**CASE STUDY 1**

 **ANSWER TO THE ASSIGNMENT QUESTIONS**

**Answer to question 1:**

I would start by describing the term “Financial Distress”. Financial distress describes any situation where an individual or company’s financial condition leaves them struggling to pay their bills, especially loan payments to creditors and, severe prolonged financial distress may eventually lead to insolvency[[1]](#footnote-1). According to Jahur and Quardir (2012)[[2]](#footnote-2), the common causes of financial distress are often a complicated mix of symptoms which may consist of lack of financial planning, high-cost structure, poor accounting records, poor management skills, unfavourable change in government policy etc. In other words, the causes of financial distress are made up of different variables and may be independent variables, significant variables, and even most significant variables. The bottom line is that attention should be given to all the variables.

Now back to Flow Management. It is not in dispute that the Company had severe financial distress, so we would proceed to analyse how the company was lured into that financial state. One of the primary causes of the financial distress of Flow Management was her poor accounting records. The company reported a pre-tax profit of € 8 million which turned out to be a loss of € 5.4 million; large management bonuses of about € 3 million were wrongly issued, anticipated book profits were never realised, failure to prepare accurate cost price calculation etc.

However, while her failure had a lot to do with the poor accounting records on the surface, a careful review would reveal that the management also played a major role in pushing the company into financial distress. This is essentially because it was their responsibility to supervise and approve the cost price calculation and ensure it was tandem with the reality of the market. In other words, this was not just an accounting error, but a management error.

According to Mellahi and Wilkinson[[3]](#footnote-3), there are different perspectives toward the cause(s) of organizational failure. The first school of scholars- Industrial Organization (IO)/Organization Ecology (OE) are of the view that “the industry matters more than the firm”. In other words, in order to properly identify the cause of Flow’s management financial distress (according to the scholars), we must consider and focus on the external factors which the management had little control over. On the other hand, the second school of thought- Organization Studies (OS)/ Organizational Psychology (OP) are of the view that the internal factors are the causes of organizational failure particularly because all organizations in a sector face the same environmental factors so it is the leaders of each organization that determines whether the company can swim or sink.

Some of the theories to support their position include group think theory, upper echelon theory, curse of success etc. While Mellahi and Wilkinson proposed an integration of the two perspectives (i.e. consider the internal and external factors to determine the cause of organizational failure), the facts of the instant case would reveal that Flow Management had little or no external factor challenge.

There is no fact which stated that the sector had challenges. Thus, the failure was primarily on the internal factors of the organization. In my view, the curse of success was responsible for paying large management bonuses when in reality, the company was in financial distress.

Flowing from the above, I’m of the view that the causes of financial distress of the Company were internal factors ranging from high-cost structure, poor accounting records, poor management skills.

**Answer to question 1b:**

Yes, the financial distress could have been prevented. Flowing from my answer that the causes of the financial distress were internal factors, I’m of the view that some of the critical factor(s) that affected the company was the upper echelon theory and curse of success. The managers of the company were not properly shuffled so they became used to the norm, focused on external challenges as opposed to internal factors. They became over-confident and eventually started losing the market without even knowing it. I’m of the view that if they had refused to be overcome by their success, they would have paid closer attention to their books, raised the alarm much earlier and prevented the financial distress to a reasonable extent.

**Answer to question 2:**

The term “out of court restructuring” basically means that the parties are driving the procedure and the mechanism of restructuring the debt. It is simply party driven. On the other hand, the term formal restructuring implies that the parties are following a laid down procedure established in the relevant jurisdiction towards the restructuring of the debt. According to Adriaanse and Hans Kuijl[[4]](#footnote-4), formal reorganization includes all possibilities of reorganization laid down by the (insolvency) law or which take place by using legal methods and possibilities; while an informal reorganization is understood to be a reorganization route which takes place outside the statutory framework with the objective of restoring the health of a company in financial difficulties within the framework of the existing legal entity.

Some of the advantages of informal restructuring include flexibility, confidentiality, and control. It is flexible because it is the parties that determine the mechanism and pace of the restructuring. It is confidential because the negotiations and documents do not form public records of any court. Another advantage is that the management of the company in distress can still be in control of the company while the negotiation is ongoing particularly if there are no issues with the conduct of the management. On the other hand, some of the disadvantages of informal restructuring are that the management may take the creditors for granted and unnecessarily elongate the process, secondly it may be a huge challenge to replace the management even when it is glaring that a total internal restructuring of the management is required.

