**GLOBAL INSOLVENCY PRACTICE COURSE 2021/2022**

**Case Study 1**

1. **What were in your opinion the causes of financial distress at Flow Management (see e.g., Mellahi & Wilkinson, 2004)? Could the financial distress have been prevented? If yes, explain how. If no, why not?**
2. *What were in your opinion the causes of financial distress at Flow Management (see e.g., Mellahi & Wilkinson, 2004)?*

In general, the term "financial distress" is used in a negative connotation to describe the financial health of an enterprise that is confronted with a temporary liquidity shortage and with difficulties resulting in a failure to meet financial obligations within their payment terms and to their full extent[[1]](#footnote-1). Sudarsanam & Lai[[2]](#footnote-2) define financial distress in terms of potential bankruptcy risk using an accounting-based index of such risk. According to Sudarsanam & Lai[[3]](#footnote-3) a firm is in distress if it has a minimum of one year of negative Z score after two consecutive years of positive Z scores.

The fact that Flow Management is in financial distress is not in doubt. As Mellahi & Wilkinson 2004[[4]](#footnote-4) argue, the symptoms of failure are evident in Flow Management. The company is facing shrinking financial resources which is evidenced by the failure to meet its financial obligations and negative profitability evidenced by continual loss making.

The board at Flow Management requested for talks with its four banks on 16 November 2013 because the reported pre-tax profit until September 2013 of € 8 million turns out to be a loss of € 5.4 million and faults have been found in the annual returns of 2012 and as a result, the results of € 3 million must be downgraded by €8 million. The causes of these losses and negative corrections as communicated by the company management are:

1. Large management bonuses of (€ 3million) have been wrongly issued (concerning salaries of the CEO and CFO of Flow Management).
2. A contingency gain relating to three years has been received in 2012 and has been wrongfully booked as a result in 2012. A negative correction of € 1.6 million must be made.
3. In 2012, in anticipation of book profit (‘paper gain’) to be realized in 2013, a € 2.8 million book profit was made. This book profit was neither realized in 2012 nor in 2013.
4. The 2013 loss is the result of the basic principles used in the cost price calculation deviating from reality (because of a ‘formula error' in a spreadsheet, it emerges later). Since they failed to periodically check the real costs against the results of the cost price calculation, the prices charged were too low, resulting in a loss.

To determine what caused the financial distress in Flow, one must examine the theories that explain such financial distress. There are two main theories that explain causes of financial distress i.e., the deterministic view and voluntaristic view. The deterministic view assumes a deterministic role of the environment. It argues that managers are constrained by exogenous industrial and environmental constraints leaving them with little real strategic choice. When it comes to failure the industry matters more than the firm. Failure is caused by external factors over which management has little or no control[[5]](#footnote-5).

One the other hand, the voluntaristic view argues that managers are the principal decision makers of the firm, and consequently, their actions and perceptions are the fundamental causes of organizational failure. The Voluntaristic view is built on the assumption that managers are the principal decision makers of the firm and their *perceptions* of the external environment have a strong effect on how they (mis)manage the firm. The one who makes a decision is more important than the external context within which the decision is made. Thus, corporate calamities are calamities created by men[[6]](#footnote-6). This view uses four theories namely Groupthink theory, Upper Echelon theory, Curse of Success theory and Threat Rigidity Theory to explain internal causes of failure.

**Analysis of causes of financial distress in Flow Management Holding BV.**

The reasons given by the board show that the causes of financial distress were more internal (voluntaristic) than external (deterministic) as explained below:

1. *Groupthink Theory*: This is the desire for group consensus in decisions which overrides people’s common desire to present alternatives. The groupthink mentality leads to overestimation of group’s chances of success and biased information processing which ultimately causes managers to miscalculate events and makes decisions that could lead to failure[[7]](#footnote-7). Such miscalculation of events led to the payment of € 3million in bonuses, overestimating the chances of success and wrongfully booking a contingency gain in 2012, and making a book profit in 2012 of € 2.8million that was never realized. The management even failed to periodically check the real costs against the real cost price calculation, hence charging low prices. The management at Flow overestimated the chances of success and processed the information wrongly.
2. *Upper Echelon Theory* deals with the composition and tenure of top management. The proposed strategies of Flow show that its management had been in existence for a long time and was homogenous. Management failed to successfully diagnose the cause of financial distress. The reduction in information processing overtime is also evidence of long-tenured management. The management chose to focus on information for Flow and yet the subsidiaries were also making losses. Lucia Michalkova, Peter Adamko and Maria Kovacova[[8]](#footnote-8) argue that financial distress can be caused by incorrect information. This is very apparent with Flow as the 2013 loss was a result of basic principles used in the cost price calculation deviating from reality owing to a formula error. Furthermore management tried to increase efficiency through tactical changes such as cost cutting when its weak strategic position was the cause of the failure[[9]](#footnote-9). It is clear that the cause of failure can be linked to maintaining the same top management for a long period of time which had a weak strategic position. With the main clients agreeing to a price increase and only receiving a few negative replies from 5,000 other contacts/clients, it is evident that the strategic position of Flow was weak, causing financial distress. Strategy is determined by management.
3. *Curse of success theory* states that successful companies are likely to fail because of overconfidence. This was part of the problem with the management of Flow. This confidence led to a wrongful payment of a bonus of € 3million, booking of a contingency gain of € 1.6million and a paper gain of € 2.8million.
4. Adriaanse & Kuijl (2006) argue that when it comes to the causes of financial difficulties, it can be concluded that the problems mainly relate to poor management-*i.e.,* inadequate reaction of management, excessive cost structure and the presence of inadequate information management systems within the company[[10]](#footnote-10). It is evident that there was an excessive cost structure in Flow Management as reflected in the payment of € 3million in bonuses and the proposed strategies in November 2013 and December 2013. The first area the board wanted to deal with was cost cutting through making 130 staff redundant and saving on car repairs. In 2014, the management information system was to be improved so that the figures are more reliable. Good management that periodically checked the information would have discovered the formula error that led to low pricing and the losses being made through car repairs. It is clear that all that the CEO and CFO cared about were large bonuses as opposed to running the business.

