INSOL International Global Insolvency Practice Course 2023 / 2024

Case Study II – Part I

Briefing and Preparation for Written Assessment Prior to Module B

This assignment requires you to write an advice addressed to a client in respect of the facts therein. There is no particular wordcount, although, in the past, candidates have written structured advice of between 15-20 pages. Please use a professional format for the advice, with only such tables and graphs as are strictly necessary to illustrate the problem and your proposed solution.

Please note that the submission date is 15 April 2024.

Introduction

The Formula 1 (F1) competition is sanctioned by the *Fédération Internationale de l'Automobile* (FIA). Although F1 began in Europe, where many of the competing teams are based, the season now consists of a series of races (*Grands Prix*) held at circuits all over the world. There is some competition for the prestige of hosting these races. Overall, there are a limited number of licences for competing teams. In addition, drivers and constructors (teams entering the competing machines) are required to hold Super Licences granted by the FIA. Drivers are only able to obtain these if they are the reigning champion or have placed well in races in lower categories of motor-sporting. Teams wishing to enter the competition for the first time are required to place a deposit with the FIA, which is refunded during the course of the season. There are two World Championships held on an annual basis, one for drivers and one for the constructors.

The high speeds at which races are held results in the machines and drivers being dependent on four key items: electronics, aerodynamics, suspension and tyres. Control of aerodynamics and suspension is partly based on the physical characteristics of the machinery and partly on the sophistication of the electronics. All in all, racing is a prohibitively expensive sport. Before the arrival of the 2021 budget cap (currently at USD 135 million for the core costs of a team) the teams had annual budgets upwards of USD 400 million. Offsetting the cost spent, including on the machines and drivers, is the income, which is derived from sponsorship, broadcasting rights to the races as well as subsidy or support from team owners. Although teams can negotiate sponsorship with individual sponsors, revenue from broadcasting is handled and distributed by the Formula One Group, the holder of the commercial rights to the televising of the *Grands Prix*, which are capable of attracting audiences of more than 600 million per race.

The Facts

Please note that the following facts are rendered as supplied to you by your client (including any lacunes and inconsistencies, as things go). In early 2014, Benedict Maximov, a wealthy American speculator who made his money by setting up various altcoins and other crypto-investments, looked to invest in something more traditional and enter the "proper, respected" international jet-set, as he put is. As F1 racing seemed just the thing to achieve this, Maximov had been looking for an opportunity to invest in the sport. To do so, he set up a company, under the law of Texas, called Efwon Investments Inc. Into this company, he put USD 100 million of his own money as well as USD 250 million borrowed by Efwon Investments from a syndicate of banks under the following key terms:

(i) the loan is secured partly on a number of homes of Maximov across the world, collectively worth some USD 75 million;
(ii) a pledge on the projected revenue to flow back from the resulting investment and participation in the sport;
(iii) a pledge over the shares of Efwon Investments;
(iv) a positive pledge;
(v) a negative pledge;
(vi) the syndicated loan is to be repaid in 10 years;
(vii) an interest rate of LIBOR + 4%;
(viii) structure: 2 senior banks (aggregate exposure 100 million USD), 2 mezzanine financial creditors (aggregate exposure 60 million USD), and 5 junior financial creditors holding an aggregate exposure of 90 million USD.

In the same year, Mr. Maximov instructed his agents to enquire about setting up a team in Europe, where traditionally teams were located. He remitted, for this purpose, the entire USD 350 million (his equity investment and fully drawing the syndicated loan) by way of loan to a company he set up under the laws of the Netherlands called Efwon Trading B.V. and which was secured on future revenue from the company's trading activities. On their demand, the US lenders obtained a pledge over the shares in Efwon Trading B.V. at this time.

His agents scouted out prospects across Europe. Cleverly, to avoid having to acquire the necessary qualification for entry to the F1 competition (which might take several years of patient and slow progress and would incidentally require the payment of a large deposit to the FIA), they advised him to buy an existing team that had a competition licence, but which was not doing too well. The agents located such a team in Romania, which was happy to do a deal, and were able to arrange for a purchase of the company's business and its inventory, which included several machines ready for racing, but which were in dire need of re-development and upgrading. Crucially, though, the purchase enabled access to the competition as the team had not yet lost their licence.