Regarding formal restructuring, some of the advantages include certainty as to the procedure and timelines, independence of the regulatory authority or court to decide based on figures not sentiments, potential appointment of an insolvency professional to manage the affairs of the company etc. On the other hand, some of the disadvantages include publicity, potential dislodgement of the management, potential liquidation, post-commencement financing may be a challenge as third-party investors may not want to get involved in the litigation depending on the level of hostility between the parties.

**Answer to question 2b:**

In Nigeria, the same general advantages of informal and formal restructurings as identified above are applicable. However, two major advantages of informal restructurings in Nigeria are flexibility and confidentiality. The parties during informal restructuring usually fast-track the negotiations by working day and night with all the relevant parties and stakeholders to restructure the facility and move on with their business activities. The parties also try to keep the terms of restructuring confidential and ensure their public relations officer manage the brand of the company with the press in interest of the value of their shares and any possibility of raising capital in the future.

Some of the disadvantages of informal restructuring is the resistance of the management to be replaced with new minds following the proposed new terms of restructuring with the creditors. For instance, we see how the creditors in the instant case nominated a representative which improved the provision of information in Flow Management. The management of some companies in Nigeria usually resist any appointment of a representative regardless of their professional background which has the capacity to improve the affairs of the company.

On the issue of formal restructuring, Nigeria just passed a new Companies and Allied Matters Act 2020 (CAMA) which is the primary law that governs insolvency in Nigeria. Our legal system used to be creditor friendly, but the new law has taken a huge step to favor debtors. Chapter 17 of the Act provides for Voluntary Arrangements, Chapter 18-Adminstration, Chapter 19- Receivers Managers, Chapter 29-Netting etc. The law has introduced administration for the first time and is now one of the formal procedures of restructuring in Nigeria.

One of the advantages of formal restructuring in Nigeria is that it carries the backing of the court and a party can be in contempt of court if the order is disobeyed. This is a huge advantage in Nigeria because sometimes, the management of the company are not prepared to let go of the company without an order of court. However, one of the major disadvantages is loss of time. Sometimes, the Judge hearing the matter may not be available due to other administrative or official assignments which would lead to long adjournments. More-so, the company may also make several attempts to frustrate the case by filing applications to delay the hearing of the substantial suit. Another disadvantage is the negative publicity following the dispute in the Court of law.

From my experience, most of the formal restructurings in Nigeria were as a result of the failure of the management to co-operate with the creditors during the informal restructurings. Thus, while the two options have their pros and cons, parties are advised to weigh both before deciding on the route to take. More importantly (particularly for my jurisdiction), management should be open and flexible toward informal restructuring if they are keen on avoiding a formal restructuring.

**Answer to question 3:**

Corporate turnarounds are managerial responses to the financial distress of a company under conditions of high uncertainty and ambiguity. In other words, how did the managers respond to the financial storm that had the capacity to make the company sink? Some of the turn-around features despite the storm should include the art of stabilizing, analyzing, repositioning and reinforcing the affairs of the company. The art of stabilizing involves identifying the significant challenges of the company that must be addressed to enable the company to have enough breathing space to even negotiate with the creditors.

In the event the first stage is achieved, the next approach is to maximize the breathing space the company has created to analyze the way forward for the company. Without creating the breathing space, the company may not have time to analyze properly. Having analyzed the situation and identified wrong turns the company may have made, the next step would be to reposition and reinforce the affairs and objectives of the company whether internally or externally and which may involve retrenchment of some of the employees.

Generally speaking, Managers’ approach turnarounds either through retrenchment or recovery or a mix of both. It would all depend on the facts and objective of the company i.e. while the objective of retrenchment focuses on increasing efficiency through cost and asset reductions, recovery focuses on improving the company’s position in the sector through strategic moves.

A careful review of the facts of the instant case would show that some of these turn around mechanisms were applied. Firstly, when it became apparent that the Company was in financial distress, the management did not only raise the alarm but also proposed plans to remove the causes of the financial distress such as spending cuts to be implemented (which included a retrenchment of about 130 staff members) and possible increase in prices (recovery).

In my view, the approach of proposing the approach to resolve the challenge was an attempt to stabilize the affairs of the company with the Banks. If there was no proposal, then there would have been nothing to discuss with the Banks on December 1, 2013.

Another approach which the company adopted was in analyzing the affairs of the company given the several projections which were not achieved. The management understood that the entire business mix of the company had to be re-assessed, and some shares had to be sold off as well as foreign branches controlled by Flow Management Work BV. Although the company explored some of the approaches presented in the material, it was not necessarily enough to resuscitate the company as the management/shareholder shared the threat rigidity perspective which constrained them from implementing decisions promptly.