From the above, in summary the causes of financial distress were voluntaristic and not deterministic. The environment in this case study was not the cause of the financial distress.

1. *Could the financial distress have been prevented? If yes, explain how. If no, why not?*

The causes of financial distress could have been prevented by:

1. Changing of top management. This would have curbed the large bonus payments. This would have also helped in ensuring that the strategic outlook of Flow is up to date with proper marketing. New management would have been able to bring a new approach in marketing the company. This would have curbed the curse of success. The management at Flow was simply not paying attention.
2. Improving the management information system to ensure the information is accurate. The accurate information would have also helped with accurate pricing. It could have helped management identify and reduce cost centers earlier, namely repairs, dispose of old fleet, and ensure that the employees that were not needed are made redundant. This did not need a distress situation to be discovered.
3. Periodically checking the information would have discovered the faults in the annual accounts returns, the formula error and avoid the entries of the contingency and paper gain.
4. Conducting periodic market surveys to ascertain information to enable it to price properly.
5. **What are in general advantages and disadvantages of an out-of-court restructuring (workout) as compared to a formal bankruptcy procedure? More specific, what are the advantages versus disadvantages in your country?**

*Advantages of an* out*-of-court restructuring (workout) as compared to a formal bankruptcy procedure:*

1. Out of court restructuring can be much less costly than a formal bankruptcy procedure. In Uganda, most restructurings, especially in the banking sector are done informally and without advisors. The Financial Institutions (Credit Classification and Provision) Regulations 2005 provide for out of court restructurings and are supervised by Bank of Uganda[[11]](#footnote-11). Formal procedures on the other hand in Uganda can only be undertaken by an insolvency practitioner which attracts a further cost. Following the impact of the COVID-19 pandemic on the economy, Bank of Uganda issued two guidelines on Credit Relief and Loan Restructuring Measures[[12]](#footnote-12) to facilitate out of court restructurings. No insolvency practitioner is required hence reducing costs and time.
2. Unlike formal procedures, out of court restructurings do not require Court approval. Formal procedures are heavily litigious which are costly in the long run. The opportunity to restructure a company can be lost in the vicious cycle of litigation.
3. Out of court restructurings are flexible. They are less rigid than the formal procedures. The solutions are tailor made and alterations or deviations can be agreed upon. As seen in a) above, in Uganda, restructurings of facilities affected by the COVID-19 situation were increased to three. Under formal procedures e.g., administration, any variation to the administration deed must be approved by the Court[[13]](#footnote-13) which makes the process heavily bureaucratic.

1. Unlike formal procedures, out of court restructurings provide for privacy. Information shared is confidential. There are no statutory requirements The silent manner in which the restructurings are done help maintain the good will of the company. Formal procedures in Uganda require public notifications. This makes it difficult to restructure since customers and suppliers may be reluctant to continue or commence business with a failed firm. In a sense, in formal restructurings, the entity is made to wash its dirty linen in public.
2. During an out-of-Court restructuring, the management of the entity remains in control and as such continues to run the day-to-day affairs of the company. In Uganda, under the formal procedures, an insolvency practitioner takes over the day-to -day running of the entity. Management is stripped of its powers. They are only engaged on a need to basis.
3. Out of court restructurings unlike formal procedures are easier to negotiate since they are generally less confrontational which creates a more conducive environment for negotiations.
4. Out of restructurings are generally quicker than formal procedures. In order to preserve value, time is of the essence. The cordial nature of workouts provide a quicker response and resolution of matters. Formal procedures often require court sanction which court provides time as it pleases.

*Disadvantages*

1. Protection is on the basis of agreement unlike in formal procedures where a moratorium is given as a matter of course. In out-of-court proceedings if no standstill agreement is reached, the uncontrolled scramble and partition of the assets is inevitable. More importantly, nothing stops a creditor during negotiations to enforce a charge or to collect through execution. In Uganda, it is noted that creditors are more likely to respect a moratorium from Court than mere undertakings by debtors, especially if the debtor has several creditors.
2. Consensus is key in out-of-court restructurings. This may be difficult to arrive at, especially where the creditors have lost trust in the management of the entity.
3. In Uganda under Regulation 13 of Financial Institutions (Credit Classification and Provision) Regulations 18 of 2005 an account classified as Doubtful or Loss shall not be restructured unless an up-front cash payment is made to cover, at the least, unpaid interest, or there is an improvement in the security or collateral taken which will make the restructured account, including unpaid interest, a well-secured account. This is not a requirement to commence formal procedures. A requirement to pay upfront before a restructure can happen can actually be a hindrance to a restructure.
4. Insufficient and/or censored supply of information. This negatively affects the ability of creditors to properly analyze a debtor’s situation thereby leading to a wrong diagnosis. Formal proceedings are better equipped to analyze the full financial situation of an entity since a third party is in control. Informal proceedings cannot benefit from other remedies such as lifting the veil.
5. Informal proceedings cannot deal with avoidance actions which will affect creditors position. Such avoidance and fraudulent actions are best dealt with in formal proceedings.
6. The requirement for the consent of all creditors will fail a workout while in formal proceedings the majority bind the minority. Like in case study, if banks A and B had the majority, they would bind banks C and D.
7. Informal proceedings miss out on the benefits of cross-border insolvencies i.e., access, recognition, relief, coordination, and cooperation of foreign courts.
8. **Were the turnaround/reorganization approaches as presented in the reading material (see e.g., Adriaanse & Kuijl, 2006, Pajunen, 2006, Sudarsanam, S, Lai, J., 2001, Schmitt, A., Raisch, S., 2013) applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.**

