This could not be further from the truth - we understand that financial sustainability has been tough to achieve and respect that the recent Covid-19 pandemic has merely served to exacerbate many of the financial issues being faced by EFL Clubs. Whilst we make no apologies for continually striving to protect the interests of our Members, through

the years, the PFA has also contributed in assisting the financial position of many EFL clubs through the provision of financial support. **We want to see English football operate in a sustainable manner – this is to the benefit of our Members, but also to that of all stakeholders across the game.**

We are not opposed to the principles of cost control measures nor a well thought out, carefully developed and rigorously monitored system of financial controls that promotes sustainability.

However, since receiving the draft rules last week, we feel it necessary to raise some of our fundamental concerns at this stage.

This document is intended to outline those concerns in a clear and understandable manner and not merely to act as process delay. **We are seeking to avoid a situation where the draft rules are formalised and adopted and then subsequently proven to be misconceived and/or not appropriately adhered to or effectively monitored.**

We have asked the independent Sports Business Group at Deloitte (who most recently assisted us with the financial review exercise as part of the response to Covid-19) to provide us with the principles of cost control measures to inform the content of this document, based on their experience of assisting multiple stakeholders in the development of cost control regulations across the sports industry.

Introduction



In order to clearly communicate our response to the draft rules, we have structured this document as follows, providing:

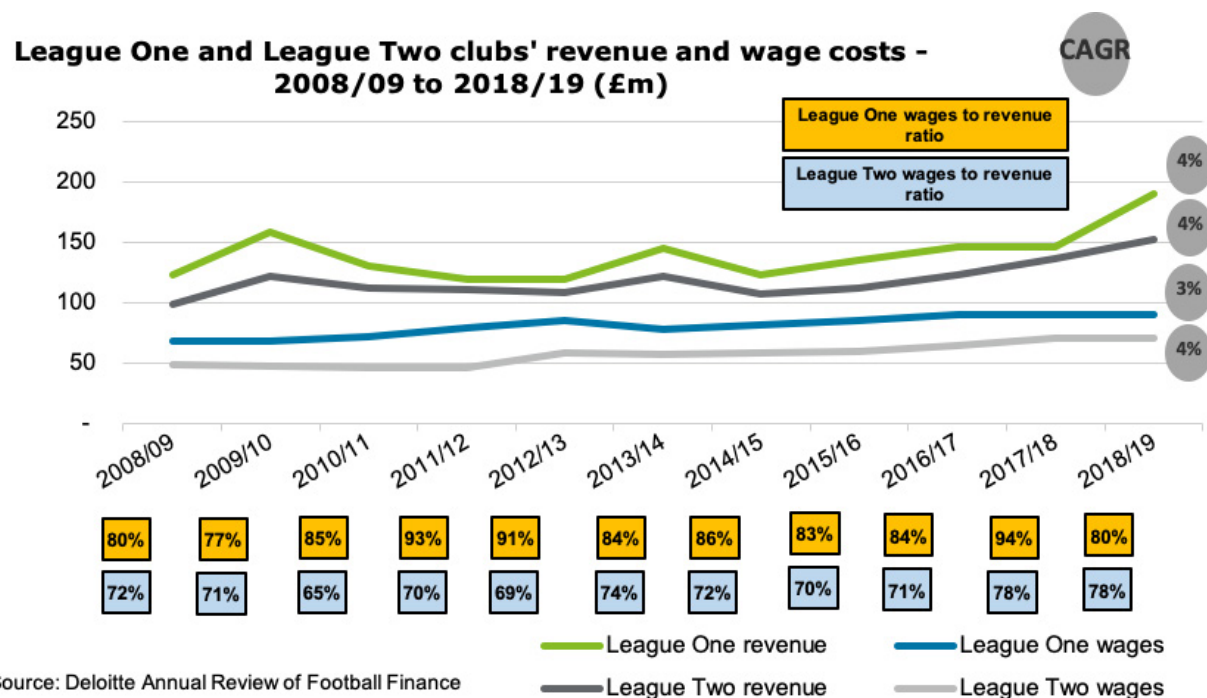
- **A high-level summary of the financial trends for League One and League Two and some key factors that we believe should be considered in the development of cost control measures in respect of player salaries;**
- **An outline of the process that we would have expected the EFL to have taken in order to design and develop effective cost control measures;**
- **An overview of the principles that we consider to be pivotal in the development of the draft rules and whether in our view they have been addressed;**
- **What we consider to be the essential points for consideration that we believe it is important to understand further at this stage; and**
- **Our recommended next steps.**