**Answer to question 4:**

Financial restructuring may involve several banks/creditors (whether between local banks or even a mix local and international creditors). It is not unusual for some creditors to co-operate with the debtors during the process of restructuring while some may be hostile to the process and attempt to disrupt the structure which may lead all creditors rushing for the “last slice of the pie” and leaving others with almost nothing. Some of the factors that may lead to the hostility may be hinged on their level of exposure and their understanding of insolvency and restructuring (This is essentially because, some Banks have taken enforcement actions which were not only detrimental to the interest of the debtor but also to their own overall interest compared to what they would have received if they had co-operated with the restructuring process.

In the instant case, though Banks C and D were co-operating at the initial phase, the lack of confidence in the management of the company and the failed projections led the said Banks to reassess their decision. This was particularly as their exposure was worse than that of Banks A & B. Thus, although the company and Banks A & B may perceive their actions as an attempt to “frustrate” the process, Banks C and D merely perceive it as an attempt to manage their risks and they had valid reasons for that. First, the projections of the company had failed, the Banks lost confidence in the management of the company and thirdly, their exposure was too high compared to the other Banks.

There is an adage that he who wears the shoe knows where it hurts. So, Banks C & D perhaps saw this attempt to “frustrate” or “manage their risk” as an awakening from their slumber as their exposure was too high compared to Banks A & B.

**Answer to question 4b:**

Incidentally, I have personally been faced with a similar scenario in Nigeria. I represented the interest of the debtor, and we had several meetings with the creditors to restructure the facility. We adopted the informal restructuring process as the laws were quite rigid and very creditor friendly. As expected, one of the Banks tried to frustrate the process. Some of the factors that propelled its decision was the lack of confidence in the management of the company, the high exposure of the Bank in terms of the money involved and the fact that the Bank was in possession of one of the material assets that was required to ensure the debtor continues its business activities. All attempts to ensure a standstill was frustrated and the Bank filed an action in Court-in *Suit No: FHC/L/CS/178/2016- United Bank for Africa Plc & Anor v Chief (Dr) Ernest Shonekan & Ors*.

In my role as adviser to the debtor, we engaged the Banks and proposed several mechanisms to solve the issue. We were also sensitive to the fact that some of the Banks felt unappreciated as it appeared the debtor was keen on rewarding the most hostile creditor as opposed to the most co-operative creditor. In the end, the shareholder of the debtor had to buy the hostile Bank out to enable the parties proceed with the restructuring.

In the instant case, as an advisor to the Banks, some of the factors I would raise are as follows:

Why are the Banks suddenly not co-operating and is this an issue that can be managed? For instance, if they lack confidence in the management of the company, do they want to nominate individuals that would represent their interest in the management team? Secondly, if their exposures are too high, how can the exposure be reduced? Perhaps some good faith payments can be made to bring the exposure in tandem with all the Banks. Another factor that would be considered is the exposure of my clients (Banks A and B) and whether if they decide to also enforce, there is a high probability they would recover the debt (although to the detriment of the company)? Another important factor is given the failure of the projections, should the Banks also be keen on restructuring rather than enforcing? What is the probability of the company resuscitating the affairs of the company if the Banks choose to buy the Banks C&D out?

Subject to the answers to the questions raised, I would generally not advise my clients to buy out the other two Banks as it increases the exposure of my clients and there is no absolute guarantee that the company would start making profit particularly with the failed projections in the past. My advise would revolve around trying to address the rationale of the recent decision of Banks C & D to pull out of the informal restructuring, and if that is not productive, put pressure on the Shareholder to reduce the exposure of the Banks and if that is not also productive, we may all have to rush for the last slice of the pie and let the best man win.

**Answer to question 5:**

I would like to start by defining cross-border insolvency. A cross-border insolvency is a situation when insolvency proceedings are commenced in one sovereign jurisdiction (or state) against an insolvent debtor that has assets and/or liabilities in at least one other state[[5]](#footnote-5). As a result of the complexity that may arise in cross-border insolvency, the United Nations Committee on International Trade Law (UNCITRAL) adopted a Model Law on cross-border insolvency which was subsequently adopted by the General Assembly in a resolution of December 15, 1997[[6]](#footnote-6). This Model Law is simply a recommendation, not a convention and may be adopted in whole or in part. The key concepts of the Model law are: Access- providing access of foreign representatives and creditors to courts; Recognition- recognition of foreign proceedings; Relief- providing appropriate relief and Co-operation- facilitating co-operation with foreign courts and foreign representatives. The Model law has adopted several concepts such as COMI (Centre of Main Interest) and establishments similar to those contained in European Insolvency Regulation (EIR).

