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## **Case Study II**

Advice to client – Mr. Benedict Maximov – concerning Efwon/KuasaNas

This report aims on advising you, Mr. Maximov, on the possible actions you can take regarding protecting your property, especially in regard to your investments in the Efwon Group. This is done firstly by describing and analyzing the current situation, the legal possibilities and finally by recommend to you what further steps should be taken by you.

### A. Description

#### I. The Efwon Group

The group consists of four parts. These are Efwon Investments, Efwon Trading, Efwon Romania and Efwon Hong Kong. Efwon Investments is incorporated in Delaware, USA, and holds the shares of Efwon Trading. Efwon Trading is incorporated in England and Wales and the single shareholder of Efwon Romania and Efwon Hong Kong. Efwon Romania holds the assets concerning the racing team. Finally, Efwon Hong Kong is the contractual partner with the main sponsor, Kretek, and in talks with the potential sponsor KuasaNas. You, Mr. Maximov, are the only shareholder of Efwon Investments and thus control the whole group.

#### II. Assets

The important assets of the group are concentrated in Efwon Romania. These are the super license for the Formula One team and all other assets concerning this operation, that allow for participating in the Formula One races. Therefore, the plausibility of the basic business case of the racing team depends on the continuation of the operations of Efwon Romania and

especially on the super licenses. This becomes especially apparent when considered that the Formula One as a whole is built on broadcasting car races held all over the world. Even if the financial crisis in 2008/09 led to the exit of three big teams, the broadcast is still able to reach an audience of 600 Mio. The teams that take part in these races are participating in the broadcasting revenue based on their team's performance. So, the good teams receive a bigger piece of the pie than the bad performing once. The annual budget of a team ranges between USD 100 and 400 Mio. A bad performing team can expect to receive part of the broadcasting revenue of about USD 30 Mio. The difference between this income and the minimal budget of USD 100 Mio. can be, it seems, closed easily through a sponsorship deal.

Therefore, from the outset the general conditions for the Efwon team are quite favorably. The biggest and fundamental problem for this specific case is the fact, that, at the moment, the team has no drivers. But KuasaNas has already proposed to hire new drivers if the acquisition of the 51 % stake in Efwon Romania is finalized.

Especially what has taken into account are the super licenses. As mentioned, the super licenses for the old drivers are gone, but KuasaNas offered a solution for that. Of much more important is the super license for the team itself. If Efwon Romania would have to be liquidated it is most plausible, that this license would be lost. Any other interested party would be able to apply for the license. On the other hand, if Efwon Romania would remain in existence it is not unlikely that the license would simply be renewed. This is quite a big advantage because the application process and the competition for the new license could be avoided.

The other relevant assets are your real estate property that you provided for the loan of USD 250 Mio. of the banking syndicate to Efwon Investments.

### III. Risk

The risks that present themselves in this case are these that effect you, Mr. Maximov, directly and those that do only indirectly. Your direct exposure is the result of giving your property with a collective value of USD 75 million to the banking syndicate as collateral to secure the loan of USD 250 million to Efwon Investments. Efwon Investments risk are its obligations to the banking syndicate, the pledge concerning the projected revenue from the operation of the Formula One team, a pledge over the shares of Efwon Investments and a negative pledge for the entire value of the loan. The syndicate consists of 2 senior banks, 2 mezzanine financial creditors and 5 junior financial creditors. The senior banks provided USD 100 million of the loan. Efwon Trading's exposure is the loan given to it by Efwon Investments of USD 350 million which is secured on the future revenue of its trading activities. Efwon Romania was given several loans by Efwon Trading. In 2010 it received USD 150 million for the season 2011, for the second season in 2012 it received further USD 100 million and additional USD 100 million for 2013. These loans where secured on the broadcasting revenue Efwon Romania was

expecting. The second lender to Efwon Romania is based in Monaco. To bridge the 2014 season he gave further USD 100 million, which were also secured by the future revenues generated.