Financial trends in League One & League Two



The financial performance of clubs in League One and League Two has remained relatively consistent in the last ten years with revenue growth being matched by increases in staff costs. Financial disparity is prevalent with the average ratio of top to bottom revenue generators being 7:1 in League One and 3:1 in League Two between 2014/15 and 2018/19



As the draft rules are being developed, it is important to consider the financial context to which they will be applied and **there are a number of factors relevant to League One and League Two that we believe are important considerations.**

Financial and operational polarisation is significant within League One and League Two

There are notable disparities between League One and League Two clubs within their respective leagues, both in scale (using attendance as a proxy) and financially:

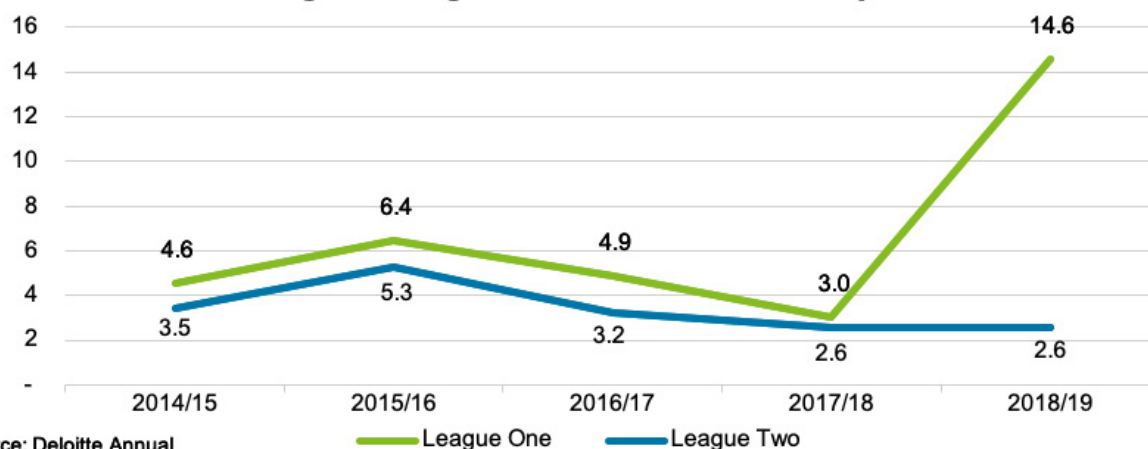
- 2019/20 League One attendance ratio (top vs. bottom): 11:1
- 2019/20 League Two attendance ratio (top vs. bottom): 7:1
- 2018/19 League One revenue ratio (top vs. bottom): 15:1
- 2018/19 League Two revenue ratio (top vs. bottom): 3:1
- Whilst this is exacerbated by the presence of specific clubs (e.g Sunderland), the average ratio of the highest to lowest revenue generating clubs has been 7:1 for League One and 3:1 for League Two over the last 5 seasons (to 2018/19), demonstrating that this is a recurring theme.

Financial trends in League One & League Two



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Revenue disparity (ratio between top revenue generating club and lowest revenue generating club 2014/15 to 2018/19)



Source: Deloitte Annual Review of Football Finance

Wage growth has not increased at a rate faster than revenue.

The revenue and wage growth of League One and League Two clubs have historically been closely correlated, with revenue in each league growing at a CAGR of 4% between 2008/09 and 2018/19, while wages in League One and League Two have grown at similar levels, 3% and 4% respectively.