The following turnaround/reorganization approaches are presented in the reading materials:

1. Identification and management of stakeholders during a reorganization. Pajunen argues that the identification of stakeholders is premised on either resource dependence-based influence and/or network position-based influence.[[14]](#footnote-14)
2. Business and Financial restructuring[[15]](#footnote-15).
3. Retrenchment and Recovery[[16]](#footnote-16).
4. Managerial Restructuring, Operational Restructuring, Asset Restructuring and Financial Restructuring[[17]](#footnote-17).

***Analysis***

I believe these strategies were in one way or the other applied in the case study in the following way:

1. *Stakeholder identification and management:*

On 16 November 2013, the four banks of Flow Management were invited by the board for a meeting. By doing this, Flow had identified its relevant stakeholders using the resource dependency-based influence. Pajunen[[18]](#footnote-18) argues that according to the resource dependencies, the owners and creditors were in a decisive position throughout the whole process. Having identified the stakeholders, Flow managed them by providing information and plans to remove the causes of the financial distress, agreeing to an audit to investigate the procedures within the company, hiring an independent turnaround consultancy agency, agreeing to replace the CFO, replacing the CEO, and agreeing to the appointment of a Chief Restructuring Officer on the board. Whereas there seems to have been no appointment of a new CFO, taking these measures are evidence of identification and management of stakeholders. There is also evidence of Network Position Based Influence. The influence of Bank A in instigating the appointment of the CRO and Flow’s agreement to this appointment is evidence that Flow identified and managed its stakeholders.

Whereas Pajunen states that employees are often an important stakeholder[[19]](#footnote-19)Flow did not consider them an essential stakeholder in the process. Though Banks C and D at one point seemed to go a different route, the fact that a Restructuring agreement was signed in July 2015, is evidence that Flow identified and managed its stakeholders.

1. *Business and Financial Restructuring*
2. Business Restructuring is a comprehensive plan the aim of which is to restore the (operational) profitability of a company in financial difficulties. The main features of a restructuring process usually consist of the following phases: (i) stabilizing (ii) analyzing (iii) repositioning and (iv) reinforcing[[20]](#footnote-20).
3. *Stabilizing:* In its communication to the 4 banks of 16 November 2013, Flow identified the critical problems that needed immediate action and the plan to stabilize the situation. Two actions were proposed namely increasing price[[21]](#footnote-21) and spending cuts which are all aimed at increasing cash flow. Whereas the plan is rejected, Flow also proposes to sell off 350 cars[[22]](#footnote-22). In October 2014, sufficient incoming flows were expected because of the sale of surplus assets. In December 2013 the plan included price increase, redundancy for 130 staff and savings through improved loss recovery, higher excess premiums, and savings on car repairs. In 2014, the strategy was focused on increasing turnover[[23]](#footnote-23) in combination with large cutbacks. Stabilizing is further evidenced by increasing repayment periods such as payment of working capital and default interest ceasing to be charged[[24]](#footnote-24). The purpose of these proposals was to stabilize the situation.
4. *Analyzing*: This stage deals with enhancing or restoring confidence of the relevant stakeholders especially the financiers of the company. This is achieved through a well-founded reorganization plan. This phase is evident in the case study. Flow has prepared a reorganization plan that identifies the cause of the negative situation following an inquiry into the actual status of the company to ascertain whether the company has prospects which was conducted by the accountancy firm and turnaround expert. Evidence of analyzing is further seen in the proposed measures and calculated effects such as discussion with clients to increase price, making 130 staff redundant and improvement of loss recovery all had the calculated effects in terms of savings and increase of cash flow. There are cash flow projections in the short and long term from which the obligations can be performed and those that show a future improvement in liquid assets. Some of the measures Flow has undertaken are adjusting the strategy and marketing through meeting clients and discussing price increase, cutting overhead costs by savings on car repairs, dismissing excessive personnel and improving the management information system. All these are aimed at improving confidence.
5. *Repositioning*: This process in which value is recovered. Its benchmark is supplying information to the stakeholders during the process in an open and timely manner. This is seen in the case study. Both management and the recruits both supply information to the Banks in a timely manner.
6. *Reinforcing*: This deals with reinforcing management as well as the company’s balance sheet. The appointment of the turnaround consultant, CRO and replacement of the CFO and CEO is evidence of reinforcement of management. Transferring the business of Flow to a shell subsidiary is further evidence of this phase.
7. Financial Restructuring is described as forming part of the informal reorganization in which, on the one hand, the relevant creditors voluntarily commit to revised terms regarding the funding they made available and on the other hand, if so required, new funding is made available by providers of risk-avoiding capital (debt) and/or risk-bearing capital (equity)[[25]](#footnote-25). The July 2015 plan is evidence that Flow undertook a financial restructuring. Flow and its shareholders cancelled all claims against Flow Management II and its subsidiaries, Banks C and D have written off €32.5m. A total of €97.5 million has been waived by the consortium that provided Flow with working capital. €55million has been cancelled in full. These adjustments are evidence of financial restructuring.
8. *Retrenchment and Recovery*

Retrenchment focuses on increasing efficiency through cost and asset reductions while recovery concentrates on improving the firm’s market position through strategic change[[26]](#footnote-26).

