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Buy out, Liquidated Damages Clauses in Football

By David Wu | Giandonato Marino

I. Introduction

As leading sports law firm in China within the football industry, several times it has come to our attention a common issue - but still very controversial - among football stakeholders when it comes to early termination of employment relationship with football players and/or coaches: the distinction among buy-out clauses, liquidated damages and penalty clauses.

We intend to provide a brief analysis on main differences, purposes and effects both from the international and domestic point of view. By means of this, the reader would be aware of the potential consequences that may come up when executing such clauses (such as payment of Solidarity Contribution as per FIFA and CFA Regulations on the Status and Transfer of Players (“*FIFA RSTP*” and “*CFA RSTP*”) and/or the imposition of sporting sanctions).

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II. Differences between a buyout clause and a liquidated damages clause in football

a. Premises

Several elements need to be considered when assessing the nature of such clauses (E.g. the wording, intention of the parties or the content of the employment contract itself) but, preliminarily, we should remark that two essential elements have a huge influence on the concrete scenario of each case: the law and jurisdiction governing the employment relationship.

These are of the utmost importance when determining, for instance, how the relevant contractual provisions shall be interpreted and applied in each specific situation, as well as the potential consequences that might derive from their execution.

b. Cases of international dimension (FIFA/CAS)

First of all, in cases of an international dimension (International player/coach – Chinese club, Chinese player – foreign club) where there is no previous agreement on the competence of a national sports judicial body in case of any dispute¹, FIFA will be the competent body, applying the FIFA Regulations and - subsidiarily - Swiss law² as the laws applicable to the matter.

We could start our analysis from the definition of **buy-out clause** given by the FIFA Commentary on the RSTP (“*RSTP Commentary*”):

“the parties, while entering into a contract, may agree that at a certain (or at any) moment one of the parties (normally, the player) may terminate the contract, by simple notice and by paying a stipulated amount.”

This provision, read together with the relevant FIFA and CAS jurisprudence³, sets the minimum requirements for a valid buy-out clause:

- a) grant one party (generally the player) the right to early terminate the contract;
- b) set in advance the consideration or the option price for the exercise of such contractual right.

In case these conditions are met, no breach would occur and thus the party terminating the contract would not risk any sporting sanction but shall simply pay the stipulated amount, which represents the “consideration” (or “price”) for the termination.

On the other hand, the **liquidated damages** or **penalty clauses** are set for a different purpose and thus may entail different consequences.

The main element to distinguish between these two types of clauses (buy-out vs. liquidated damages /

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penalty) lies in the definition of “damages”. In case the player shall pay damages to the club for terminating his employment contract without just cause, such clause does not constitute a buy-out clause. The term “damages” is inconsistent with the concept of a buy-out clause, since when triggering a buy-out clause, any payment to be made by the breaching/terminating party would only be the consideration or the option price for the exercise of a contractual right.

FIFA and CAS⁴ in multiple occasions have established that, in accordance with Swiss Law, a clause is qualified as a contractual penalty or “liquidated damages” clause if it contains all the necessary elements required for such purpose, such as:

- a) the parties bound thereby are mentioned;
- b) the kind of penalty has been determined;
- c) the conditions triggering the obligation to pay it are set;
- d) its measure is identifiable.

In other words, a provision which sets an amount of “damages” to be paid “if” the contract is breached (without just cause) is consistent with the definition in Swiss law of a penalty or liquidated damages clause.

The parties, when including a specific amount as liquidated damages or penalty in case of breach, need to consider all facts and circumstances that surround each contractual relationship, as FIFA and CAS judicial bodies would eventually reduce said amount in case of exceptional circumstances⁵. Therefore, it is likely that FIFA or CAS will award the amount established as liquidated damages or penalty clause in the contract, in case such clause is triggered.

In light of the above, we can conclude that the purpose of liquidated damages and penalty clauses - differently to the buy-out clauses - is to set the financial consequences that will bear one party in case of breach without just cause. Therefore, liquidated damages and penalty clauses do not grant any right to early terminate the contract, and thus, potential sporting sanctions - apart from the payment of the full amount - may be imposed to the breaching party by the competent judicial body (and inducing club, if the case) as it will be explained here below.

III. Domestic cases (CFA)

In case CFA is the competent body to deal with the matter, although its judicial bodies keep a quite similar approach to the one of FIFA and CAS in respect of the interpretation of the nature and requirements of such clauses, there might be certain differences, as CFA applies its own Regulations, and subsidiarily Chinese law.