The level of financial transparency means it is challenging to fully understand the actual level of player wage spend amongst clubs

There is currently a lack of transparency in respect of the financial information available for League One and League Two clubs:

- No League One or League Two clubs disclose player salary costs in their accounts.
- For the most recently available accounts of League One and League Two clubs, only 71% of League One clubs for the 2018/19 season disclosed full accounts. This falls to 29% in League Two.

The process required to develop effective cost control regulations in sport

A comprehensive understanding of the current situation, detailed financial modelling of potential impacts and an iterative consultation process are critical factors employed by others sports regulators in the development of financial regulations

The three phases indicated below are those typically associated with the development of effective Cost Control regulations in sport from concept through to implementation. From the information we have been provided, we understand that the EFL is currently in Phase 2, **but we have not been provided with evidence of Phase 1 having fully taken place, nor any plan for completion of Phase 2 or Phase 3.** We outline the risks associated with this more full on pages [6 and 7].

Phase 1 Defining the regulations	Define the key objectives of the regulations
	Evidence the need for new regulations (current situation analysis, including financial modelling)
	Agree key principles of new rules
	Agree timing of implementation and any transition arrangements
Phase 2 Process development and first time implementation	Define project outputs and establish project plan
	Stakeholder consultations
	Drafting of regulations
	vActions to mitigate risk of legal challenge
	Reporting materials / templates and guidance for teams
	Resources for regulatory development and implementation



Current status of the EFL's draft rules

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The process required to develop effective cost control regulations in sport

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Phase 3 Compliance monitoring and enforcement	Phase 3 develops an effective compliance monitoring and enforcement process with key areas to consider including: <ul style="list-style-type: none">• The annual process of information submission for monitoring and assessment;• Where necessary, the application of investigatory powers by the regulator (and/or an independent third party assessor);• Decision making processes for alleged breaches of the regulations;• The adjudication process by an appropriate disciplinary body (and the types of sanctions available)• The resources available for monitoring and enforcement and appropriate additional support (i.e. independent auditors and legal advisors).• Continuing application of good governance to ensure separation of compliance monitoring / enforcement and adjudication
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The process required to develop cost control regulations in sport



The risk of not following an appropriately rigorous process is that the regulations are either not appropriate for the specificities of that sporting competition or they become open to challenge, misinterpretation and difficulties in enforcing

To mitigate against the risk of ineffective regulation, the first phase of the regulatory development process for other sports competitions has typically:

