1. **What were in your opinion the causes of financial distress at Flow Management? Could the financial distress have been prevented? If yes, explain how. If no, why not?**
2. The root causes of Flow Management (“**Flow**”)’s financial distress were:
3. The failure of management information systems within the company; and
4. Poor management.
5. In Jan Adriaanse and Hans Kuijl, *Resolving Financial Distress: Informal Reorganisation in the Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions* (the “**Adriaanse and Kuijl Article**”), the authors analysed the most important causes of corporate decline in various countries (including the Netherlands and the UK) and concluded that (i) poor management, which they defined as the inadequate reaction of management to both internal weaknesses and strengths; and (ii) the presence of inadequate management information systems within the company (as a result of which important warning signals of imminent decline are missed by management).They then concluded that contrary to popular belief, it is not economic circumstances, but rather poor management and management systems that are the real causes of the problem.
6. It is apposite that Flow Management Work BV (“**Flow Management Work**”), the main subsidiary in the Flow group, is a Netherlands-incorporated company as the observations from the Adriaanse and Kuijl Article apply squarely here.
7. **The Failure of Internal and External Management Information Systems**
8. It is obvious that there was a failure of the accounting systems within the group, given the gross misstatements relating to, among other things, the booking of contingency gains and profit in 2012, which then led to large management bonuses being wrongfully issued on the false basis that the group was profitable when it was not. In fact, as we learn later in the case study, the group was suffering deep losses across its various subsidiaries.
9. Significant responsibility for the failure of the group’s internal accounting systems should also be attributed to the CFO and the internal finance team – which explained the bank creditors’ push for the CFO’s replacement.
10. However, there is also something to be said about the failure of external monitoring systems, in the form of the failure of the group’s auditors to spot the significant discrepancies and misstatements in the accounts.
11. In the much-publicised UK Brydon Report[[1]](#footnote-1), the purpose of an audit is defined as to “*help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements*”.[[2]](#footnote-2) Based on this definition, the auditors of the Flow group appear to have failed in their duties..
12. **Poor Management**
13. In Kamel Mellahi and Adrian Wilkinson, *Organizational failure: a critique of recent research and a proposed integrative framework* (the “**Mellahi and Wilkinson Article**”), the authors note that the “organization studies (OS)” and “organization psychology (OP)” perspectives of organisation failure is premised on managers being the principal decision makers of the firm. It would follow from this theory that the managers cannot escape responsibility for the failure of the firm.
14. Without downplaying the possible impact of external factors – the “new” company post-restructuring continued to incur operational losses- there are a few factors here pointing to the fact that the group’s management (including senior management) ought to take significant responsibility for causing the financial distress:
15. As discussed above, the CFO and the senior finance managers were responsible for implementing proper internal accounting systems but failed to do so.
16. However, the other members of senior management should also have probably been alive to and detected the errors in pricing formulas, given how fundamental this was to the group’s business. Based on the measures taken after the independent turnaround consultancy was engaged, it also appears that the staffing levels might have been too high and there were costs overruns (for e.g. for car repairs) and operational inefficiencies (poor loss recovery and excess premiums being lower than it should).
17. The management’s failure was exacerbated by what the Adriaanse and Kuijl Article calls the “*threat rigidity effect*”, which they broadly define as the management’s tendency to ignore the issues and delay intervention. That probably explains why it took the Flow group’s management – despite being under significant pressure from the creditors who pushed for the replacement of the CFO – almost a year (from when the problems were first discovered in November 2013) to unpack and correct the management information systems.
18. To take the point further, given that the 2013 profit figures likely formed the basis for the (large) management bonuses paid out to the CEO and CFO of Flow Management Holding BV (“**Flow Management Holding**”), this would have created a perverse incentive, or at least strong disincentivised the CEO and CFO from reviewing the accounting systems. In my view, this also underscores the importance of robust external accounting systems, *i.e.* via the auditors.
19. **Situation Might Have Been Avoided Had A Proper Audit Been Done**
