Professor at the Department of Commercial Law, University of Geneva  
Partner of the law firm “Sganzini, Bernasconi, Peter & Gaggini”  
Lugano, Switzerland

Introduction

1. The current state of affairs in Formula One
   1.1 Origin and recent history
   1.2 Where are we today? What is unsatisfactory?
2. Who are the stakeholders and what are their respective interests
3. Synergies and divergences
4. Proposed model

We all know that Formula One is a "hot issue". It is indeed said to have the largest worldwide audience, together with the summer Olympics and the soccer world cup. It is just that, unlike such other events, Formula One is "permanent" since it occurs each year and year round, staging 16-17 races around the world.

The media coverage of Formula One is huge. Indeed, it is currently considered that the figure arrived at by adding up the total number of persons watching the races in about 200 countries during the total number of races during any one year is about 6 billion viewers. This immense audience combined with the excellent quality and reliability of the show is very attractive for all kinds of players, ranging. Inter alia, from the main car manufacturers, to the sponsors, suppliers, the public and the TV networks.

Although undisclosed and, in any event, very difficult to evaluate, a huge cash flow rotates around Formula One. If an estimate were to be given, it could probably be said that the total income (or at least budget) of the Formula One teams is somewhere between USD 1,5 and 2 billion on a yearly basis, here as the total revenues deriving from the commercial exploitation of the Formula One show is, on a yearly basis, in the range of USD 750 Mio, with an EBIDTA somewhere in the range of USD 450 Mio.

Undoubtedly, these impressive figures attract a lot of attention and interest. From a business stand point, they have led to – or at least can be put in relation to – two recent developments, which have been talked about a good deal lately:
- the bankruptcies of EMTV and of the Kirsch Group in Germany, which had purchased 75% of the company which is, substantially, in charge of exploiting Formula One's commercial opportunities;
- the announcement of the plan of a majority of the main car manufacturers involved in Formula One (Ford; Daimler-Chrysler (Mercedes); BMW; Renault and Fiat (Ferrari)), to abandon Formula One and to set up, by 2008, their own championship under the name "Grand Prix World Championship – GPWC".
The promoters of this conference thus thought it appropriate to talk about Formula One today, to try to better understand what is currently happening in such sport and why, and to see what experiences can be drawn therefore. To do so, I thought that the best way was:

1. To first outline the current state of affairs in Formula One.
2. This will assist us in identifying the main stakeholders – i.e. the parties having fundamental interests – in the sport and to determine their respective interests.
3. Thirdly, to try to put into prospective the synergies and divergences which arise between such interests.
4. Finally, to endeavour to suggest a model which could be satisfactory to all stakeholders.

I will remain synthetic since my main goal is neither to talk about the details of Formula One nor about Formula One as such, but rather to use it as an example since it raises issues, provides experiences and, perhaps, procures solutions, which could be useful for other sports.

1. The current state of affairs in Formula One

In order to better understand the current situation, it is, I believe, useful to recall the recent history of Formula One.

1.1 Origin and recent history

Let's start in 1981. For years, the FIA (International Automobile Federation) has organised a Formula One Championship the "old fashion way". Practically, this meant that:
- there was no certainty as to the ownership of the rights to broadcast the races (the sporting federation? if so, which one: the local one (ANS) or the FIA? the promoters of the races? the teams?);
- there was, therefore, no certainty about how possible income should be allocated and no guarantee that the teams would receive any part thereof;
- there was no centralised exploitation of the TV rights;
- there was no obligation on the teams to take part in all races or in the entire championship of any given year, let alone that of the following year(s);
- there was no certainty that the FIA would indeed organise a championship beyond the then current year;
- there was no certainty with respect to the stability of the sporting rules and especially of the technical rules;
- the exact role of the FIA was unclear: was it of a purely sporting nature? Could it exploit any commercial right or play any role in that respect?