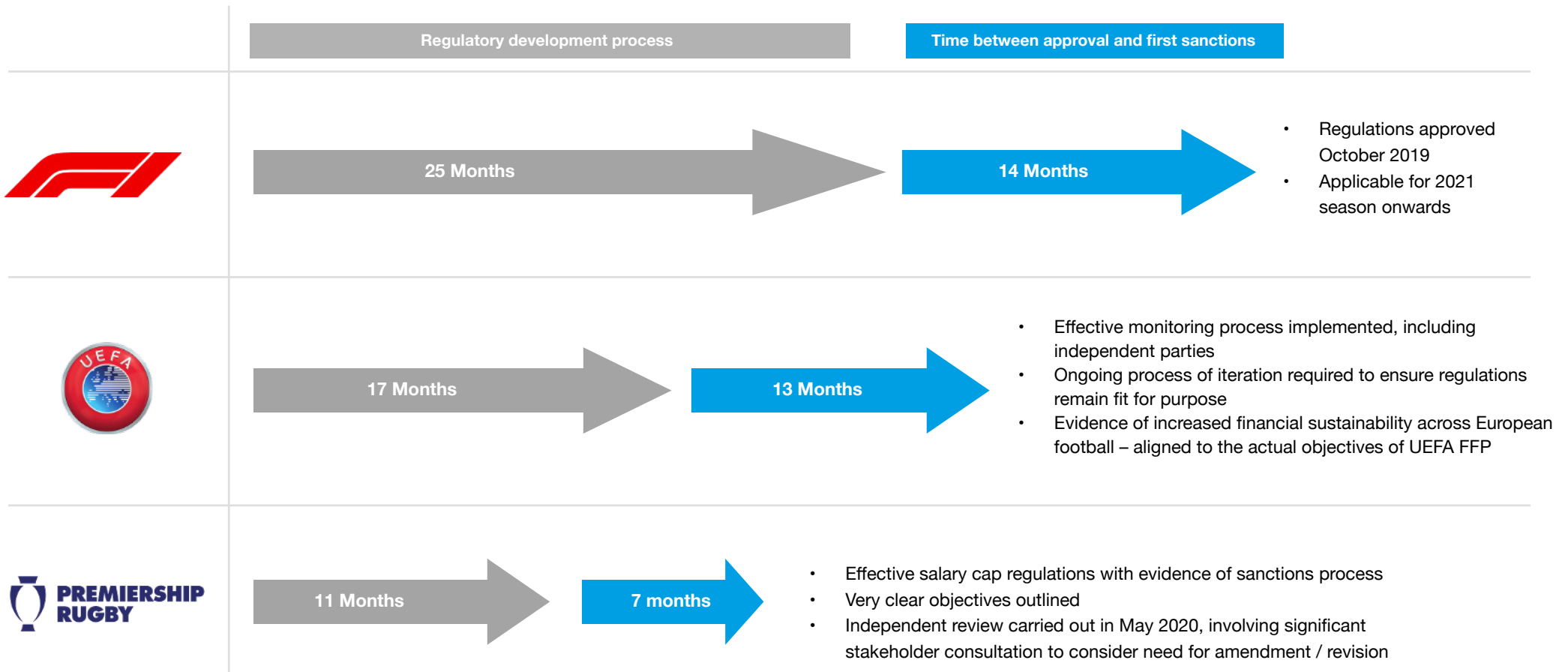
- i **taken in the region of 11 to 25 months** (elapsed time between initial feasibility considerations and approval of the new regulations);
- ii. involved **several rounds of stakeholder consultations;**
- iii. utilised a **variety of approaches** to help build understanding and consensus **prior to being voted upon;** and
- iv. resulted in a **regulatory framework** incorporated into the regulations and supplemented by documentation outside of the regulations providing **guidance and clarity to stakeholders.**



The process required to develop cost control regulations in sport



The timelines of the development of cost control regulations for three major stakeholders in sport are shown below. Whilst it is not our view that the EFL needs to take its time for the sake of it, we would recommend that further consideration is given to how understanding and consensus can be achieved at this stage. Without this, we believe that there is a risk that the draft rules will be ineffectively implemented – a scenario we all wish to avoid.



Principles of Cost Control regulations and comparability to the draft rules

It is our view that the draft rules highlight that more consideration of the specifics of English football in League One and League Two is required and a more complete process should be implemented in order to achieve consensus of stakeholders.

The table below lists eleven principles, which we consider to be fundamental to effective cost control regulations. Against each principle, we have, at a high level, assessed the draft rules and noted the extent to which they meet the description of the principle. Whilst this does not constitute a full and thorough review, we have set out some further views on how the principles have been addressed.