Retrenchment is achieved through asset and cost retrenchment. Both are evident in the case study. Asset restructuring is evidenced in the plan of 2014 which was to sell off shares of the companies outside the Benelux countries as well as some foreign branches controlled by Flow and the evaluation and reassessment of the entire business mix. In October 2014 it is also reported that there has been a sale of surplus assets. Cost retrenchment is evidenced by the plan to lay off 130 employees, save repair costs and improve the management information system which is aimed at improving the process.

Recovery is evidenced by strategies aimed at improving its penetration in the market such as conducting a market survey to understand the response of a price increase. By going out to the clients this evidence that the management of Flow had not initially been aggressive in understanding the market in which it operated. Conducting a market survey will help align its strategy with the market.

The case study in my opinion applies retrenchment and recovery separately as opposed to collectively.

1. *Managerial Restructuring, Operational Restructuring, Asset Restructuring and Financial Restructuring*
2. *Managerial Restructuring*: Flow proposal to replace CFO, replacement of CEO, appointment of turnaround consultant and appointment of the CRO were received positively by the interested parties. Though the situation did not change as anticipated, these restructurings in management restored confidence in the management of Flow which led to a slight result improvement due to the reorganization.
3. *Operational Restructuring*: This deals with cost reduction, revenue generation and operating asset reduction[[27]](#footnote-27). Laying off staff, improving loss recovery, savings on car repairs, increasing turnover, increasing of prices, and selling of shares of companies outside Benelux countries as well as foreign branches and selling of surplus assets are all part of operational restructuring.
4. *Asset Restructuring* is evidenced by both asset divestment through selling of shares for the entities outside Benelux countries as well as foreign branches and selling of surplus assets and asset investment through the change of the management information system.
5. *Financial Restructuring* which basically deals with cash generation strategies is seen in Flow’s approach in market survey to ensure proper pricing, improving management information system to ensure accuracy of information used in the business, cessation of application of default interest, debt equity swap, raising additional working capital from the shareholder and CEO.
6. ***Banks C and D seem to frustrate the process at a certain point. What could have been the (rational and/or opportunistic) reason(s) for them to behave like that? What would you have done in that situation in your role as advisor of the other two banks?***

Reasons that could have caused Banks C and D to frustrate the process at a certain point:

1. Managerial inaction by failing to appoint a new CFO yet it was an agreed position in December 2013.
2. Lack of intensity and poor implementation of turnaround strategies e.g., appointment of CFO, no evidence that the proposed redundancies were done, no evidence of price increases etc.
3. Banks C and D did not have confidence in the management of Flow to turn the situation around. It seems that with Flow it is all words and no action.
4. The actual loss is higher than what was stated on 1 December 2013 by € 11.3million. This questions the accuracy of the information provided by the management of Flow. These Banks could have felt that what was being shown was the tip of the iceberg.
5. The cash available can only fulfil the obligations until April 2014 which is only two months away.
6. Failure by the shareholder to contribute the much-needed capital to alter the insolvency rating.
7. The failure by Flow to achieve its financial projections.
8. The variance between the forecasted loss of € 8.5million for the year 2014 and the expected loss announced by the CRO in June 2014 of €27.5m. It is important to note that it was initially projected that the result of the year 2014 would be €-/-5.7million. There seems to be a spiral decline which Flow cannot turn around.

What would you *have done in that situation in your role as advisor of the other two banks?*

Pajunen[[28]](#footnote-28) makes 6 propositions for dealing with stakeholder management in organizational survival and the 8 Principles for a Global Approach to multi-creditor workouts give guidance as to what I would have done in the circumstances. As proposition 1 states the more secure the continuing support of governing stakeholders in an existence-threatening crisis, the more probable is organizational survival[[29]](#footnote-29). Securing the continued support would be my top priority and as such all advice would be to guarantee this.

1. Referring the banks to the decision to act jointly and in a controlled manner.
2. Ensure that there is open, frequent, and active communication between the Banks. This helps the Banks better understand where each is coming from. This can be achieved by calling for a meeting(s) of all Banks
3. Find and utilize informal and personal relationships between the Banks. If they are not there, have them established. Bank A seems to have a relationship with all the banks that can be utilized.
4. Ensure that the management of Flow knows its unlocked brokerage function and encourage them to effectively utilize it. This could be achieved through meetings.
5. Identifying and obtaining consensus on the long-term goals. A common goal maintains continued support by stakeholders.
6. Ensuring change of top management. Banks A which was influential would take the lead in ensuring change of top management.
7. Propose the adoption of the 8 principles in the ‘Statement of Principles for a Global Approach to Multi-Creditor Workouts II’ particularly appointment of a representative for all the banks so that communication is collective and coordinated.
8. Convince Banks C and D by means of management actions that the going concern value will be higher than the forced-sale value because the banks admit issues with their security. It is only through a restructuring that any security issues can be remedied.
9. ***Which of the eight principles of the ‘Statement of Principles for a Global Approach to Multi-Creditor Workouts II’ can be found in the workout process of Flow Management (explicit or implicit)?***