20. While there can be a debate about the degree of responsibility borne by management in any organisation failure, in my view, the *key* cause of the financial distress (*i.e.* the failure of internal accounting systems) suffered by the Flow group could likely have been avoided by a proper external audit.
21. The need for a proper external audit is underscored by the fact that the creditors (including the bank creditors) would no doubt have relied on the audited annual reports as well as any periodic financial reporting by the Flow group, in conducting their own internal credit assessments and/or monitoring financial covenants etc.
22. While the recommendations contained in the UK Brydon Report is directed primarily at public listed companies, the conclusion that there is an urgent need for audit reform in order to increase confidence in business and increase the chances of preventing unnecessary corporate failures, is probably applicable here. While a detailed discussion of UK Brydon Report is beyond the scope of this answer, one of the recommendations is interesting: the introduction of the concept of “*professional suspicion*” (in addition to “*professional scepticism*”) into the qualities of auditing. In my view, given the extent of the misstatements in the accounts, the external auditors should have been expected to have detected them. Had they detected these misstatements early, and there was early intervention by the creditors (and perhaps the shareholder), there is a good chance that the financial distress might have been prevented.
23. **What are the 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?**
24. The Adiaanse and Kuijl Article defines[[3]](#footnote-3):
25. formal reorganisation as including all possibilities of reorganisation laid down by the insolvency law or which take place using legal methods and possibilities; and
26. an informal reorganisation as being understood to be a reorganisation route which takes place outside the statutory framework – therefore in the *shadow of the law* – with the objective of restoring the health of a company in financial difficulties within the framework of the existing legal entity.
27. As a preliminary comment, it is worth highlighting that informal workouts are often facilitated by the parties’ knowledge of the formal framework and processes which are in place, and which can be resorted to if informal workouts fail.
28. In that sense, both are symbiotic and the overall restructuring ecosystem of a particular jurisdiction will be shaped by the quality (in particular the sophistication and predictability) of the formal bankruptcy/restructuring procedures, as that will have a knock-on impact on the ability of stakeholders to engage meaningfully in informal workouts.
29. The dichotomy between informal and formal reorganisations may also be somewhat false. In my personal experience, it is critical in many restructurings to identify the point at which informal restructurings may be futile, and to swiftly invoke formal processes (for e.g. an application for a moratorium). Moreover, the possibility for an informal resolution does not cease upon the commencement of a formal bankruptcy procedure – frequently stakeholders can, and do, continue to negotiate in the *shadows* of the formal legal process.
30. That being said, the Adiaanse and Kuijl Article identified flexibility, silence and control as being the three (3) primary advantages of an informal workout:
31. Flexibility: Possibilities within the framework of informal reorganisations are said to be greater. In particular, the parties would not be constrained by what is contained in the legislation.
32. Silence: In essence, that the negotiated arrangements will be private and confidential. This may promote more candid and transparent discussions between the company and its stakeholders.
33. Control: Management can continue to fully run the company independently, without court scrutiny.
34. In addition to these, another important advantage of informal workouts is that it typically would involve less time and costs than a formal process, as the parties involved can determine the progress and outcome of the reorganisation themselves, without the need to worry themselves about factors such as the Court’s schedule. The importance of the reorganisation being concluded in a timely fashion cannot be understated. Anecdotally, reorganisations tend to have a higher chance of success if they are concluded quickly. The legal fees tend to be lower as well in an informal workout as there is no need to invoke the judicial process (see the Adiaanse and Kuijl Article at pg 147).
35. On the flipside, where there is a significant creditor or group of creditors who are uncooperative (holdout creditors) or unsophisticated, an informal process is likely to be inefficient and ultimately unsuccessful. An informal workout is also unlikely to be successful if there is a significantly risk of creditor “hold-out” due to the presence of creditor groups with widely differing interests.
36. Additionally, an informal process might also be unsuitable where the creditors have serious concerns about the management’s ability, or probity (for e.g.in case of suspected fraud etc). In such a situation, the invocation of a formal process will allow the creditors to preserve value in the company, as well as allow any duly appointed administrator of the company to conduct the necessary investigations as to the cause of corporate failure.