This background is necessary because a careful review of the Statement of Principles for a Global Approach to Multi-Creditor Workouts II are in tandem with the principles of The Model Law. Some of the principles that can be found in the work-out process of Flow Management are as follows:

The First & Second Principle- Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give limited time to the debtor to make a proposal, unless such a course is inappropriate in a particular case. The relevant creditors are also expected not to take any enforcement steps during the “stand still” period.

In the instant case, when the four banks were invited for a meeting by the management of Flow Management and the Management communicated the financial condition of the Company and the steps to manage the distress, the Banks did not raise alarm and seek to enforce any of their rights immediately. They actually agreed to a return meeting on December 1, 2013 with the interim condition that a firm is engaged to conduct an investigation into the affairs of the company. This shows that the Banks were willing to co-operate with the Company and give the Company some time to evaluate its financial position and make proposals to resolve its debt.

The Second Principle was applied in part because although the Banks refrained from taking steps initially, the Creditors failed to identify and deal with their conflicts and/or concerns which resulted in Banks C&D trying to pull out. Assuming their concerns were raised and dealt with early, Banks C&D may not have raised any objections at the later part of the restructuring because same would have been dealt with earlier.

The Fourth & Fifth principle can also be found in the instant case as the Banks had a representative and other appointed professionals who helped ensure free flow of information and also conducted a deeper investigation which revealed the accurate financial state of the company.

The Sixth and Seventh Principle can also be found as the company indeed made information available to the creditors even when the information was not necessarily profitable. At least, that openness and vulnerability (though some Banks lost the confidence in the management) showed some of the Creditors that the company was sincere and committed to the restructuring to the extent that some creditors were exploring buying out the other creditors. The Eight Principle which generally deals with post-commencement financing could also be found as 25 million was paid back to the providers of the (additional) working capital.

A careful review of the facts and Principles would reveal that Principle 1, 2, 3,4, 6, 7 and 8 could be found in the work out process of the company.

**Answer to question 6:**

Flowing from the answer in 5 above, the UNCITRAL Model law may also be applicable. Article 1 of the Model law provides for the scope of the law which includes-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 etc. Article 27 provides for the different forms of co-operation which includes coordination of the administration and supervision of the debtor’s assets and affairs; appointment of a person or body to act at the direction of the court; communication of information by any means considered appropriate by the Court etc.

Thus, if the parties are not able to adopt the Statement of Principles, the UNICTRAL Model law may be adopted.

**Answer to question 6b:**

In my jurisdiction, although soft law may be referred to the court or parties to adopt, it is entirely persuasive and at the discretion of the court or stakeholders. In the event that the creditors representing 75% of the exposure consent to the restructuring, it may be possible to bring an application for cram down against the dissenting creditors. Other alternative informal possibility would be to buy the dissenting creditors out in the interest of a peaceful restructuring.

In jurisdictions like the US, some of these Statement of Principles have already been codified in their domestic law which makes it easier to restructure suppose it’s not possible to convince the creditors to adopt the Statement of Principles. For instance, section 362 of the Bankruptcy Code provides for the worldwide automatic stay which comes into effect on the filing of any plenary petition and gives the debtor breathing room to negotiate and restructure as any act taken in violation of the stay (even if without notice of the stay) may constitute contempt of court.

**Answer to question 7:**

The general essence of an informal restructuring agreement as signed in the instant case is to achieve a win/win between the creditors and the debtor. In order to achieve this, there must be compromise on the two sides which was reflected in the agreement. Some of the clauses which reflect the compromise in favor of the Company are as follows:

1. Banks C& D took a hair-cut of at least 32.5 million.
2. The consortium took a waiver of about 97.5 million
3. The 55 million in Flow Management Work BV was cancelled in full

Some of the clauses which reflect a compromise in favor of the Banks include

1. Some of the shares of the company were transferred to the consortium of Banks (which was a form of debt-equity swap).
2. The holding company in good faith would cancel all claims against the company and its subsidiaries
3. All operating companies of Flow Management Holding BV would be accommodated in a shell subsidiary and the company would be liquidated in an undisclosed manner.

The four generic restructuring strategies bother on operational, asset, managerial and financial strategies; and clauses in the agreement reveal that the parties focused on operational, asset and financial strategy to restructure the facility.

The result of the executed agreement is not far-fetched. First it prevents the creditors from taking independent enforcement actions which could have resulted in receiving less than what they received through the restructuring agreement. The agreement also tried to address the exposures of all the creditors as opposed to some getting funds with no funds to the others. Furthermore, despite the operational loss incurred in May 2016, the debt reduction which was achieved through the restructuring agreement made the net profit positive and left light in the room for the company to resuscitate its activities.

Assuming the debt reduction was not achieved through the agreement and there was yet another loss in 2016, that they have been the last breath of the company.