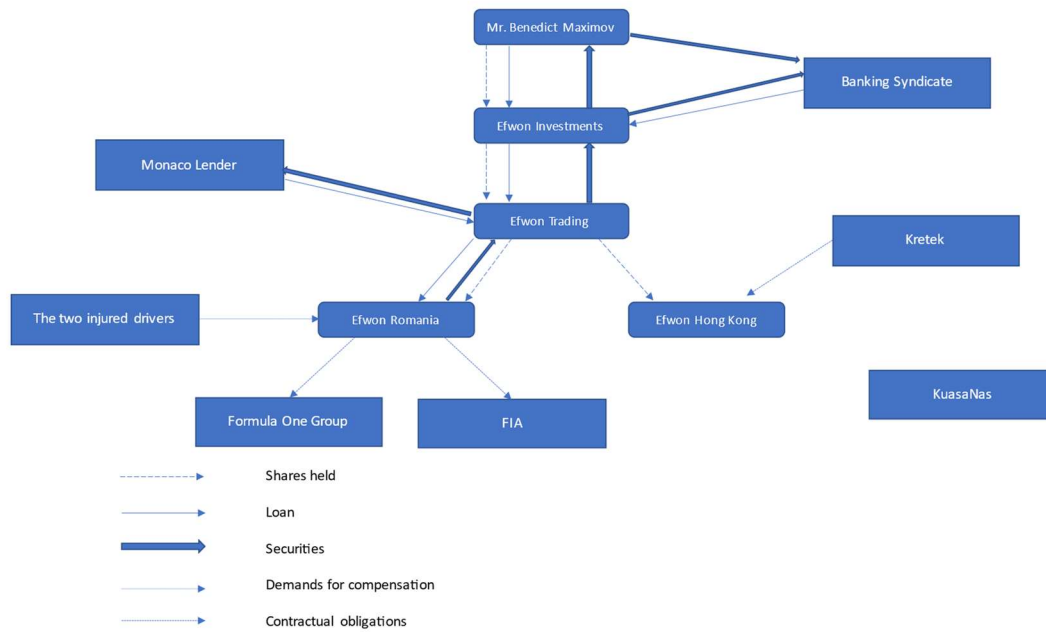
If one of these risks materializes, it is most likely that it will also have repercussions on the other levels in the group structure, e.g. if Efwon Trading would default on the loan payments to the lender from Monaco he most likely would foreclose on the company and especially Efwon Romania would have to deal with another problem because they would also have to deal with the administrator in the proceedings concerning Efwon Trading. The same is in principle true if the banking syndicate would foreclose on Efwon Investments. But additionally the senior bank would also foreclose on your real estate property.

Therefore, to view this conundrum simply as a problem concerning Efwon Romania would ignore this risk to you personally. A solution in regard to Efwon Romania would or at least should also have to take into account a viable solution for you.

#### IV. Other Stakeholders

The other stakeholders in this case are the Formula One Group, FIA, Efwon Hon Kong, Kretek, KuasaNas and the two injured drivers. The Formula One Group manages the broadcasting rights and the revenue from this to the teams. FIA is providing the super licenses which essentially function as a bottleneck for entering this business. Efwon Hong Kong is the contractual partner of Kretek and simply gave their sponsorship money for the seasons 2015-2020 to Efwon Romania. Kretek is the exclusive sponsor for Efwon Romania and provided the budget for the racing teams for the seasons 2015-2020. It doesn't want to continue with the sponsorship deal beyond 2020. KuasaNas offers to provide the further budget but wants a controlling share of 51 % in the racing teams. Furthermore, it demands that the team relocates to Malaysia, where it wants to provide a racetrack and new drivers that can apply for new super licenses. KuasaNas makes this depend on removing all uncertainties regarding the insolvency risk of the group.