Principle	Description	Draft rules - how principles are addressed
1. Objective clarity	Clear, concise objectives on the goals of the regulations and how they benefit members	Unclear in draft rules. The letter from EFL to PFA dated 29 July 2020 (“the EFL letter”) states “the proposed new rules will help ensure that as normality returns, Clubs cannot again extend themselves to the point that could cause financial instability.” The draft rules are, in our view, currently lacking defined, fully considered and clear objectives, that align to the specific situation of English football in League One and League Two
2. Regulatory clarity	Clear, concise framework that clearly articulates the relevant cost restrictions imposed by the regulation	Clear in draft rules. The draft rules for League One and Two respectively are the framework articulating the cost restrictions and they appear to do this in a clear and concise manner. However, we currently do not understand the basis on which the restrictions have been developed (e.g. there is no evidence of full financial modelling having been carried out)
3. Financial sustainability	How these regulations will aid financial sustainability following implementation	Unclear in draft rules. Whilst the EFL letter describes current metrics around wage to turnover ratios and reliance on owner funding, there is no evidence e.g. supported by financial modelling, of how the regulations will aid future financial sustainability or why they are the appropriate mechanism to achieve the overall objectives (which do not appear to have been defined)
4. Financial transparency	Transparency, fairness and equality of treatment to create trust and confidence in the system amongst all clubs	Clear in draft rules. Rule 5 clearly sets out the Club’s Obligations and Process, and the EFL letter notes “the focus is on transparency”. However, unless all clubs are consulted, their trust and confidence in the system remains unknown and there is a risk that if consensus is not gained, clubs may seek to circumnavigate the regulations

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Principles of Cost Control regulations and comparability to the draft rules

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5. Competitive balance	<p>The promotion of a healthy competitive environment that does not reduce the quality of the leagues</p>	<p>Unclear in draft rules. Whilst the enforcement of a fixed salary cap should deliver competitive balance, it is not clear whether financial modelling around the impact of the regulations on quality has been carried out and whether this has been incorporated into the draft rules. Whilst sustainability is key, maintaining a certain quality of football will be vital to achieving future revenue growth, both centrally and for individual clubs.</p>
6. Enforceable framework	<p>Meaningful sporting and financial penalties that are enforceable and appropriate</p>	<p>Clear in draft rules. Rule 5 clearly sets out the Club's Obligations and Process, with Rule 8 detailing sanctions that will apply if the Rules are breached. Nonetheless, it is unclear whether the appropriateness of these has been assessed (e.g. via consultation with clubs and comparison with sanctions in place for existing SCMP regulations) against the specifics of English football. We would also recommend further explanation is provided as to how the levels of sanctions will be decided.</p>
7. Knowledge/analysis of current situation	<p>An appreciation for the current financial environment and the impact the regulations will have on this</p>	<p>Unclear in draft rules. Whilst the EFL letter states "the financial position of League One clubs [is] deteriorating generally even with the application of the existing SCMP rules" and "the financial impact of Covid-19 will be profound" it is not apparent whether any forecasting or modelling as to the impact of the draft rules on the overall financial position of Leagues One and Two has been carried out. This is a critical step in ensuring the financial cap is appropriate and aligned to all other principles.</p>
8. Implementation timescale	<p>Realistic implementation timescale to enable teams to adjust operating levels, structures and reporting processes without creating unfair competitive disadvantage</p>	<p>Unclear in draft rules. EFL proposal is that "if thought fit adopt revised rules so that they can be in place for next season (2020/21)". It is not evident whether the ability of Clubs to carry out the additional level of reporting has been assessed, or if likelihood of competitive disadvantage (e.g. due to the considerable variability amongst financial profile of Clubs in Leagues One and Two) has been considered. It is our view that the implementation of these draft rules appears rushed and risks undermining their future effectiveness.</p>
9. Transition	<p>Transitional arrangements to enable clubs to compete without undue advantage or disadvantage.</p>	<p>Clear in draft rules. It is clear that, as stated in the EFL letter "no Club will be in breach on implementation", and safeguards are in place to ensure no Clubs are penalised for existing contracts entered into prior to the date of adoption of the draft rules. We trust, but cannot be certain, that the full impact and risks on transition have been considered by the EFL.</p>

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Principles of Cost Control regulations and comparability to the draft rules

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10. Review process	Appropriateness of periodic review process on workability and impact of the regulations	Unclear in draft rules. Apart from Rule 2.3 which states “The Squad Salary Cap shall be adjusted in the Salary Cap Year that each new Broadcast Agreement comes into effect” there is no evidence of a periodic review process being in place. We recommend that full consideration is given to a review process (as we have seen with other sports, this can be highly effective) to allow the EFL to appropriately react to future changes in the environment of English football, outside of the broadcast cycle timing.
11. Compliance	Appropriateness of compliance process for clubs	Clear in draft rules. Rule 5 clearly sets out the Club’s Obligations and Process, however as noted under ‘8. Implementation timescale’ above it is unclear whether the ability of Clubs to carry out the additional level of reporting – and thus compliance - has been assessed.