**Answer to question 8:**

Having defined the term cross-border insolvency in question 5, it is not in dispute that this was a cross border situation as Flow Management Holding BV operating in Netherlands was the subsidiary of Lease Group Holding operating in the United Kingdom. More so, Flow Management Holding BV had about 6 subsidiaries in several jurisdictions including Spain, France, Australia, South Africa, USA etc.

Assuming a formal restructuring was adopted, some of the legal cross-border issues that would have arisen range from distinguishing main-proceedings from non-main proceedings, competent court authority particularly in view of the different jurisdictions, foreign representatives and domestic representative authorised in foreign proceeding, cooperation between the foreign courts, appropriate reliefs etc.

Thankfully, an informal restructuring was adopted so it reduced the potential legal cross-border issues that would have arisen. Some of the legal cross-border issues that would have arisen inspite of the fact that it was an informal restructuring would range from the appointment of the liquidator and the undisclosed manner in which the company would be liquidated. Since the company has subsidiaries in different jurisdictions and liquidation is a formal procedure with the guide of the court, some cross-border legal issues may arise in that restructuring process. The non-legal cross-border issue would range from the cancellation of the debts of Flow Management, the transfer of shares to the creditors and the incorporation of the shell subsidiary.

**Answer to question 9:**

A moratorium maybe described as the process of allowing a debtor to defer payment of its debts giving it room to resuscitate its business operations. According to Sir Kenneth Cork, companies in financial distress need a period when the dogs are called off to enable the debtor to recover a degree of equilibrium[[7]](#footnote-7). The general objective of a moratorium is to encourage corporate rescue while acknowledging the rights of the affected creditors. See Article 20 and 21 of the Model law.

In the instant case, four scenarios were drawn up and scenario 4 called for a formal moratorium or restart following liquidation with the company being sold in a ‘controlled’ manner. In my view, calling for a moratorium in an informal restructuring is generally a good option and in the instant case was a good option. The objective of calling for that moratorium is not a 100% guarantee that a rescue would eventually be achieved but it’s the attempt of creating room for the company to show that it can survive. Given the assets of the company and resources of its shareholders, it was a good option to call for a moratorium.

In the IBA case[[8]](#footnote-8), one of the issues the court had to resolve was whether as a matter of settled practice, the court should not exercise its power to grant an indefinite moratorium continuation where to do so would:

1. In the substance prevent the challenging creditors from enforcing their English law rights in accordance with the Gibbs Rule and/or
2. Prolong the stay after the restructuring has come to an end.

The Court held that it could not properly grant the indefinite moratorium continuation unless it was satisfied of two things: first, the stay would have to be necessary to protect the interests of IBA’s creditors and, secondly, the stay would have to be an appropriate way of achieving such protection.

This persuasive authority can be applied in my jurisdiction to guide the court or parties in calling or granting the moratorium. It is important to note the “situation at the time” when the options were being explored. From the facts of the case, it is apparent that the Banks were content with not only new management Flow Management, but they also noticed a slight result improvement due to the re-organisation.

Therefore, given the potential light at the end of the tunnel, it was a good option to call for moratorium at the time because it was necessary to protect the interest of the Banks by ensuring the assets are maximized and the call was one of the informal appropriate ways of achieving the goal.

**\* Thank you \***

1. [Financial Distress - Overview, Causes, and Remedies (corporatefinanceinstitute.com)](https://corporatefinanceinstitute.com/resources/knowledge/finance/financial-distress/) [↑](#footnote-ref-1)
2. Jahur, S.M & Quardir, N.M (2012). Financial Distress in Small and Medium Enterprises of Bangladesh: Determinants and Remedial Measure. Economia management, 15 (1), 46-61 [↑](#footnote-ref-2)
3. Kamel Mellahi and Adrian Wilkinson (2004)-Organizational failure: a critique of recent research and a proposed integrative framework [↑](#footnote-ref-3)
4. Resolving financial distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions 2006 [↑](#footnote-ref-4)
5. United Nations Commission on International Trade Law, Possible Future Work [↑](#footnote-ref-5)
6. UNCITRAL Guide to Enactment, p. 23 at para 16 [↑](#footnote-ref-6)
7. Cork, K. Cork on Cork (Macmillan, London, 1988) p. 195 [↑](#footnote-ref-7)
8. Description of the Gibbs Rule by Mr Justice Hildyard in the matter of the OJSC International Bank of Azerbaijan and the CBIR 2006- Bakshiyeva v Sberbank of Russia, et al (2018) EWHC 59 (Ch) at 44 [↑](#footnote-ref-8)