**Advantages and Disadvantages in Singapore**

1. Singapore has a fairly developed set of formal workout legislation as well as a sophisticated ecosystem of insolvency professionals and judges, which ought to attenuate some of the highlighted disadvantages of a formal process.
2. Further, Singapore has in recent years implemented (adopted from other jurisdictions such as the US and Australia etc) in its legislation various toolkits, such as the automatic statutory moratorium for companies intending to propose a scheme of arrangement, rescue financing provisions (which allows the Court to confer various degrees of priority to new monies furnished by a white-knight investor), as well as the provisions restricting creditors from enforcing *ipso facto* provisions (*i.e.* provisions allowing creditors to terminate or suspend contractual obligations on the occurrence of an insolvency event) against the company undergoing restructuring. These provisions, among others, represent concrete advantages that a company can avail itself of when it commences a formal procedure in the Singapore Court. These are advantages that would not be available (or at least difficult to achieve) in an informal workout.
3. An additional perspective / factor worth highlighting is that as a seat of Asian-centric restructurings, Singapore has to contend with the cultural element in Asia, where many large businesses continue to be (i) family-controlled and run; and (ii) there is perception that if a formal bankruptcy process is resorted to, there will be a loss of “*face*” or “*status*”, given the connotations associated with business failure.
4. Against that context, the “*silence*” (i.e. privacy and confidentiality) aspect of informal restructurings perhaps has greater salience, and many large Asian businesses facing financial distress prefer informal restructurings. All the more so given that many of these businesses are underpinned by close personal relationships built up over many years between the business owners and key creditors (for e.g. the onshore banks).
5. Ultimately, much depends on the needs of the particular restructuring (including those of the stakeholders involved), as well as the restructuring advisors’ ability to persuade their clients of the benefits of an approach.
6. **Were the turnaround/reorganisation approaches as presented in the reading materials applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently?**
7. Yes, many elements of an informal reorganisation as discussed in the Adiaanse and Kuijl Article were applied in the present case:
8. *First,* there was an attempt to restructure the business of the Flow group (in particular, Flow Management Work) ahead of any financial restructuring by:
9. *Stabilising* the core business by having discussions with the main clients about possible price increases (in light of the cost price calculation errors) and possible spending cuts and other measures aimed at conserving cash (specifically in respect of labour costs), both of which were meant to protect and increase the cash flow for the business;
10. *Analysing* the viability of the business by, among other things, bringing in external professional firms such as an accountancy firm as well as an independent turnaround consultancy – which culminated with concrete plans being drawn up;
11. *Repositioning* and *reinforcing* by removing the previous CEO and CFO of Flow Management Holding and appointing a new CRO. This was to ensure realignment with, and to reinforce, the intended objectives of the restructuring.
12. *Second*, as far as financial restructuring is concerned, various options were mooted and considered in terms of how to reorganise the capital structure of the company, as well as whether a sale of the business might be preferable to continuing as a going concern. The creditors of the group also agreed to revised terms, including the waiver of part of the debt/interest. The shareholder agreed to inject additional equity so that the solvency rate would be higher.
13. Likewise, the approaches discussed in Sudi Sudarsanam and Jim Lai, *Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis* (the “**Sudarsanam and Lai Article**”) were applied. See for e.g. *managerial restructuring* (replacing the CEO and CFO of Flow Management Holding and the appointment of a CRO); *operational restructuring* (reducing costs by implementing spending cuts and other measures aimed at conserving cash); *asset restructuring* (rather than the divestment of specific assets the restructuring here contemplates a going concern sale of the entire operating business of the group, by hiving off all the shares in the operating subsidiaries into a newly formed shell company); and *financial restructuring* (debt equity swap by transferring the shares in the newly formed shell company to the bank consortium).
14. Thus, in theory the restructuring in this case applied many aspects of the informal reorganisation approach advocated in the Adiaanse and Kuijl Article and the Sundarsanam and Lai Articles. However, given various challenges (for example intercreditor issues among the banks), it took some time for the business and financial restructuring to be properly implemented.
15. **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?**
16. There are a few possible reasons for Banks C and D’s behaviour:
17. The first is that Banks C and D had lost confidence in the ability of the shareholder / directors of Flow Management Holding and Flow Management Work, and therefore they might have been considering resorting to formal proceedings to enforce their rights (even though liquidation will diminish the value of the assets of the group) rather than continuing with the informal workout. It may also be that Banks C and D were unhappy with the pace of the informal discussions and were trying to push pressure on the other parties to progress matters.
18. The second possibility (not necessarily mutually exclusive with the first possibility) is that Banks C and D might have decided, either individually or collectively, that their refusal to cooperate with the other banks in the consortium might force Banks A and B to buy out their debts. We do not know the extent of the debts held by each of the banks in the consortium, but if Banks C and D’s debts are much smaller than Banks A and B’s, then there is a greater likelihood that Banks C and D’s internal credit departments might have given approval to write-down their debts (partially or wholly) in which case it might have made it easier for Banks C and D to decide to break ranks with the other banks in order to compel Banks A and B to buy them out. They might have also formed the view that even though there will be discount applied to the buy-out price, this is likely to offer better recovery than the outcome under any agreement reached pursuant to the informal workout (based on their own internal projections).
19. It is also possible that Banks C and D’s debt position was subordinated to Banks A and B (for e.g. senior secured creditors vs mezzanine) and they were trying to improve their negotiating position within the consortium.
20. We know from Banks A and B’s reaction in investigating whether it would be possible to buy out Banks C and D with a 15-20% discount that if Banks C and D had the intention at (b) above, then their conduct in ceasing cooperation achieved at least some of their intended effect.
21. If I were advising Banks A and B, I would have advised my clients to immediately engage the bankers at Banks C and D to try to ascertain the true reasons behind their change in behaviour.
22. If the concern on Banks C and D’s part was due to the lack of progress / lost in confidence in the informal discussions (*i.e.* the first possibility discussed above), then I would have suggested the expeditious formation of an ad-hoc committee representing the bank consortium in order to increase co-ordination between the banks: see Fourth Principle of the ‘*Statement of Principles for a Global Approach to Multi-Creditor Workouts II*’ (the “**Statement of Principles**”). The intention for the formation of the ad-hoc committee would be to increase co-ordination between the four banks and increase the pace of the negotiations, which would hopefully have assuaged some of Banks C and D’s concerns.
23. Of course, if Banks C and D had been willing to consider it, then I would have urged my clients to have them sign up to a Letter of intent to apply the Statement of Principles (see for e.g. Form 2, sample of Letter of Intent to Adopt Workout Principles contained in the World Bank Group’s *A Toolkit for Out-of-Court Workouts* (2016) (the “**World Bank Toolkit**”) at pg 87.
24. If, however, the intention of Banks C and D were strategic in nature (i.e. the second and third possibilities discussed above), then I would have advised my clients to impress upon Banks C and D that their attempts to improve their own negotiating position would be to the detriment of the bank consortium as a whole, and that if their conduct resulted in value destruction, this would likely affect the long-term commercial relationship between the two (2) bank groups, which would not be to Banks C and D interests given that the parties’ relative positions may be reversed in another case: see Commentary to First Principle of the Statement of Principles at pg 6.
25. Depending on whether it was commercially feasible to buy out Banks C and D, I might also have advised my clients to engage with Banks C and D over a possible buy-out of their debts, but only on the condition that (i) they worked with my clients to first agree a immediate standstill agreement with the company; and (ii) they agreed to the formation of an ad-hoc co-ordination committee to represent the bank consortium in progressing negotiations with the company and the shareholder. This would have ensured that as the parties negotiated the terms of the buy-out of Banks C and D’s interest, the informal workout with the company was not prejudiced.
26. **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 First Principle: Cooperation among the relevant creditors to give sufficient (though limited) time to the debtor in order to obtain information about the debtor, evaluate the information and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed.*