In late 2014, Efwon Trading entered into a contract to acquire the team and established, for reasons to do with the licences already accorded by the FIA, a wholly-owned subsidiary, Efwon Romania, to do so. Efwon Trading lent Efwon Romania USD 150 million: USD 50 million being the cost of acquisition of the team and USD 100 million the projected budget for the first racing year under Maximov ownership (which would be 2015). The loans were secured on the team's share of the broadcasting revenue from participation. At that time there were no sponsorship contracts in place any longer for the dilapidated team. Two drivers were contracted with the Romanian team and their contracts were also taken over by the Romanian company.

Team Maximov (a trade name of Efwon Romania) entered the competition in the 2015 season as planned in machines carrying the company logo and a larger than life portrait picture of Benedict Maximov. The team placed a modest 17th in the rankings. As a result, the return for Efwon Romania in the first year was a disappointing USD 30 million, much of which had to be re-invested in the company. This did not allow for upstreaming any monies to Efwon Investments to service the syndicated debt, for which waivers were duly obtained from the relevant lenders; but the margin on the loans was raised to 6% in return.

Undeterred, Benedict Maximov directed Efwon Trading to advance a further USD 100 million of the funds it held to Efwon Romania as the budget for the 2016 racing season. The team placed 10th in the rankings and the revenue was much healthier at USD 60 million, out of which some was re-invested and some used to begin the upstream flow of repayments to Efwon Trading, and the latter in turn to Efwon Investments. At the same time, Benedict Maximov was advised, under pressure from his American bankers, that although the revenue from a better placing in subsequent seasons would assure a steady and increasing flow of income, he ought to consider moving from what is effectively his private sponsorship of the team towards a more diversified sponsorship portfolio, so that Efwon Romania would be able to grow the repayment stream further.

Alongside a further advance from Efwon Trading of USD 100 million for the 2017 season, Benedict Maximov directed his agents to investigate sponsorship opportunities. They reported that most of the likely European and North American sponsors were already heavily invested in other F1 teams, but that opportunities could exist in the Far East.

In light of these opportunities, Efwon Trading set up a wholly-owned subsidiary in Singapore (Efwon Singapore) in 2017 to deal with potential sponsors. They quickly located a number of potential sponsors, including one in Indonesia (Kretek) who was willing to provide sponsorship from 2019 on an exclusive basis worth an estimated USD 100 million annually. This would add to the broadcasting and other revenue at the disposal of the team and would enable repayments to Efwon Trading and Efwon Investments to take place. In 2018, Efwon Singapore signed a 5-year agreement with Kretek for exclusive sponsorship. Unfortunately, this left funding for the 2018 season itself short and Efwon Trading needed to find additional liquidity to be able to advance moneys to Efwon Romania. It eventually obtained a USD 100 million loan with a high interest rate from a lender based in Monaco, secured on its revenues, those of Efwon Romania and those of Efwon Singapore (each of which would also act as a guarantor).

Once sponsorship was in place, the 2019-2022 seasons went well enough with the team climbing through the rankings, ultimately reaching 6th place, although they were not quite able to break the dominance of the manufacturer teams: Renault, BMW, Toyota, Honda, and Ferrari. Through the sponsorship and better performance in the rankings, income was more assured during this period and more repayments to Efwon Trading and Efwon Investments were made, although substantial amounts continued to be required as re-investments in the team budget, particularly in light of changes in the technology and enhanced safety requirements by the FIA.

The Problem

Despite the improvement in the team's rankings, at the end of the 2022 season, Kretek indicated informally that they had doubts about renewing the sponsorship for the period 2024 onward. This left Efwon Singapore (and the Efwon group at large) in the position of needing to secure a replacement sponsor. During the course of 2023, Efwon Singapore were successful in locating a potential interested party, the Malaysian state company supplying alternative energy fuels (KuasaNas), who were likely to be able to offer funding in excess of USD 100 million annually. However, KuasaNas indicated that a condition of this funding was that KuasaNas would be able to acquire a majority stake (51%) in the team and that the team move to Malaysia, where, amongst other benefits, a deal could be secured to obtain the use of the Sepang GP racetrack for practice and training purposes and new drivers sufficiently qualified to be able to obtain Super Licences could be engaged.

KuasaNas indicated that they were interested in finalising the deal in short order and contracts were ready to be signed in mid-2024, when the Malaysian General Election saw the election of a new Government. The Government made it one of their priorities to review actual or intended contracts with state companies due to allegations of rampant corruption under the previous regime. Unfortunately, while awaiting finalisation of the review process, disaster struck. In the last race of the 2023 season, the Romanian drivers were injured.