The following principles are found in the workout process of Flow:

1. There is evidence that the Banks are agreed on co-operating with one another to give sufficient time to the debtor for information to be obtained and evaluated and proposals to be formulated and assessed which is the First Principle. The gathering of information is spearheaded by an accountancy firm to investigate procedures within the company, monthly reporting based on actual costs and turnover, hiring of an independent turnaround consultant to ascertain the viability of the Company.
2. The Banks have agreed that legal action will not be undertaken against the company pending the final report from the consultancy agency. It is concluded by the Bank’s not to panic. This is the Second Principle which requires all relevant creditors to agree to refrain from taking any steps to enforce their claims.
3. Though implicit, Flow has not undertaken any action which might adversely affect the prospective return to the relevant creditors e.g., when the proposal to sell off 350 cars was rejected by the banks, Flow did not pursue the strategy. This is further evidenced by it continually submitting proposals first to the creditors before implementation. In a sense to obtain the consent of the banks before action can be taken. This is the Third Principle.
4. There is coordination by the relevant creditors evidenced by hiring a consultancy firm and an independent turnaround consultancy. Further coordination is seen when the banks announce the appointment of a CRO. This is the Fourth Principle. This principle is further evident by the participation of all the creditors in the process. They attended all meetings and were all consulted in the process.
5. Whereas the banks were not happy with the constantly changing information given by the company, Flow has provided and allowed reasonable and timely access to all relevant information relating to the assets, liabilities, business, and prospects. Without this the accountancy firm would not have been able to ascertain the actual loss nor would have the consultancy firm been able to ascertain the viability of Flow. The slight improvement due to the reorganization is further evidence that the necessary information was being availed otherwise wrong strategies would have been proposed. This is the Fifth Principle.
6. The signing of the Restructuring agreement in July 2015 is evidence that the positions of all the relevant creditors as at the standstill commencement date were reflected. This is the Sixth Principle.
7. Though implicit, there is no evidence that the information obtained during the restructuring process was ever published or given to a non-relevant party to the process. This therefore suggests evidence of the Seventh Principle.
8. ***Suppose it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, are there any other possibilities for “soft law” to use (perhaps specifically in your country/region)? If yes, explain in what way. If not, do you see any alternative (informal) possibilities?***

If creditors cannot be convinced to adopt the Statement of Principles, the alternative soft law that could be applied in the situation include

1. The World Bank Principles for Effective Insolvency and Creditor Rights Systems, specifically Principle B3, B4 and B5. Principle B3 establishes the conditions that a legal system should satisfy to foster informal debt restructurings; Principle B4 deals with debt restructuring processes; finally, Principle B5 touches upon the specific questions that affect financial institutions in the context of debt restructuring[[30]](#footnote-30).

Principle B3 is to the effect that corporate workouts and restructurings should be supported by an enabling environment, one that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An environment that enables debt and enterprise restructuring includes laws and procedures that:

***B3***.***1*** *Require disclosure of or ensure access to timely, reliable, and accurate financial information on the distressed enterprise.*

***B3.2*** *Encourage lending to, investment in, or recapitalization of viable financially distressed enterprises.*

***B3.3*** *Flexibly accommodate a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt rescheduling, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges).*

***B3.4*** *Provide favorable or neutral tax treatment with respect to losses or write-offs that are necessary to achieve a debt restructuring based on the real market value of the assets subject to the transaction.*

***B3.5*** *Address regulatory impediments that may affect enterprise reorganizations; and*

***B3.6*** *Give creditors reliable recourse to enforcement, as outlined in Section A, and to liquidation and/or reorganization proceedings[[31]](#footnote-31).*

1. Whereas the UNCITRAL Model Law of Cross Border Insolvencies deals with access, recognition, relief and cooperation and coordination in cross border related matters, its objectives namely the fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor; protection and maximization of the value of the debtor’s assets; and facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment[[32]](#footnote-32), are another tool that can be used to help Flow restructure. It would help the parties focus on protecting the interests of all creditors and the debtor, protection, and maximization of the value of the debtor’s assets while facilitating the rescue of Flow which is financially in trouble thereby protecting investment and preserving employment.
2. ALI-III Global Principles for Cooperation in International Insolvency Cases 2012 are another alternative soft law. Global Principle 2 provides that in particular, these Global Principles aim to promote: (i) The orderly, effective, efficient and timely administration of proceedings; (ii) The identification, preservation and maximization of the value of the debtor’s assets, including the debtor’s business, on a global basis; (iii) The sharing of information in order to reduce costs; and (iv) The avoidance or minimization of litigation, costs and inconvenience to the parties in the proceedings[[33]](#footnote-33). Global Principle 8 provides for stay while Global Principle 9 provides for cooperation and sharing of information[[34]](#footnote-34). Interestingly, under Global Principle 30 a court can recognize a reorganization case as the main proceedings and such a court is expected to conduct any parallel domestic case in a manner that is as consistent with the reorganization objective in the main proceeding as is possible under the circumstances, with due regard to the local law[[35]](#footnote-35). Global Principle 31 provides for post-insolvency financing. These are a great option for adoption. They provide the necessary protection and recognition of a reorganization which could bring much comfort to the creditors.