Basically, the stake holders in this case and their legal relationships can be illustrated as follows:



## B. Goal

Any recommendation to you, the client, is based on what is the best possible outcome for you personally. Therefore, especially your individual situation must be considered. The most important aspects, economically speaking, for you, are your assets – your controlling share of the group and the real estate you gave as collateral. The value of the shares of the group members is mainly grounded on the performance or value of Efwon Romania. Without the Formula One team and the revenue it has generated or will potentially generate, the going concern of the group is zero. Quite differently from this, the value of the real estate you gave as collateral is independent from the group and the Formula One operation. The banks who have been given these assets to secure the loan given to Efwon Investments can easily foreclose on these properties to reduce their losses. As shown above the logic that will determine the most likely actions of the different stakeholders are quite different from each other, e.g., the senior members of the banking syndicate are secured by the real estates of the client, while the junior members aren't secured at all. Therefore, a solution or solutions has/have to be found that accommodate the most important stakeholders and have a real possibility of succeeding. Following, the possible scenarios are illustrated.

### I. Best possible outcome

The best possible outcome for you, Mr. Maximov, would be, that you retain all shares and full control of the group as well as all your real estate, while ensuring a continuous operation that will enable to fund a successful Formula One team and the repayments of all the loans. This option would require the following:

- The drivers to settle their claims against Efwon Romania.
- and their lawyers to withdraw their filing for insolvency proceeding.
- A sponsor has to be found that will replace Kretek without seeking any control of the company.
- New drivers will have to be engaged.

Besides all other requirements, there is no new sponsor in the cards who fulfills the requirement not seeking control of the company. Therefore, this option does not seem to be feasible.

## II. Relinquishing Control

The second-best option seems to be for you to retain most of the value of your assets, while relinquishing some form of control of the group. KuasaNas is willing to step in to not only replace the sponsorship of Kretek but even providing more money, providing a new racetrack and new drivers. But KuasaNas makes this dependent on acquiring a controlling stake in Efwon Romania and relocating the team to Malaysia. This option would require the following:

- The drivers to settle their claims against Efwon Romania.
- and their lawyers to withdraw their filing for insolvency proceeding.
- You, the client, will have to transfer 51 % of the shares of Efwon Romania to KuasaNas.
- New drivers will have to be engaged or will have to be built up from the ground by let them acquire the requirements for applying for a super license.

The requirements Nr. 3 and 4 seem to be already met or can be fulfilled by you, Mr. Maximov. But is most uncertain if this can be said for Nr. 1 and 2. First, it is most unclear to what amount the damages claimed by the two drivers pile up. Under prudence it must be assumed that this amount is too high for the group to pay. Therefore, this option also has to be discarded.

## III. Insolvency Option

The final option to you would aim at retaining the value of the group by restructuring it in the framework of a judicial proceeding, e.g insolvency proceeding. This could be accomplished by using a proceeding that makes it possible to retain control of the operations of Efwon Romania. Any other form, that would need you to relinquish this control to, for example an insolvency administrator, should be dismissed from the outset, because this would remove the outcome of the proceeding from any kind of influence you could exert. This proceeding should

- provide for the restructuring of the debts of the important group members,
- prevent the creditors to foreclose on the assets of the group members,
- retain the super license for the Formula One team of Efwon Romania,
- secure the funding of the team and
- also the future operation of team.

#### IV. Conclusion

An amicable solution for this case isn't apparent so that the "insolvency option" is the best solution.

#### C. Problems

Besides these considerations it has to be determined what are the main problems that any solution would have to take into account.

##### I. Problem description

First, it has to be determined, what is the most pressing issue that's faced by the group and what can be done to tackle it.