Citing defects in safety and management, the drivers have brought claims before the Romanian courts where, if they succeed, substantial compensation is likely to be awarded. As part of their strategy and as an interim measure, lawyers acting for the drivers have filed for the insolvency of Efwon Romania and have obtained, pending an order being made, freezing injunctions over the company's assets and income. This will place the company in the position of defaulting on its payments to Efwon Trading due to be made in early 2024. This will cause the latter to default in its obligations to Efwon Investments. Similarly, Efwon Trading is also at risk of insolvency and will be unable to meet its repayment obligations, including those to the Monaco lender, raising the spectre of enforcement actions and/or bankruptcy.

The American bankers are understandably nervous and are considering proceedings to foreclose on the security provided to them. Likewise, the Monaco lender is considering its position and options. All of this, combined with the overall situation and its potential ramifications for the group as a whole and the various group companies, has also sent some of the local directors into panic mode (due to tax / substance considerations and other local requirements, Maximov much to his chagrin has had to put in resident directors at the Dutch and Romanian subsidiaries – "blood-sucking strawmen" as he calls them).

Moreover, if the intended contract with KuasaNas passes the Malaysian government review, one of the pre-conditions KuasaNas have now stipulated for closing the deal will be that the insolvency issues affecting the companies in the Efwon group are dealt with promptly. They will only invest and participate in an Efwon group that has been restored to a stable platform (that is, without any issues at any level in the group) and through or into a structure that ensures that their investment is safe from the current turmoil.

All of this prompts Benedict Maximov to consider how he might protect his position, the position of Efwon Investments and his ownership of the Maximov F1 Team (and hence, his global pizzazz).

The Substance of the advice

You are asked to advise Benedict Maximov on how to facilitate the deal with KuasaNas, save the Maximov F1 team and best safeguard Maximov's position at the same time. In light of the foregoing, this will require a coherent, comprehensive strategy for dealing with the insolvency issues affecting the companies in the Efwon group and the various stakeholders involved.

It should be noted that, at the behest of the US lenders, Maximov spent a considerable amount of money on an IBR (Independent Business Review) commissioned from one of the large consultancy firms providing such services, as well as market research as to other (M&A) options. Perhaps predictably, the conclusions were that (a) Efwon will need to improve operations to be more cost efficient, but (b) can never (service its debt and) be cash-positive without a sponsorship deal such as KuasaNas, and (c) time is up, and it is not realistic to timely expect to find another partner / investor. Conversely, KuasaNas have signalled that they would be willing to, as consideration for their stake in Efwon, pay part of the total consideration for the deal directly on the closing thereof.

Mr Maximov's general counsel has indicated that your advice should in any case address the following matters:

(a) your proposed strategy for dealing with the group and its various stakeholders;
(b) whether one or more insolvency proceedings or (preventive) restructuring frameworks are required to achieve the goal of selling a stake in the group to KuasaNas (assuming the intended contract receive government clearance);
(c) where and how these proceedings will take place;
(d) how these proceedings may (or may not) interact or influence each other;
(e) what impediments may exist to proceedings taking place;
(f) what advantages / disadvantages may exist in relation to proceedings being organised in the way you propose;
(g) the factors that will allow you to determine the above;
(h) any further facts or information that may be needed to answer the questions / solve the situation;
(i) where you envisage the application of the European Insolvency Regulation and / or UNCITRAL Model Law and / or other international instruments in achieving this;
(j) in particular, how the provisions of these texts may assist or impede the strategy you propose to implement?
(k) should Efwon (with hindsight) have structured through England rather than the Netherlands?
(l) what will the outcome for each of the various stakeholders be, are they likely to accept the same and, in case they will not, can they be forced to accept them?

(While Maximov's general counsel's pointers appear apt, you should of course not limit yourself to these)

A Note on Structuring your Advice

Overall, the intention behind this case-study is to assess your response to the facts and consideration of the strategies that would assist in achieving the desired result. In this, although the main focus is and should be a legal one, you may set out in a very pragmatic way what will need to be done and this will need to take into due consideration the economic facts and circumstances of the case.

You will also need to display your knowledge and appreciation of both of the international texts referred to and their potential interaction and application. You should ideally do this by reference to supporting material to underpin the recommended strategy, including through the use of sources such as statutory provisions, case-law and arguments raised in the supporting literature. Some knowledge (or research) of the domestic legal systems referred to may be required, including substantive law issues in the subject area, but this is not the primary object of this exercise.

Please note that there is no right answer. The outcome is entirely dependent on your assessment of the facts and strategy you choose to deal with the facts as stated.