In Uganda, a financially distressed company may also seek informal out-of-court measures to revive the company through raising capital by making a call on shares, obtaining equity injections from shareholders or investors, mergers and acquisitions, renegotiating contracts with creditors to remedy default and breach of contract, consensual out-of-court arrangement schemes, refinancing through debt buyout, bank loans, debt restructuring which may involve debt write off, debt rescheduling; and conversion of debt into equity.

A debtor may also utilize informal dispute resolution mechanisms such as negotiation, mediation, and reconciliation to restructure a debt.

Soft laws that would facilitate this process include the Bank of Uganda Financial Consumer Protection Guidelines 2011 and the guidelines on Credit Relief and Loan Restructuring Measures for Financial Institutions. Whereas they have no force of law, being guidelines, like the Statement of Principles they provide possibilities for restructuring loans. They mandate financial institutions to act fairly and reasonably in all its dealings with a consumer[[36]](#footnote-36). These dealings in my opinion include debt restructurings. In their deals, Financial Institutions are required not to engage in unfair, deceptive, and aggressive practices such as threatening or intimidating behavior towards a customer[[37]](#footnote-37). The Guidelines deter any financial institution from exerting undue influence or duress on a customer to enter a transaction and from disclosing any information about a customer to a third party[[38]](#footnote-38).

Whereas the Financial Institutions (Credit Classification and Provision) Regulations 2005 have provided for debt restructurings, the impact of COVID-19 has led to the publication of the two guidelines on Credit Relief and Loan Restructuring Measures to enable rescheduling of debt obligations by providing a debtor some relief in how and when debt obligations are met. The key objective is to enable borrowers to deal with the impact of COVID-19 and reduce the risks faced by lenders. The Guidelines provide for restructuring of a loan up to 3 times.

Under the Credit Relief Guidelines, a financial institution is expected to assess the impact of COVID - 19 on the borrowers’ cash flows. After assessing the impact, a financial institution is allowed to grant the following credit relief options individually or a combination (i) suspension or reduction on the repayment of principal and/or interest, (ii) extension of loan repayment period, (iii) reduction of the rate of interest on the loan (iv) other forms of loan rearrangements under the Regulations. The repayment holiday is only for 12 months which suspends the requirement of payment of arrears as a precondition for any restructuring to commence. Even under these Guidelines Consumer Protection remains paramount and any credit reliefs given must be in the best interests of the borrower.

A combination of the Consumer Protection and Credit Relief guidelines provides for good soft law to apply in each situation. Not only are creditors required to act fairly but the borrower is given an opportunity to restructure its loan obligations.

1. ***Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015.***

According to Adriaanse and Kuijl[[39]](#footnote-39) a reorganization plan is because of Phase II of a business restructuring in which a company looks at its long-term prospects. The argue that a restructuring plan ought to consider the following matters[[40]](#footnote-40)

1. A strategic and financial analysis ex post to trace the causes of the negative state of affairs
2. An inquiry into the actual financial position and an assessment as to whether or not the company still offers sufficient basis for recovery
3. Proposed measures and the calculated effects thereof on long-term exploitation overviews and balance projections
4. Cash flow projections in the short and long term from which it appears that the obligations entered into (and to be entered into) can be performed
5. Cash flow projections which show a future improvement in the liquid assets

**Essence**

The essence of the Restructuring agreement of 4th July 2015 is an informal reorganization of the business and finances of Flow Management with a long-term perspective. The most important qualities of this agreement are:

1. A business restructuring majorly characterized by measures to restore long term profitability and asset restructuring all aimed at repositioning. Through the transfer of the business to a healthy company, the parties are repositioning Flow Management.

1. A financial restructuring

It is evident that the creditors have voluntarily restructured the debts owed by Flow through reduction or write of loan obligations. Cancellation of all claims by the Banks and shareholders against Flow Management BV, Flow Management BV and its shareholders will cancel all claims against Flow Management II and its subsidiaries, waiver of €32.5 million by banks C and D, waiver of €97.5 million and cancellation of a €55 million loan in Flow Management is evidence of financial restructuring. At the beginning of the story, Flow Management had a working capital loan amounting to €360 million and other loans amounting to €55 million. As at the date of the agreement, the outstanding obligations had reduced to €240 million. Thereby the debt was restructured.

**Result**

1. The foundation is laid for selling the company (now being Flow Management II) in a going concern.
2. As a result of the debt reduction, the net profit is positive, and the equity capital is strengthened (solvency is higher than 5%).
3. The reorganization takes place. This gives a new lease of life to the company. Though the situation is critical, a better future is forecast, and the parties are carefully optimistic about a good result.
4. The business was transferred to a new company.
5. The debt was restructured. Amounts owing were reduced to €240 million.
6. Liquidation has been avoided by postponement of the proposed refinancing of the working capital to July 2017. This is because of the negative results and troubled takeover talks.
7. The company has been stabilized. Solvency is now at 5%. It has been repositioned as there is restored confidence in the interested parties of Flow and Flow has been reinforced. Reinforcing of Flow was achieved through transferring of the business to a healthy company. With the improved solvency rate, future payments are guaranteed.
8. ***Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process?***

The UNCITRAL model law on cross-border insolvencies focuses on four areas namely access, recognition, relief, coordination, and cooperation. The following are the potential cross-border issues in the Flow Management restructuring process:

1. Being an informal proceeding, if any of the subsidiaries were to undergo a formal insolvency proceeding, an insolvency practitioner has no means to apply to be recognized in this process. The center of main interests of the six operating companies is Flow Management.
2. Whereas a formal proceeding may be recognized in any of the subsidiaries, an informal process will not. The restructuring process is only binding on the parties that participate in the process. Flow will have issues in having this agreement recognized and enforced in the countries the six operating companies are situated.
3. Since Flow cannot have this process recognized, it cannot benefit from an automatic stay upon recognition of main proceedings and relief at the discretion of the court for both main and non-main proceedings following recognition which would be available in a formal process.
4. If formal proceedings, foreign courts are required to cooperate and coordinate. If a formal proceeding were to commence in any of the six other countries, the foreign court would not be required to cooperate or coordinate with an informal process. This would be problematic.
5. Flow is likely to be faced with the determination of the COMI for Flow Management II BV in which all operating companies are to be accommodated.
6. ***In October 2014 four scenarios have been drawn up. Why was or wasn’t calling for a moratorium (see scenario 4) a good option given the situation at that time? [you are allowed to give your opinion based on your own countries’ Bankruptcy act; be as detailed as possible.***

The call for a moratorium wasn’t considered a good option because of the following reasons:

1. A moratorium requires a formal court process. While certain jurisdictions provide for a statutory moratorium which allows “breathing space” to a debtor before the onset of formal insolvency, in many jurisdictions a statutory moratorium on creditors’ claims is available only as part of a formal insolvency process[[41]](#footnote-41). In Uganda, this would require the commencement of insolvency proceedings either liquidation or administration.
2. Applying for a moratorium attracts a cost and publicity. In Uganda both proceedings require publication of the process which in essence could jeopardize the on-going concern option
3. The standstill agreement signed in the middle of August 2014 had the same effect as a moratorium. By effect of the standstill agreement the creditors in essence agreed not to enforce their securities or demand for the payment of money for a period of 120 days. The remedy suspending any enforcement had already been obtained by Flow. The confirmation of a “standstill” provides some reassurance to the debtor’s management that their attempts to achieve a rescue or orderly workout through the provision of information about the debtor to its creditors and their advisers and negotiation with them will not be immediately undermined by enforcement actions by those creditors; and also to the relevant creditors to the effect that the others of them are prepared to proceed on a coordinated basis while the evaluation process occurs[[42]](#footnote-42).
4. In certain jurisdictions, an agreement by the debtor with all or some of its creditors which provides for a moratorium on the payment of debts will itself trigger formal insolvency. In such cases it may still be possible for the creditors to agree between themselves (rather than with the debtor) to operate a moratorium on their claims against the debtor and for the debtor separately to agree not to take steps which might prejudice the relevant creditors during an agreed period[[43]](#footnote-43).
5. Though the banks were not happy with the progress of the reorganization, the additional security in the form of €10 million of tax refunds and sufficient incoming cash flows are expected because of the sale of surplus assets. In formal proceedings this could potentially be avoided by the insolvency practitioner as a voidable transaction. In Uganda, the Insolvency Act 14 of 2011 provides that a transaction is voidable if a preference, at an undervalue, is a voidable charge or relates to insider dealings. According to the Ugandan position, this transaction would potentially be labeled as a preference which would subject it to being set aside by a liquidator because it was made on account of an antecedent debt, at a time when the company was unable to pay its debt, or it enabled the banks receive more towards satisfaction of the debt that they would have received in a liquidation[[44]](#footnote-44). This is probably why seeking a moratorium was not a good option as such a transaction would have been subjected to scrutiny.
6. A moratorium would impede the going concern option since it would in effect indicate publicly that Flow is incapable to pay its debts. Any interested buyers or investors would prefer then to buy in a liquidation setting rather than a going concern. This would ultimately reduce the creditors value or potential receivable.