To analyze what the most pressing issue is, it seems appropriate to look for the reasons for the organizational failure. The integrative approach differentiates into external and internal factors.<sup>1</sup> Furthermore the two internal factors are either organizational or psychological factor. Neither seem to be the problem in this specific case. Environmental and ecological factors on the other hand constitute the external factors. And at least the environmental category seems to be applicable because they are defined as „jolts in the external environment generate waves of organizational failure“.<sup>2</sup> One such jolt is the filing for insolvency of Efwon Romania by the lawyers of the two injured drivers. If the insolvency proceedings can't be averted KuasaNas will not sign the deal. The creditors will foreclose on their loans and Mr. Maximov will not only loose the Efwon group but also his real estate.

To tackle this problem restructuring measures have to be applied. These can be differentiated into managerial, operational, asset or financial restructuring. Managerial restructuring aims basically at a change in the top management.<sup>3</sup> On the other hand operational restructuring aims „aims to stabilize operations and restore profitability by pursuing strict cost and operating-asset reductions.“<sup>4</sup> Asset restructuring „covers reorganizing the firm into self-contained

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<sup>1</sup> Mellahi/Wilkinson pp. 31

<sup>2</sup> Mellahi/Wilkinson pp. 23

<sup>3</sup> Sudarsanam/Lai p. 184

<sup>4</sup> Sudarsanam/Lai p. 185

*strategic business units; divestment of lines of businesses not fitting the core businesses.*<sup>5</sup> Finally the financial restructuring tries to „*alleviate financial distress, pay down borrowings, reduce interest cost and improve cash flow*“.<sup>6</sup> Managerial restructuring does not apply here. Removing the management will, based on the information provided, solve any problem. The same is true for measures aiming at the operation of the group. There seem to be only two avenues to tackle the problem shown above. First the financial distress of the company could be taken on, by removing the threat of the impending insolvency proceedings. But that won't ensure the funding of the team from 2021 onwards. Rather the only deal on the table at the moment that would do this is the offer of KuasaNas, and the demand that the insolvency problem is solved. Therefore, only a solution that achieves to remove the insolvency threat will be able to also ensure the continuous operation of the racing team. The solution in this case cannot be clearly described according to the categories mentioned above. It's more or less a solution mainly aiming at asset and financial restructuring.

## II. Asset Analysis

To get a picture what actions are viable in this case it must be determined what will ensure such a solution. The most interesting part of the group is Efwon Romania, because it holds the operations for the Formula One Team and is especially the holder of the Formula One super license. The super licenses for the drivers are basically gone. This would have to be compensated in another way. But KuasaNas has already shown such a solution. Also, Efwon Hong Kong seems of interest because it is the contract holder with the main sponsor and in discussion with the most desirable investor. But because Kretek isn't really interested in keeping up the sponsorship from 2021 onward and KuasaNas wants to invest into the operation of the company, Efwon Romania, directly, this part of the group isn't of any real interest, except for tax purposes maybe. The assets of Efwon Investments and Efwon Trading are essentially the shares they hold of the shares of the other group members they hold, and the collateral that was given to them regarding their loans. But this collateral also depends on the continuous operation of the racing team.

Therefore, Efwon Romania is representing the real value of the company because the other members of the group are not generating any revenue. This is also true for Efwon Hong Kong. Even if this entity holds the sponsorship contracts with Kretek or even KuasaNas, these payments are received because of the business activities of Efwon Hong Kong.

Because of this the most important thing to do now, in regard to the group, is to retain the value of the racing team.