The result of these many doubts was a lack of stability and the loss of many opportunities and, consequently, also an absence of credibility. The bottom line was a poor and uncertain income and a general dissatisfaction of all the players, which, at one point, even lead to most teams going on strike.

In these circumstances, one of the team owners, Bernie Ecclestone, offered the FIA and the other teams to run the show from a commercial standpoint. To that effect, he required that both the FIA and the teams contractually grant him all necessary rights for 5 years. As compensation for his services, he requested a percentage of the income.

This lead to the so-called "Concorde Agreement" (named after the "Place de la Concorde" where the FIA is based, and in consideration of it bringing long term peace amongst the parties). The Concorde Agreement took effect in 1982 and can since be considered the "constitution" of Formula One. It is a "sui generis" agreement between
the three main constituencies (stakeholders), which are traditionally involved in any kind of sport:
- The international federation (here the FIA) which:
  - undertakes to organise a championship composed of 16 races;
  - guarantees stable regulations (both sporting and technical);
  - creates (and incorporates in its statutes) bodies of which the teams and other interested parties (sponsors, promoters, etc.) are members;
  - grants a licence to exploit all rights that it may own (primarily broadcasting rights);
- The teams (each and all of them) which:
  - undertake, for the entire duration of the agreement, to take part in the entire championship;
  - grant a licence to exploit all necessary broadcasting and ancillary rights;
- The agent, so called "Commercial Rights Holder" who undertakes:
  - to procure that about 16 races are duly and properly organised through appropriate promoters;
  - to exploit all rights granted to him to the best of his abilities;
  - to pay agreed quotas of the income to the FIA and to the teams.

The system proved to be very satisfactory and the agreement was thereafter renewed in 1987, 1992 and 1998. It is currently in force until December 31, 2007.

For a good part, it explains the success of the sport and the wealth of many:
- the commercial rights holder;
- the teams (or their owners) or at least of some of them;
- the drivers;
- the sponsors and suppliers;
- the race promoters and track owners;
- the TV broadcasters;
- and the FIA.

1.2 Where are we today? What is unsatisfactory?

Notwithstanding its unquestionable advantages and successes, the system has lead to increasing dissatisfaction. Why?

Probably for three main reasons, which were not foreseen (and perhaps not foreseeable) when the Concorde Agreement was initially conceived twenty years ago.

a) The success of the sport

First of all it is quite obvious that nobody expected that the sport would become so successful. Teams were starting "from scratch"; thereafter any substantial and in a way guaranteed income was welcome. In those days, the income generated by the TV rights was not substantial; therefore the percentage of such income that the teams were accepting (47%) was not very material. Because of the dramatic increase of the global income, the difference between what the teams are receiving and what they should – or could – receive by applying normal market rates has progressively become, in absolute terms, quite shocking. This is particularly true considering the dramatic increase incurred in the teams' costs. The "quick ratio test" of this fundamentally dissatisfactory situation is probably the fact that an increasing number of teams are not able to survive or is struggling to do so (see the bankruptcy or difficulties of the teams Prost, Arrows, Minardi, Jordan, etc. over the last two years).
b) **The definition of the licensed property**

Secondly, in 1982 the only "property" that one could exploit and that was indeed the subject matter of a licence, were the broadcasting rights. The teams therefore accepted to limit their entitlement to part of the so-called "TV income". Since then, however, many other sources of income developed, ranging from the promotion of races, track advertising, merchandising and licensing, internet opportunities, hospitality services, etc. The income generated by these activities is very substantial however the teams have no right to any share therein.

c) **Assignment of the business**

During all these years, the Commercial Rights Holder has progressively organised and packaged his business in a single company. In the late nineties, at the time of the "going public frenzy", he tried to float it. Having been unable to do so, he, in substance, sold 75% of the business, which ultimately ended up in the hands of a media group, namely the German Kirsch Group. The process whereby this was achieved is somewhat complicated but it can safely be said that the total amount cashed in by the Commercial Rights Holder following the assignment is in excess of USD 2.5 billion.