1. Lucia Michalkova, Peter Adamko and Maria Kovacova “*The Analysis of Causes of Business Financial Distress”* 3rd international Conference on Economic and Business Management (FEBM 20180 *Advances In Economics, Business and Management Research, Volume* 56 , Atlantis Press, Page 49 at <https://www.researchgate.net/publication/329956900_The_Analysis_of_Causes_of_Business_Financial_Distress> [↑](#footnote-ref-1)
2. Sudi Sudasanam & Jim Lai *“Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis* “British Journal of Management Vol 12, 183 - 199 (2001) at page 184 [↑](#footnote-ref-2)
3. Sudi Sudasanam & Jim Lai (2001) *Supra* Page 188 [↑](#footnote-ref-3)
4. Kamel Mellahi & Adrian Wilkinson *Organizational Failure: A Critique of Recent Research and A proposed Integrative Framework””* International Journal of Management Reviews Volume 5 - 6 Issue 1 March 2004Page 22 [↑](#footnote-ref-4)
5. Kamel Mellahi & Adrian Wilkinson *Supra* Page21 and 22 [↑](#footnote-ref-5)
6. Kamel Mellahi & Adrian Wilkinson *Supra* Page 27-28 [↑](#footnote-ref-6)
7. Kamel Mellahi & Adrian Wilkinson *Supra* Page 28 [↑](#footnote-ref-7)
8. Lucia Michalkova, Peter Adamko and Maria Kovacova Supra page 49 [↑](#footnote-ref-8)
9. Kamel Mellahi & Adrian Wilkinson *Supra* Page 29 [↑](#footnote-ref-9)
10. Jan Adriaanse and Hans Kuijl “*Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions?”* Review of Central and East European Law 31 (2006) 135-154 at Page 147-148 [↑](#footnote-ref-10)
11. Regulation 13 of Financial Institutions (Credit Classification and Provision) Regulations 18 of 2005 defines a restructured credit facility is a facility which has been refinanced, rescheduled, rolled over, or otherwise modified because of weaknesses in the borrower’s financial position or the non-payment of the debt as arranged. [↑](#footnote-ref-11)
12. On 14 April 2020 which set the cap of restructurings to two over a period of 12 months from April 2020 to March 2021. On 6 May 2021 the Guidelines were amended to increase the number of restructurings to 3. [↑](#footnote-ref-12)
13. Section 167 of the Insolvency Act 14 of 2011 [↑](#footnote-ref-13)
14. Kalle Pajunen “*Stakeholder Influences in Organizational Survival”* Journal of Management Studies 43.6, Blackwell Publishing Limited September 2006 page 1272 and 1274 [↑](#footnote-ref-14)
15. Jan Adriaanse and Hans Kuijl Supra at page 139 [↑](#footnote-ref-15)
16. Achim Schmitt and Sebastian Raisch “*Corporate Turnarounds: The Duality of Retrenchment and Recovery*” Journal of Management Studies 50:7 John Wiley & Sons Limited and Society for the Advancement of Management Studies. November 2013 [↑](#footnote-ref-16)
17. Sudi Sudasanam & Jim Lai Supra [↑](#footnote-ref-17)
18. Kalle Pajunen Supra at page 1272 [↑](#footnote-ref-18)
19. Kalle Pajunen Supra at page 1274 [↑](#footnote-ref-19)
20. Jan Adriaanse and Hans Kuijl Supra at page 140 [↑](#footnote-ref-20)
21. Jan Adriaanse and Hans Kuijl Supra at page 140 [↑](#footnote-ref-21)
22. Jan Adriaanse and Hans Kuijl Supra at page 141 refer to this as asset stripping. [↑](#footnote-ref-22)
23. Jan Adriaanse and Hans Kuijl Supra at page 140 refer to this as optimizing turnover times of the accounts receivable. [↑](#footnote-ref-23)
24. Jan Adriaanse and Hans Kuijl Supra at page 141 refer to these as optimizing spontaneous financing. [↑](#footnote-ref-24)
25. Jan Adriaanse and Hans Kuijl Supra at page 144 [↑](#footnote-ref-25)
26. Achim Schmitt and Sebastian Raisch Supra at Page 1216 [↑](#footnote-ref-26)
27. Sudi Sudasanam & Jim Lai Supra page 185 [↑](#footnote-ref-27)
28. Kalle Pajunen Supra at page 1279- 1283 [↑](#footnote-ref-28)
29. Kalle Pajunen Supra at page 1279 [↑](#footnote-ref-29)
30. José M. Garrido “*Out of Court Restructuring”* International Bank for Reconstruction and Development / International Development Association or The World Bank 2012 at Page 2 [↑](#footnote-ref-30)
31. José M. Garrido “*Out of Court Restructuring”* International Bank for Reconstruction and Development / International Development Association or The World Bank 2012 at Page 15 [↑](#footnote-ref-31)
32. UNCITRAL Model law on Cross- Border Insolvency with Guide to Enactment and Interpretation at Page 3 at chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/viewer.html?pdfurl=https%3A%2F%2Funcitral.un.org%2Fsites%2Funcitral.un.org%2Ffiles%2Fmedia-documents%2Funcitral%2Fen%2F1997-model-law-insol-2013-guide-enactment-e.pdf&clen=675481&chunk=true [↑](#footnote-ref-32)
33. ALI-III Global Principles for Cooperation in International Insolvency Cases 2012-page 4 chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/viewer.html?pdfurl=https%3A%2F%2Fwww.iiiglobal.org%2Fsites%2Fdefault%2Ffiles%2FALI-III%2520Global%2520Principles%2520booklet\_0.pdf&clen=893186&chunk=true [↑](#footnote-ref-33)
34. ALI-III Global Principles for Cooperation in International Insolvency Cases 2012 Supra at Page 6 [↑](#footnote-ref-34)
35. ALI-III Global Principles for Cooperation in International Insolvency Cases 2012 Supra at Page 12 [↑](#footnote-ref-35)
36. Guideline 6 (1) (a) of the Bank of Uganda Financial Consumer Protection Guidelines 2011 at page 4 https://bou.or.ug/bou/bouwebsite/bouwebsitecontent/FinancialInclusion/Financial-Consumer-Protection-Guidelines-2011.pdf [↑](#footnote-ref-36)
37. Guideline 6 (1) (b)(i) Supra page 5 [↑](#footnote-ref-37)
38. Guideline 6 (1) (b)(vi) Supra [↑](#footnote-ref-38)
39. Jan Adriaanse and Hans Kuijl Supra at page 141 [↑](#footnote-ref-39)
40. Jan Adriaanse and Hans Kuijl Supra at page 141 Table 2 [↑](#footnote-ref-40)
41. Insol International Statement of Principles for a Global Approach to Multi-Creditor Workouts II. Insol International 2017 Page 12 [↑](#footnote-ref-41)
42. Insol International Statement of Principles for a Global Approach to Multi-Creditor Workouts II. Insol International 2017 Page 12 [↑](#footnote-ref-42)
43. Insol International Statement of Principles for a Global Approach to Multi-Creditor Workouts II. Insol International 2017 Page 13 [↑](#footnote-ref-43)
44. Section 15 of the Insolvency Act 14 of 2011 at page 29. [↑](#footnote-ref-44)