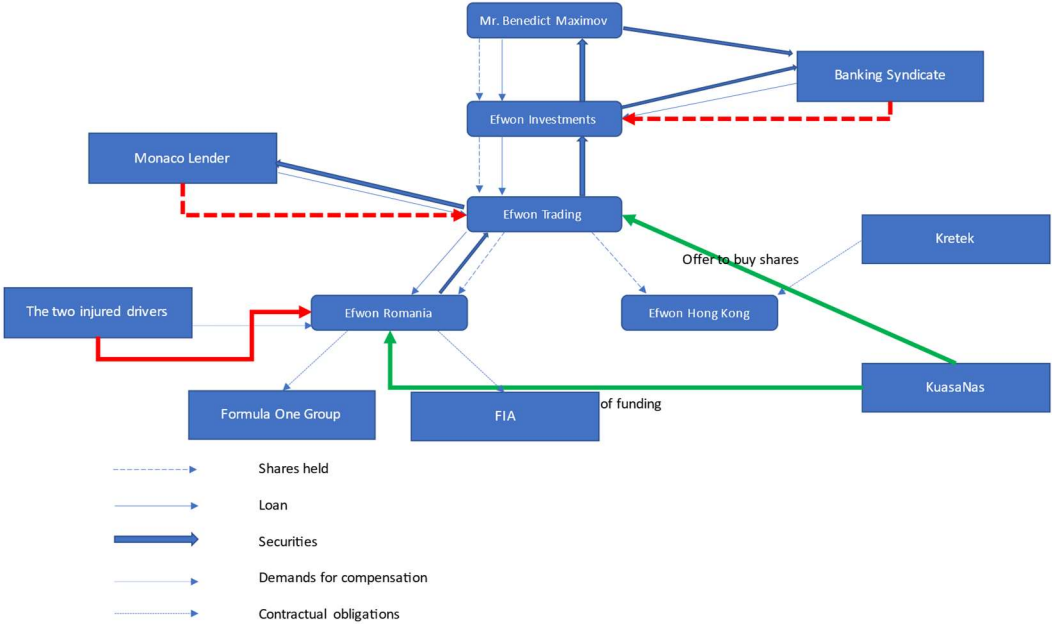
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<sup>5</sup> Sudarsanam/Lai p. 186

<sup>6</sup> Sudarsanam/Lai p. 187

III. Stakeholder Analysis

This problem can be approached by analyzing the stakeholders involved. It is of utmost importance to assess them regarding their interests in this matter and the leverage they hold. One way in which to do this the model for stakeholder influence identification proposed by Pajunen.<sup>7</sup> This approach is a combination of the analysis of resource dependencies and network positions. „Resource dependency theory examines relationships by describing how power is organized around crucial and needed resources.“<sup>8</sup> This has to be combined with the network position, to take into account not only the nature of the resource dependency relationship but also the structure based influence. The „network position is defined through its betweenness centrality and its inter-stakeholder resource dependencies.“<sup>9</sup> To accommodate their positions the picture above can be adopted as follows:



But this illustration is not taken into account the actual power over the resources of the group. These are in this context on the one hand side the resources that keep the operation going and on the other hand side the power to restrict the access to this operation.

IV. Resource Analysis

<sup>7</sup> Pajunen pp. 1263  
<sup>8</sup> Pajunen p. 1263  
<sup>9</sup> Pajunen p. 1264



The main resources that are taken into account are the influence the stakeholders can exert because of their position within the legal framework and the financial assets they can provide. The power level of the stakeholders is going to be assessed in the range of low-middle-high.

## 1. Legal Resources

Legal resources in this context are essentially the power to influence the decisions within the framework provided by the applicable jurisdiction. This is done here by taking a view at the possibilities in Romania and the US.

### a. Romanian Law

The Romanian insolvency law knows basically four proceedings. The judicial reorganization, which aims at rehabilitating a debtor facing financial difficulties, bankruptcy, which aims to realizing and distributing the debtor's estate to satisfy the debts owed, the ad-hoc mandate and the composition, which are applicable for debtors not yet insolvent.<sup>10</sup> In both first cases the court appoints an insolvency practitioner. The last two are most likely not applicable because now, it seems, the company isn't able to settle the claims of the drivers. The bankruptcy proceedings don't seem to be attractive because its goal would be a wind-up of Efwon Romania. This leaves the judicial reorganization as the last option. Its central aim is to settle with all creditors by implementing a rescue plan.