In a nutshell, the current dissatisfaction can be explained by the fact that:

. the teams are benefiting from only a very minor part of the total income generated by the sport (a small percentage applied only to a small part of the total income);
. the control of the business has been sold to a third and undesired party;
. by selling the control of the business, what has actually happened is that the former Commercial Rights Holder has cashed in (in advance) the future income of the business. I realise that this may seem a banality: is it indeed not what happens each time a business is assigned, be it through an IPO or otherwise? Certainly, although it is not sure that this is always understood. In addition, in this particular instance:
  - what was being cashed in was a (future) income which was deemed to be outrageously exaggerated by those who were generating it (the teams);
  - the purchasers probably did not fully realise that such income was deriving from an agreement (the Concorde Agreement) which would terminate in 2007 and that the flow would thereafter die (unless the Concorde Agreement was renewed, which was impossible at the same conditions).

In any event, from the point of view of the teams, which are actually staging the show. And for the car manufacturers - which are, for a large part, financing it, this state of affairs is unacceptable. This is why they reacted and stated that at the end of the validity of the current Concorde Agreement (i.e. 31.12.2007) they would be released from any obligation to participate in the Formula One championship and announced that they would therefore start and run their own series from which, as owners, they would derive the entire income.

Here as well, the idea is nothing really new. It tends to occur quite often in sports where, for one reason or another, things have reached a sufficiently high degree of dissatisfaction for one or more of the constituencies. In recent years, examples are provided, inter alia, by soccer and basketball.
2. Who are the stakeholders and what are their respective interests

Any kind of sport and Formula One in particular is fundamentally a joint venture. As I will try to outline more in detail, all parties involved indeed have the same, common interest in the success of the particular sport: namely to have available as large a cake as possible. Such interests do clash only as to the manner in which the cake is to be divided amongst the stakeholders. This has been illustrated in what could be called the "sport's virtuous circle".

The so-called "Concorde Agreement" is interesting because it is a multiparty agreement, which involves those who are probably the three fundamental stakeholders, namely:

(i) The sporting authority: in this particular case, the FIA, the highest sporting authority in automobile racing, comparable to the FIFA, in the soccer environment or, in the Olympic organisation, to the CIO. It should be noted that the fact that a sport federation accepts to enter into this type of agreement is not to be taken for granted. Such federations usually consider that they are above all parties and that they should not restrict their "sovereignty", whether contractually or otherwise.

The interests of the sporting authority are:
- primarily that all competitions take place in a fair and well organised environment, which implies that they are well managed and regulated through appropriate bodies and rules;
- to have available sufficient financial resources in order to cover the cost of its own structures and assist that part of the sport, usually at a lower lever, which is not "self sufficient". To that extent the federation is interested in the commercial exploitation and success of the competitions;

(ii) the "players": depending on the type of sport, these are the teams or the individual athletes, often both. In Formula One, the players are the teams, but also the drivers and most probably also the car manufacturers, which provide engines and, not infrequently, own or finance the teams. If the number of players is subject to a numerous clauses, i.e. if it is close ended, the system incorporates one of the main feathers of what is known as a "league". In such case the teams can be considered as owning a so-called "franchise", which can be a valuable asset;

(iii) the third category of stakeholder is certainly that of the agents or promoters who make sure that the series or the events take place and are properly exploited from a commercial stand point: in Formula One, this is the so called Commercial Rights Holder.

All of these stakeholders have the same interest: to benefit from a long term, stable and competitive environment generating the highest possible income (see the sport's virtuous circle).

