CASH POOLING — Does the end justify the means ?

Cash pooling is a method to combine the liquidity of companies within a group in order to distribute such cash centrally as required. It serves to improve liquidity control in a group, and both the group and its constituent companies can derive benefits from the overall cash reconciliation obtained by cash pooling. Nevertheless, as the failure of several large-scale companies in recent years has shown, the method carries some risk with it: without such a pool, individual companies might not have come close to the brink of bankruptcy. Similarly, cash pooling exposes board members and CEOs to a considerable liability risk that must not be underestimated .

Seen from the financial planning side, a group made up of several constituent companies means that each such component needs to set up its own cash management. Cash requirements varying over time cannot (or no longer) be compensated internally; where one company has surplus funds, its sister company may be forced to borrow money at short term and against high interest rates. Cash pooling aims to counter such effects by the central control of funds. "Effective" cash pooling (as is discussed here) means that the constituent companies turn their (total) excess cash over to a central cash pool, from where funds are paid out (or returned) to them as required. Excess cash is centrally invested, cash requirements are covered by central borrowing. Due to the greater volume involved in money borrowed or invested centrally, banks tend to grant better terms.

PREREQUISITES FOR PARTICIPATION

Seen from a legal perspective, the turning-over of excess cash amounts to a loan. Austrian laws on the preservation of corporate assets stipulate that Aktiengesellschaften (public limited companies) and Gesellschaften mit beschränkter Haftung (private limited companies) grant such a loan to a parent or sister company only at terms comparable to those granted to third parties: the loan must as a rule be made at market interest rates and, if required, collateralised. Regarding loans within a group, experts agree that the management must, within the scope of an obligatory risk assessment, consider whether it is in the company's interest to participate in a cash pool, e.g. because it need not perform its own cash management and is thus able to save on costs. A general interest in promoting the group as such is not deemed to be sufficient. Prior to participating in a cash pooling system, the management needs to check whether the payback claim is enforceable and whether the (inevitable) risk of default is commensurate with the concrete advantages. It is therefore necessary to examine the credit standing of participating companies and the scope of their liability, especially that of the parent company.

ONGOING MONITORING

Once the cash pooling system has been introduced, it is necessary constantly to monitor the credit standing of participants.

Flourishing group companies that feed their excess cash to the cash pool need to exercise particular caution: if such funds are used by the master company (i.e. the company that handles the cash pooling system) to cover losses of another company in the group, this might mean that the repayment claim is not enforceable in the medium run, due to the provisions governing substitute equity or the refund of contributions or "merely" a lower credit standing. This could make further participation in a cash pool (subsequently) illegal: the higher risk is no longer reasonably commensurate with the company's prospective benefit from cash pooling.

If a group company suffers a liquidity crisis and fails to withdraw from the cash pool in good time, and if the parent company is not or no longer able to compensate from its own resources the outflow of funds to its group company, the liquidity squeeze of a single company could endanger the liquidity of the entire group. Failing a proper response in good time, this could cause all the companies involved to become insolvent.

Thus, if a participating company is in trouble, all other companies need to examine whether their repayment claim is still enforceable or whether it is advisable to leave the pool.

Continuing illegally the participation in a cash pool may lead to personal liability on the part of the manager, possibly even to criminal-law consequences.

DEDICATED FUNDS

Particular caution needs to be exercised in those cases where "dedicated funds" (such as subsidies for the full or partial financing of a project) are contributed to the cash pool.

If such funds are transferred to the cash pool and then used to finance other projects, this may trigger a request for repayment, especially when the repayment claim is not collateralised. In addition, the liability risk is particularly high for the individuals involved. In the wake of the failure of a German shipyard company (Bremer Vulkan), its board members are still faced with German criminal and civil law suits.

For dedicated funds in particular it is thus advisable to leave such moneys in a special account held by the group company rather than include them in a cash pool.

For more information on this topic:

Dr. Martin Bartlmä
Attorney-at-law and partner

areas of expertise:
insolvency law and the law of voidable transfer, financing and company law

bartlmae@preslmayr.at

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P) UP AND RUNNING!

Pursuant to its motto "P) UP AND RUNNING!", our office entered two three-member teams (drawing on external re-enforcements) in the LCC Vienna business and team run that took place on 17 June 2004. Following up on their feat, the teams happily celebrated their endurance over the 5 km distance jointly with their fans and advocates from the office, right in the heart of the Ernst Happel stadium.
Infected with the track bug, once again two threesomes have formed to take their chance at the Wien Energie business run on 2 September 2004 .