### b. US Law

But also, a Chapter 11 proceeding is feasible in this case. It would allow for the management of Efwon Romania to continue the operation until the creditor's claims could be reorganized with a plan. Furthermore, this proceeding isn't restricted to just insolvent debtors and the doctrine of "substantive consolidation" would allow for pooling the assets of two or more entities. This proceeding would also conclude with a plan and provide a moratorium on the creditors.

### c. UK Law

A plausible alternative could be the company voluntary arrangement according to UK law. But it is advised to aim for Chapter 11 because it isn't apparent that the doctrine of "substantive consolidation" can be applied to it.

### c. Forum for the insolvency proceeding(s)

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<sup>10</sup> Pp. 4 Allen & Overy

So an insolvency proceeding appears to be the most likely and prudent solution. At the moment there don't seem so much avenues remaining that can be taken in this regard because the lawyers of the drivers have already filed for the insolvency of Efwon Romania. The most pressing question at the moment therefor is, if this filing is prohibiting any other solution that an insolvency proceeding according to Romanian Law. At the moment it isn't apparent that this filing has set things in motion. Especially it isn't clear that following this filing an preliminary insolvency proceeding has been commenced by the respective Romanian insolvency court. According to the principle of priority the commencement of an insolvency proceeding prohibits the commencement of a further such proceeding. This principle is immanent to international insolvency law. The UNCITRAL Model Law on Cross-Border Insolvency (Model Law) stats in Article 20 para. 1 that the recognition of a foreign main proceeding prohibits the recognition of a further proceeding locally. This principle also finds expression in Article 3 para. 3 EUInsVO. But this could only apply for the full commencement of an insolvency proceeding. But the Model Law stats in Article 2 that it is also applicable to interim proceedings. The same is true for the EUInsVO in Article 1 para. 1.

An Romanian insolvency proceeding is always preceded by perioadă de observație. This is true for a restructuring proceedings (reorganizare) as well as for a simple (procedură simplificată) as well as a regular insolvency proceeding (procedură generală).<sup>11</sup> But according to the information provided there hasn't been issued a court order yet. Furthermore, it isn't out of the question, that the claims of the two drivers may be contested.

Because the UK, the USA and Romania have all adopted the Model law all jurisdictions would recognize each others orders and insolvency proceedings. Because the main creditors of Efwon Investments are situated in the USA it should pose no problem to file there for an Chapter 11 proceeding for the whole Efwon group.

#### d. Other legal considerations

Further legal considerations are the powers the Formula One group and especially FIA can exert in this case. If FIA isn't agreeing that the solution found will make it possible to retain the super license for the racing team, it isn't a solution at all.

#### e. Conclusion

In conclusion the threat posed by the filing for insolvency by the lawyers of the two drivers doesn't represent such a big lever, that the terms of the restructuring could be dictated by them. At least, the same lever is possible to pull for the other creditors. The most influential stakeholder in regard of legal resources is in fact at the moment is you Mr. Maximov, because

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<sup>11</sup> Munteanu/Rădulescu/Mihai/Schlegel, Rn. 33-35

you are still able to file for an insolvency proceeding that is most attractive for you. Therefore, the most powerful stakeholder in this regard is Mr. Maximov.

<b>Stakeholder Group</b>	<b>Legal Power Level</b>
Mr. Maximov	High
FIA	High
Banking Syndicate	Middle
Monaco Lender	Middle
Drivers	Middle
KuasaNas	Low
Kretek	Low

2. Financial Resources

The stakeholders who hold the most sway in this case financially are Kretek and especially KuasaNas. Kretek because it provides the budget until the end of season 2020 and KuasaNas because it doesn't just provide the budget after this season but also because it provides the drivers and the racetrack. The financial leverage the other stakeholders can pull can be neglected because the securities they have been provided are mainly the revenue generated by the racing team. This isn't true for the banking syndicate which has been secured with the real estate for Mr. Maximov. Therefore their power level in this regard is in the middle range.