Besides these three constituencies, other stakeholders are:

(iv) the sponsors and suppliers (a distinction is not always easy – and indeed artificial - to trace) who have a direct interest in the success of the sport, measured in terms of audience. The greater the success, the more they will invest. Audience supposes visibility, which usually, requires access to free on air TV as opposed to pay TV. In Formula One, because of the permanency and world-wide exposure of the events, global and world-wide players, have not surprisingly, opted for this sport; Philip Morris, for years now, Shell, Mercedes and, more recently, Vodafone;
(v) the broadcasters who are looking for exciting, i.e. competitive, credible world-wide and stable shows to display in order to attract the largest possible audience which will enable them to sell their time (pay TV) or, in any event, their "advertising space" at more favourable conditions.

3. Synergies and divergences

I believe that this analysis speaks for itself with respect to understanding if and what synergies and divergences exist with regard to the interests of the stakeholders.

It seems quite clear to me that there are mostly synergies and only very few conflicts of interests between the parties involved, even though too often the latter loose sight of this fundamental reality. Divergences do exist, but they usually derive from a narrow sighted and short-term understanding of the relevant stakeholders' interests. They are:

- conflicts regarding the way the total income deriving from the sport is divided among the stakeholders: the current situation in Formula One shows that an excessively unfair sharing scheme is self-injuring: it leads to a destructive crisis;
- divergences in terms of who should be the decision maker in respect of the sporting or technical regulations: here, again, if the decision making process does not involve the appropriate stakeholders in the appropriate manner, the other stakeholders will be unsatisfied, will feel insecure and will perhaps withdraw. This is very clear in motor racing where the large manufacturers have to be involved because they, better than anybody else, know in which direction technical developments should be made;
- divergences in respect of maximising the audience versus maximising the income. Conflicts have arisen, lately, due to the tendency to favour pay per view TV over free on air broadcasting. Reducing the audience hurts the interests of the sponsors and of the sporting authority. If they are unsatisfied, they will withdraw or find other solutions, which will result in the broadcasters (and Commercial Rights Holder) loosing their underlying asset;
- "individual" versus centralised exploitation of the rights: some players (individuals or teams) - usually the most successful ones - believe that they are better off exploiting their rights individually rather than through a centralised organisation. This may be true, but by doing so the other players will be unsatisfied and may not be able to finance their survival, which will weaken the sport since no challenging competition takes place without a substantial number of competitors. This does not mean that all rights have to be exploited by the same agent, but that all rights of the same nature have to. Indeed, it is probably wise to grant the different types of rights (the various "windows") to different promoters because:
  - by diversifying the counterparts, the risks arising from one of them going out of business (see the recent bankruptcies of ISL, Kirch, etc.) will be attenuated;
  - this will create competition amongst the various agents who will aim at doing better;
  - this will enable access to the best experts in each particular field;
  - this should satisfy the well-known competition law requirements (see the latest development in that respect).
4. Proposed model

Whatever the sport, I believe that these thoughts do lead, *mutatis mutandis*, to what I would suggest is a model which could be applicable to most types of sports.

Fundamentally, I suggest that in today's environment any sport should (or could) be "constitutionally governed" by contractual arrangements and that these could have a "triangular structure", institutionally involving each one of the three constituencies (see Exhibit 2).

The way this is achieved is an ancillary issue:
- it can be done by entering into a three party agreement such as the Concorde Agreement;
- it can be achieved by having one party or constituency (usually the sporting body or the Commercial Rights Holder) entering into two separate agreements, one with each of the other two constituencies;
- it can be achieved by entering into three separate agreements, one between each one of these main stakeholders.

Fundamentally, the result is the same.

On the other hand, what really matters is that all opportunities are duly captured and exploited in a centralised manner to all possible and reasonable extent. A possible model satisfying all requirements of the equation is as follows (Exhibit 3).

Whether triangular or bilateral, the relationship has to be carefully regulated. As the Formula One example has shown, things have evolved and have become quite technical and complex. Even more so because of the increasingly demanding requirements deriving from competition laws.

My assignment was to set the scene. We would now be ready to go into more detail and, in particular, to review what should be the exact rights and obligations of the respective stakeholders. Although extremely interesting and indeed challenging in today's increasingly complex environment, this would be beyond my mission of today.