The main difference consists in the approach that CFA bodies have when it comes to assess whether a

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liquidated damages or penalty clause is excessive and disproportionate, as their tendency is to reduce the amounts set in such clauses. Such common practice, as matter of fact, affects the deterrent effect of such clauses, as well as the principle of contractual stability, of utmost importance in the world of football.

In addition to that, due to the restrictions imposed under Chinese Law, various limitations are made in the name of fairness and which could result in a different interpretation of the rules of CFA.

As per the Contract Law in the People's Republic of China, namely in its Article 114, "[...] *Where the agreed penalty for breach of contract is excessively high (when the liquidated damages agreed by the relevant parties exceeds the actual losses by 30%) compared with the losses sustained, a party may request the People's court or an arbitration body to reduce the said amount to an appropriate and fair amount. This issue was further explained in one Interpretation of the Supreme People's Court on several issues concerning the application of the "Contract Law of the People's Republic of China"*⁶. Moreover, for instance, Article 29, states that in case "[...] a relevant party asserts that liquidated damages agreed are too high and requests for a reasonable adjustment, the People's Courts shall rule on the basis of the actual losses, taking into consideration comprehensive factors such as the performance of the contract, the extent of culpability of the relevant party, and the anticipated profits, etc., and therefore, adjust such amount in accordance with the principles of justice, integrity and good faith [...]"

Therefore, considering that Chinese Laws have to be respected and followed when CFA is the competent body, in case of breach it cannot be assured that the agreed compensation would be paid in full. When situations like these occur, the parties having the right to do so could easily trigger the execution of such clauses, thus putting in danger the deterrent effect that such penalties are made for.

In fact, there has been no case reported that a buy-put option was executed by a Chinese player, as normally the parties terminates by mutual agreement. It would be interesting to see how CFA will react when the first buy-out case arises in China.

IV. Potential additional consequences

Finally, we should consider the collateral consequences that may be triggered when one party executes the right established on a buy-out clause (fulfills the payment or consideration) or on the other hand, when one party is considered in breach of contract, being condemned as a result to the payment of the liquidated damages or penalty established in the contract.

We assume that the FIFA RSTP and CFA RSTP provide the same content in this respect and thus we consider both scenarios under the same paragraph in this article.

i. Payment of Solidarity Contributions as per FIFA and CFA RSTP

Solidarity Mechanism⁷ ("SM") is a concept introduced by FIFA⁸ in order to reward those clubs

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contributing in the education and training of football players.

Article 21 of the FIFA RSTP and in the definition part of the CFA RSTP provide as follows:

“If a professional is transferred before the expiry of his contract, any club that has contributed to his education and training shall receive a proportion of the compensation paid to his former club (solidarity contribution). The provisions concerning solidarity contributions are set out in Annexe 5 of these regulations.”

Similarly, in article 10.1 of the FIFA RSTP and Article 11 of the CFA RSTP it is stated:

“A professional may be loaned to another club on the basis of a written agreement between him and the clubs concerned. Any such loan is subject to the same rules as apply to the transfer of players, including the provisions on training compensation and the solidarity mechanism.”

In this sense, every time there is an international transfer/loan of a player (domestic transfer/loan in case of CFA RSTP) solidarity contributions are to be paid by the acquiring club to the corresponding third clubs in which the player was registered between the seasons of his 12th and 23rd birthdays.

In this line, we should address a problematic issue with regards to buy-out clauses and penalty/liquidated damages clauses: **what is a transfer for the purposes of the FIFA RSTP/CFA RSTP?**

According to the FIFA RSTP Commentary, solidarity contributions are due *“if a professional player transfers during the validity of his employment contract, i.e. the player and the club mutually agree to terminate the employment contract before its expiry date.”* Same line is followed by FIFA and CAS case law. Therefore, it can be considered as a “transfer” in the eyes of FIFA and CAS when a player moves from one club to another and it exists mutual consent between the parties involved (i.e. the two clubs and the player).

Interestingly, CAS has determined in different occasions that in case of buy-out clauses the consent required for a transfer is granted in advance, i.e. at the time the parties agree to introduce such clause in the contract. Therefore, execution of a buy-out clause triggers the obligation to pay solidarity contributions to the third “training” clubs.⁹

However, we consider that each case shall be treated on a case-by-case basis, as there are multiple factors which may alter the interpretation of the execution of a buy-out clause as a “transfer” and further consequences (E.g. whether a buy-out clause it is an statutory provision, as it occurs in Spain due to the Real Decreto 1006/1985¹⁰).

ii. Application of Sporting sanctions

On the other hand, in those cases where:

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(i) one party breaches and is condemned to pay liquidated damages or the penalty agreed on the contract;

or (ii) one party erroneously executes a “supposed” buy-out clause, at a later stage eventually determined as a liquidated damages or penalty clause;

Sporting sanctions may be applied to the party in breach (in addition to the payment of compensation) if the breach is committed within the protected period, as per the definition given in the FIFA and CFA RSTP¹¹.