<b>Stakeholder Group</b>	<b>Legal Power Level</b>
Mr. Maximov	Low
FIA	Low
Banking Syndicate	Low
Monaco Lender	Low
Drivers	Low
KuasaNas	High
Kretek	Low

Therefore, in the regard of financial influence KuasaNas has to be taken into account.

D. Conclusion

From the outset it wasn't apparent that any insolvency proceeding is necessary. Rather it seems much more opportune trying to avoid such a proceeding because of the imponderables

associated with it. If it can't be avoided the proceeding with the most level of influence for the client should be taken. But as has been shown above, the biggest stumbling block will be the drivers and their lawyers. If you would approach them to offer them a settlement, maybe even implying that you could otherwise yourself file for insolvency under a different jurisdiction that could have the adverse effect of the lawyers filing for even stricter court orders that would prevent any other legal solution under any other jurisdiction or pushing for such a court order. Because of this the aspect of time or rather priority of the legal actions taken is of utter importance. Therefore, it seems prudent for you to take the legal initiative and thus preventing the other stakeholders to dictate to you the terms of any solution.

The most attractive way to do this is to file for a Chapter 11 proceeding. This would be accepted in the most important jurisdictions in this case, Romania and the UK, would allow for the restructuring of the whole group without and restructure all debts in one go. Within this solution a specific solution for the creditors that had their loans secured with the real estate would have to be found. This could be done by giving them a bigger share that represents the value of the real estate. The money to do this would be generated by the sale of the 51 % stake in the group to KuasaNas.

#### Further Questions

##### 1. Impediments for insolvency proceeding(s)

The main impediment for any insolvency proceeding is the uncertainty concerning the super license of the Formula One team, Efwon Romania and the reaction of the two drivers and their lawyer in regard to a proposal to settle their claims.

##### 2. Further information needed

The most important information needed at the moment is the amount which is demanded by the two drivers because of the damages to them. If it would be financially feasible to settle these claims, insolvency proceedings could be avoided and a deal with

Furthermore, it is of paramount importance to know how FIA would react to the insolvency of Efwon Romania. It has to be ascertained what effect this would have on the assessment regarding the super license of the Formula One team.

##### 3. The role of the EU Insolvency Regulation and/or the UNCITRAL Model Law

The EU Insolvency Regulation (EUIsVO) is only applicable to cases which touch legal questions of cross-border insolvency that affect only more than one EU member state. As soon as a jurisdiction is effected that is outside the European Union that EUIsVO can't be applied. This is also logical because these rules are nothing more or nothing less than international contracts between sovereign states.

This also, in effect, is true for the Model Law. It only applies to those countries that have adopted its provisions into national law.

#### 4. How do their provisions assist or impede the proposed strategy?

The biggest impediment for the proposed strategy is the principle of priority. It has to be assumed that the filing for insolvency in regard to Efwon Romania by the lawyer of the two drivers has at least set in motion a preliminary insolvency proceeding. Because of this, the main proceeding is going to be an insolvency proceeding according to Romanian law. This is true for the EUIsVO as well as for the Model Law.

#### 5. Effects of Brexit.

The EUIsVO can't be applied to new insolvency proceedings in the UK from 01.01.2021 onwards. Therefore it can't be taken into account when determining which laws have to be applied regarding questions of cross-border restructuring if the UK is involved. Furthermore, there are no apparent international contracts between the UK or Romania in this regard. But Romania has, as well as the UK, adopted the Model Law into national law. Because of this the Model Law can be taken into account when evaluating which laws have to be applied to the specific case.

The one thing that has to be taken into account is that the Romanian Insolvency Law has adopted the Model Law in such a way that it only recognizes orders from jurisdictions under the principle of mutual recognition, that is, that only such orders in regard to insolvency are taken into account that have been issued in jurisdictions that have the same provisions in regard to cross-border insolvency recognition as the Romanian ones. In regard to the UK that isn't a problem because, as mentioned above, it has also adopted the Model Law.

Therefore, Brexit has no effect on the proposed solution.

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