The ultimate goal of the draft rules should be to ensure compliance and we believe it is necessary for the EFL to demonstrate further how they shall monitor and enforce these regulations, before the Clubs carry out a vote on their adoption

Legality – Whilst not a ‘principle fundamental to effective cost control regulations’ akin to the 11 listed above - since the ability for the rules to be legally robust should underpin every principle - we would also note that legality is “unclear in draft rules” for two reasons: first because such rules must be subject to collective bargaining with the PFA and other stakeholders through the PFNCC, and these have not yet been so; and secondly it is unclear that the rules would satisfy competition law scrutiny, in particular given the lack of consultation and consideration given to less onerous rules or cost controls. For the credibility of all and the potential to achieve sustainability, it is essential that the draft rules are legally sound.

Essential points for consideration

Whilst we have noted the areas that we believe require further alignment with the principles of cost control regulations, which could be achieved through the implementation of a more collaborative process, we have listed below the essential points for your consideration at this stage. We would urge you to understand these further before any further decisions are made

Area for further consideration	Risk of non-consideration and further questions
Objective clarity	<ul style="list-style-type: none">• Without clear, concise objectives on the goals of the draft rules and how they benefit members we believe their whole rationale is brought into question.• For example, how do the specific objectives of these draft rules differ from the cost control measures currently in place via the Salary Cost Management Protocol (SCMP)?
Process and timeline	<ul style="list-style-type: none">• It is unclear whether the process typically associated with Cost Control regulations from concept through to implementation as detailed on page 5 of this paper has been followed.• Stakeholder consultation and consideration would be an important component of any design process but the level of any consultation, and resultant feedback from stakeholders, is, at this stage, unknown.• As a result, the framework that we would expect to see underpinning the draft rules prior to a vote (or at the very least evidence of its development) is not apparent.
Relevance to the football industry	<ul style="list-style-type: none">• From our reading of the draft rules, and knowledge of similar measures adopted in other sports, they appear to be closely aligned to the Premiership Rugby Salary Regulations.• However, there are a number of notable differences between Premiership Rugby and League One and League Two football that we believe need to be considered before a very similar set of rules are applied. For example, the range and disparity of revenue between clubs in the respective leagues vary quite significantly which is an important consideration. We would wish to ensure that full consideration to the situation in English football has been given, for the benefit of all stakeholders.

Essential points for consideration

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Financial information informing the level of the cap	<ul style="list-style-type: none">• We are unclear how the level of the salary cap for each division has been determined (£2.5m for League One and £1.5m for League Two), either from the draft rules or from accompanying information provided in letters from the EFL.• The mechanism by which these salary cap amounts have been determined is important for us to understand, alongside the objectives and overall rationale of the draft rules. Whilst those figures may be appropriate, we believe that without review of the calculations involved in their derivation, the risk of the draft rules being flawed is high.
Suitability of broadcast income 'peg'	<ul style="list-style-type: none">• We understand the proposal for the salary cap to be adjusted in the year that a new broadcast agreement comes into effect. But has no other mechanism for adjusting the cap been considered in intervening years to allow a more flexible approach? A peg to broadcast income alone may, in our view, seriously inhibit the overall development of the game.• The most recent EFL broadcast cycle is for five years, which is a notably long period under which the cap remains fixed with no flexibility around other economic or financial factors that may affect the game.• Additionally, the majority of the current value associated with the current EFL broadcast deal is with the English Football League Championship (FLC), which is not covered by the draft rules. Is this agreement therefore an appropriate metric by which the salary cap is adjusted? And have other potential 'pegs' e.g. metrics incorporating revenue of all clubs in the league been considered? We believe these are critical considerations that must be given.