The FIFA RSTP and CFA RSTP, at articles 17. 3 and 17.4 and articles xxxxx respectively, establish the potential sporting sanctions that may be imposed to the party in breach:

- a) A restriction on playing official matches from four to six months, in case the player is the breaching party;
- b) a ban from registering any new players, either nationally or internationally, for two entire and consecutive registration periods for the breaching club or the club inducing the breach¹².

Check CFA impose the same sporting sanctions as FIFA

On account of the foregoing, clubs and players need to be aware that in case of breach of contract within the protected period, in addition to the payment of compensation, the judicial bodies shall impose sporting sanctions as well. Such sanctions could cause serious prejudice to both football player and clubs.

V. Conclusion

By means of this article we can reach a preliminary conclusion concerning the nature of these clauses, summarized as follows:

a clause that provides a party with the right to early terminate an employment relationship in case certain conditions are met is to be considered as a **buy-out clause**, while a clause *establishing the economic consequences in case one of the parties terminates the employment relationship without just cause* shall be deemed as **liquidated damages or penalty clause**.

Furthermore, the nature, validity and potential consequences of such clauses will mainly depend on how those clauses are drafted, together with the analysis of all the specific circumstances which surround each concrete case, such as the jurisdiction, applicable law or intention of the parties when included such clause, among others.

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The final interpretation of such clauses by the competent judicial bodies will be crucial for the potential application of sporting sanctions or payment of solidarity contributions that may be generated as a result.

In conclusion, the reader should consider this article as a guidance for a general understanding of the matter. Nevertheless, we consider that legal assistance is strongly recommended when it comes to drafting and/or executing such clauses, both at a national and international level. For instance, proper legal advice would be of great support in order to evaluate the single clause, as well as all circumstances surrounding the case, in order to avoid any negative consequences, both from the economic and sporting point of view to the parties involved.

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¹ FIFA Circular Letter No. 1010 establishes the minimum procedural requirements to consider an arbitral tribunal set by a national association as “independent” and “duly constituted” in accordance with article 6.3 (c) of the FIFA Statutes.

² Same scenario is provided in the FIFA Decisions appealed before the CAS, in which FIFA Regulations are the applicable to the merits.

³ Arbitrations CAS 2016/A/4550 Darwin Zamir Andrade Marmolejo v. Club Deportivo La Equidad Seguros S.A. & Fédération Internationale de Football Association (FIFA) and CAS 2016/A/4576 Újpest 1885 FC v. FIFA, award of 24 November 2016

⁴ Arbitration CAS 2013/A/3411 Al Gharafa S.C. & Mark Bresciano v. Al Nasr S.C. & Fédération Internationale de Football Association (FIFA), award of 9 May 2014.

⁵ Hence when such amount is considered as grossly unfair and disproportionate (see Arbitration CAS 2010/A/2317).

⁶ Interpretation of the Supreme People's Court on Several Issues Concerning Application of the “Contract Law of the People's Republic of China” (2) (2009), Article 29.

⁷ Annex 5 FIFA RSTP and xxx CFA RSTP.

⁸ - together with the Training Compensation (see Annex 4 FIFA RSTP and xxx CFA RSTP).

⁹ CAS 2011/A/2356 SS Lazio S.p.A. v. CA Véz Sarsfield & FIFA.

¹⁰ Spanish Real Decreto 1006/1985, de 26 de junio. See the famous Kondogbia and Keita cases for reference (Decision of the DRC dd. 24 April 2015 and CAS 2010/A/2098).

¹¹ Protected period: a period of three entire seasons or three years, whichever comes first, following the entry into force of a contract, where such contract is concluded prior to the 28th birthday of the professional, or two entire seasons or two years, whichever comes first, following the entry into force of a contract, where such contract is concluded after the 28th birthday of the professional.

¹² Inducing club: “It shall be presumed, unless established to the contrary, that any club signing a professional who has terminated his contract without just cause has induced that professional to commit a breach.” (Article 17.4 FIFA RSTP)