

Case study

You have before you two applications for commencement of insolvency proceedings. On review of the documents filed, you ascertain that cases 1 and 2 are separate applications against one debtor company, by two different creditors, with the background facts as follows:

Decent Manufacturing Ltd is a limited liability corporation that manufactures turbine components. The company has operated for many years and constantly recorded modest profits, until in July 2022, the company decided to grow the business by taking on larger projects outside its historic area of expertise. In line with this new strategy, in September 2022, Decent Manufacturing Ltd bid for a contract to supply turbines for a wind power station.

In October 2022, Decent Manufacturing Ltd was awarded the contract. They began preparing to supply the wind turbines. However, they quickly realized that the process would be more expensive than manufacturing the smaller turbines which they were accustomed to building. However, their internal team determined that if they completed the project efficiently and with minimal difficulties, they could still earn a profit.

By December 2022, the company had fulfilled around a quarter of the wind turbine orders and made a small profit. However, in February 2023, steel prices spiked. This meant that Decent Manufacturing Ltd could not make a profit on the wind turbines. As time went on, it became clear to Decent Manufacturing Ltd's management that the losses on this contract were having a significant impact on the company's financial position. Decent Manufacturing Ltd had fallen behind on repayments to two key suppliers: \$15,000 owed to Fumos Energy for natural gas already supplied; and \$25,000 to Ferrum Metal for two batches of steel supplied on credit. The company successfully negotiated to exit the turbine contract and pay an exit fee of \$500,000. As a result of this agreement, Decent Manufacturing Ltd no longer has any involvement or obligations relating to the power station project.

The payment was made in June 2023. However, it came at an unfortunate time for the company as it coincided with the company's annual tax payment of \$50,000 and an earmarked annual bonus payment for high performing employees of \$150,000 in aggregate. Decent Manufacturing Ltd had \$550,000 of cash on hand and used all of this cash to pay the \$500,000 exit fee to exit the turbine contract and the \$50,000 tax bill. The company decided not to pay the bonuses as it was not legally required to do so under any legislation. The company also made no further repayments on its outstanding accounts with Fumos Energy and Ferrum Metal.

In August 2023, due to its poor financial position, Decent Manufacturing Ltd sought to obtain additional financing from its primary bank. However, due to rising interest rates, the financial regulator had recently increased the minimum capital reserves that must be held by financial institutions. In light of this information, the bank declined to provide further lending. Decent Manufacturing Ltd had meetings with several other banks, but none were willing to extend credit to Decent Manufacturing Ltd. Around this time, after learning that the year-end bonuses would not be paid, several key employees quit.

In order to help strengthen their case for additional funding, Decent Manufacturing Ltd hired external consultants to conduct a review of its financial position and ongoing viability. The review was completed in September 2023 and found that the turbine component business could theoretically be capable of producing sustainable profits, but only at a modest level. The review noted the company's net positive balance sheet. However, the report also noted that some of the employees that had recently left the company had significant knowledge about the operations of Decent Manufacturing Ltd, and that if unaddressed, these capacity gaps may impact viability.

As a result of the non-payment of the natural gas bill, Fumos Energy filed a creditor application for commencement proceedings in October 2023. Fumos Energy had previously notified Decent Manufacturing Ltd of their intention to do so if Decent Manufacturing Ltd did not pay the amount due in full. When Decent Manufacturing Ltd requested more time, Fumos Energy demanded that Decent Manufacturing Ltd pay

immediately or Fumos Energy would initiate commencement proceedings. Also in October 2023, Ferrum Metal filed a creditor application for commencement proceedings.

Counsel for the debtor, Decent Manufacturing Ltd, submits that insolvency proceedings ought not be commenced:

- In respect of both applications: because the company is not legally insolvent and because it has a net positive balance sheet.
- In respect of Fumos Energy: on the grounds that it is not owed \$15,000, because Fumos used the wrong tariff for this bill (since December 2022, Decent was promised a 15% discount on normal rates because of its increased consumption), which Decent Manufacturing has been arguing for months.
- In respect of Ferrum Metal: on the grounds that the application is an abuse of process. First, Counsel submits that the Board of Directors of Ferrum Metal recently made a decision to enter the turbine components market and they viewed Decent Manufacturing Ltd as their largest competitor. Counsel submits that the motivation for seeking commencement of insolvency proceedings is to eliminate Decent Manufacturing Ltd as a competitor. Second, Counsel submits that Ferrum Metal is not owed \$25,000 because the first batch of steel delivered in October 2022 was two weeks late (causing Decent Manufacturing production delays, increased costs and reduced profitability at a critical time for its cashflow).
- Counsel asks for an adjournment because most economists consider that during the next quarter, the financial situation will improve and the directors of Decent Manufacturing believe that there are very good prospects of obtaining a 6-month term loan.

- 1. How are you going to manage these two applications?**
- 2. Are you going to grant an adjournment?**
- 3. Is Decent Manufacturing insolvent? If so, on what basis?**
- 4. What are the key issues in the Fumos Energy application? How do you deal with the dispute over the energy bill? Is it significant that Decent Manufacturing has been disputing the bill for months?**
- 5. What are the key issues in the Ferrum Metal application? How do you characterise the dispute between Decent Manufacturing and Ferrum Metal concerning the payment of the invoice? What are you going to do about it? What is the significance of Ferrum Metal's commercial motives?**
- 6. Would it be possible to save the company? Would your jurisdiction facilitate it? What is the problem with Decent Manufacturing? How could it be solved?**