Essential points for consideration

The overarching point that the PFA, and presumably a large number of other stakeholders, wish to highlight is that we do not have sufficient information in order to effectively assess the appropriateness of the draft rules, and is one that we request you to take very seriously

Area for further consideration	Risk of non-consideration and further questions
Financial impact	<ul style="list-style-type: none">• It is unclear whether a financial modelling exercise assessing the impact of the draft rules has been carried out. There is a risk that without such modelling there may be further as yet unidentified or anticipated financial consequences if the draft rules are adopted.• The financial disparity between leagues and lack of similar salary cap regulations in the FLC and National League are likely to pose a significant challenge on promotion to the FLC for League One clubs/relegation to the National League for League Two clubs, both from a financial and operational perspective. It may now become more attractive for a player to compete in the National League than in EFL competitions, if these draft rules proceed.• It is not clear whether consideration has been given to the number of clubs that are currently operating under the proposed salary caps in each division. Compared to those clubs over the salary cap these clubs will effectively operate under less scrutiny and may then still be able to spend beyond their financial means, putting in jeopardy the overall objective of financial sustainability.• The proposed salary caps, if implemented, could potentially reduce the ability of clubs to generate commercial revenue with sponsors and commercial partners now fully aware that clubs wage obligations will in some cases be significantly reduced. This effectively represents a potential loss of revenue to EFL clubs. This should be considered in greater detail and its impact assessed.• A fundamental pillar of English football is its attractiveness to third parties. The attraction of Leagues One and Two to external entities that may wish to invest – whether external investors, broadcasters, commercial partners – is an important consideration. If wage costs at some clubs are to be significantly reduced, this threatens to limit value creation and reduce the overall quality of the product on offer.
Credibility and integrity	<ul style="list-style-type: none">• The credibility of the draft rules from the perspective of all stakeholders should be considered. For example, does adoption of a fixed salary cap in leagues containing significant disparity between clubs with no consideration of their financial profile appear credible to the wider football industry?• Whilst factually correct or incorrect, there is a public perception that cost control regulations in EFL competitions have not been appropriately implemented in the past. Consideration must be given at this stage to reputational risk – it is vital that all stakeholders work together to get this right
Alternative options considered	<ul style="list-style-type: none">• As information behind the process used to design the draft rules is unclear, we are not aware of other options being considered, rather than a fixed salary cap. For example, other sports have variances on salary caps such as a ‘soft’ salary cap (which varies depending on the specific circumstances of each club), or the allowances for marquee players.• Ultimately, the overarching question remains of whether enough consideration has been given to making these draft rules a success.

Recommended next steps

Following consideration of the points we have highlighted, our recommended next step is for EFL Member Clubs to consider the need for a process more akin to that seen across other sports, or for the EFL to disclose more fully the process followed, in order for all stakeholders to consider the likely implications

- 1.** We recommend that consideration is given to the process outlined on Page 4, and for EFL Member Clubs to ensure they are comfortable that appropriate due process has been followed in respect of the development of the draft rules.

- 2.** If comfortable, then we would appreciate the opportunity to review and understand the detailed information supporting the draft rules. If EFL Member Clubs are not comfortable at this stage then we, alongside other football stakeholders, would be open to assist in a more complete process in order to reach a more understood conclusion. An important priority for the PFA is to more fully understand the impact of the draft rules on the average player salary in due course.

- 3.** We recommend that consideration is given to the principles and key risks that we have set out on pages 6 – 9.

- 4.** Having addressed the principles and key risks, we recommend that a more thorough framework is developed, providing guidance and clarity for how the draft rules will work in practice.

- 5.** Following satisfactory completion of points 1-3, we believe that the Salary Cap draft rules will then be in an appropriately developed form to be subject to a vote, with all stakeholders united and EFL Member Clubs in a position where their actions will ensure long-term financial sustainability in an appropriate manner.



Thank You