GLOBAL INSOLVENCY PRACTICE COURSE (ONLINE)

2021 / 2022

Case Study II

CONTENTS

INSOL INTERNATIONAL

GLOBAL INSOLVENCY PRACTICE COURSE

Guidelines Case Study II

Please answer the questions as provided in case study II as thoroughly as possible.

For an excellent grade your answers should excel in most or all of the following criteria:

- Thorough knowledge and understanding of the subject/question;
- Sophisticated argument presenting personal reflection which is backed by evidence from a wide range of sources (including the mentioned sources in the case);
- A clearly developed response to the questions demonstrating an original argument and pragmatic insight into the subject area;
- Thoughtful structure of argument and presentation;
- A lively, engaging and stimulating quality of writing; and
- Careful, thorough and consistent referencing.

Your knowledge, understanding, insight, ideas and experience are the essential ingredients for answering the case questions. Your ideas are important and you should not be hesitant to express them. Be sure, however, to do so in a professional way – i.e. with arguments for and against, with referenced support from relevant authors, and with a critical, creative and thoughtful attitude.

You must type your answers on a word processor. Make sure that you use the spell check function. It is important that your case study answers look attractive. Use margins of 2,5-cm. Use font 11 and line space 1,3; you may use other fonts for titles, headings etc.

Do not use more than 20 pages.

<u>INSOL International Global Insolvency Practice Course 2021 / 2022</u>

<u>Case Study II- Part I</u>

Briefing and Preparation for Written Assessment Prior to Module B

Please note that this problem question requires you to write an advice addressed to a client in respect of the facts therein. There is no particular word-count, 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 for this Case Study is 21 February 2022.

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 holding 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 with drivers only being able to obtain these if they are the reigning champion or have placed well in races in lower categories of motor-sporting. Furthermore, teams wishing to enter the competition for the first time are required to place a deposit with the FIA, which is then 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. Racing is a prohibitively expensive sport and the teams have annual budgets of between USD 100 and 400 million. Off-setting this 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

The 2008 Global Financial Crisis affected F1 much as any sport was affected by fluctuations in the world economy. In the course of 2008-2009, Honda, BMW and Toyota withdrew from F1 within the space of a year, citing the economic recession as a major contributing factor to their decisions. Bucking the trend, Mercedes re-entered the sport in 2010 by buying Braun and some new teams were able to enter, though many represented national interests and received the backing of their national governments with others relying heavily on sponsorship by one or more powerful backers. The impact of the financial crisis also meant that pressure came to bear on teams to improve their performance and to take on the manufacturer teams in order to obtain a greater share of the revenues. In addition, there was a need to revisit all sources of income available and to maximise these wherever possible.

In early 2010, Benedict Maximov, a wealthy American speculator jaded by the 2008 Global Financial Crisis, in which he managed to keep sufficient of his portfolio from evaporating, looked to invest in something less traditional. For some years, he had cultivated an interest in F1 racing and looked for an opportunity to invest in the sport. To do so, he set up a company, under the law of Delaware, called Efwon Investments. Into this company, he put USD 100 million of his own money as well as USD 250 million, borrowed from a syndicate of banks, under the following 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, and a negative pledge for the entire value of the loan; the syndicated loan is to be repayed in 10 years, with an interest rate of LIBOR + 2%, and with a structure of 2 senior banks (exposure of 100 million USD), 2 mezzanine financial creditors (60 million USD) and 5 junior financial creditors holding an 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 by way of loan to a company he set up, under the law of England and Wales, called Efwon Trading, and which was secured on future revenue from the company’s trading activities.

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 that it would be worth buying an existing team that had a competition licence, but which was not doing too well. Bearing in mind the impact of the 2008 Global Financial Crisis on teams everywhere, it was not too difficult to do so. 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 stock, 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 2010, 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, lending it 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 (which would be in 2011). The loans were secured on the team’s share of the broadcasting revenue from participation, there being at that time no sponsorship moneys, owing to contracts having lapsed. Two drivers were contracted with the Romanian team and their contracts were also taken over by the Romanian company.

Efwon Romania entered the competition in the 2011 season in machines carrying the company logo and a picture of Benedict Maximov and the team placed a modest 17th in the rankings. This period was a difficult one for F1 generally with the dominance and monopoly of a number of key teams and drivers, leading to viewing figures dropping as fans became disenchanted by the lack of novelty and real competition. 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.

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 2012 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 2013 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, where business was returning to health once more after the 2008 Global Financial Crisis.

In light of these opportunities, Efwon Trading set up a wholly-owned subsidiary in Hong Kong (Efwon Hong Kong) in 2013 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 2015 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 2013, Efwon Hong Kong signed a 5-year agreement with Kretek for exclusive sponsorship. Unfortunately, this left funding for the 2014 season short and Efwon Trading needed to find additional liquidity, obtaining a loan of USD 100 million with a high interest rate from a lender based in Monaco, secured on its revenues, with a view to advancing moneys to Efwon Romania.

Once sponsorship was in place, the 2015-2017 seasons went well 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 better 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 2017 season, Kretek indicated informally that they had doubts about renewing the sponsorship in 2020. This left Efwon Hong Kong in the position of needing to secure a replacement. In early 2018, Efwon Hong Kong 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 200 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-2018, 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. While awaiting finalisation of the review process, unfortunately, disaster struck. In the last race of the 2018 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 compensations are likely to be awardsed. 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 2019. This will cause the latter to default in its obligations to Efwon Investments.

The American bankers are understandably jumpy and are considering proceedings to foreclose on the security Benedict Maximov has provided. This prompts Benedict Maximov to consider how he might protect his position and the position of Efwon Investments, perhaps by recourse to a Chapter 11 procedure. 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 proceedings in the United Kingdom. Moreover, if the intended contract with KuasaNas passes the Government review, one of the conditions KuasaNas have now stated will form a pre-condition for the deal going ahead will be that the insolvency issues affecting the companies in the Efwon group are dealt with promptly.

The Substance of the Advice

You are asked to give advice to Benedict Maximov on how to facilitate the deal with KuasaNas, particularly in how the insolvency issues affecting the companies in the Efwon group can be dealt with.

In giving your advice, you must outline the following matters:

(a) your proposed strategy for dealing with the group;
(b) whether one or more insolvency proceedings are required to achieve the goal of selling a stake in the group to KuasaNas (should the intended contract receive Government clearance);
(c) where these proceedings will take place;
(d) what impediments may exist to proceedings taking place;
(e) what advantages/disadvantages may exist in relation to proceedings being organised in the way you propose;
(f) the factors that will allow you to determine the above;
(g) any further facts or information that may be needed to answer the question;
(h) where you envisage the application of the European Insolvency Regulation and/or UNCITRAL Model Law in achieving this?
(i) in particular, how the provisions of these texts may assist or impede the strategy you propose to implement?
(j) In December 2019, Brexit finally happened. Advise as to the possible effect, if any, of Brexit on your solution.

Please note that, by January 2020, Romania will have fully implemented the European Directive 2019/1023 on preventive restructuring frameworks. This means that Romania counts on a full out of court/hybrid procedure to deal with financially-distressed but viable businesses.

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. 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 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.