1. We see the bank creditors coming together at the end of 2013 to put pressure on the company’s management to (i) appoint an independent accountancy firm to investigate procedures within Flow Management Work; (ii) appoint an independent turnaround consultancy agency to review the viability of Flow Management Work’s business, both of which provided useful information about the company and allowed the bank creditors to better assess the prospects for restructuring.
2. All of the banks also agreed to grant forbearance by not taking legal action against the company and enforcing against the pledged assets.
3. The accounting firm and the turnaround consultancy agency were then given sufficient time to prepare their reports, but the banks charged default interest in order to put healthy (time) pressure on the company to facilitate the information gathering exercise and to progress matters.

*The Second Principle: During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or to reduce their exposure to the debtor but are entitled to expect their relative positions will not be prejudiced. Conflicts of interest in the creditor group should be identified early and dealt with appropriately*

1. In my view, the Second Principle was also substantially followed.
2. Although the bank group faced challenges agreeing to a standstill agreement due to, among other things, Banks C and D being uncooperative, in substance the bank creditors refrained from pressing from repayment of the debt (save for default interests to place healthy pressure), did not seek to (at least expressly) improve their individual positions by enforcing security or seeking preferential treatment, and did not terminate the credit lines (although this might have been due to the issues with the perfection of security), until the formal 120-day standstill agreement was signed in August 2014.
3. It was unclear whether the standstill agreement was subsequently extended, though the informal reorganisation continued until 4 July 2015 when the restructuring agreement was signed. Again, the bank group did not appear to have taken any steps in breach of the Second Principle in the period following the expiry of the 120-day standstill period until the signing of the restructuring agreement.

*Third Principle: During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors*

1. The debtor did not take any steps in this case which affected the prospective return to the relevant creditors. In fact, there appeared to have been engagement between the management of the company and the creditors, and the management/shareholder of the Flow group had injected further capital into the group, which would have improved the solvency position of the group.

*Fourth Principle: The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty*

1. As discussed above, there was no formal or ad hoc coordination committee formed, nor any co-ordinator appointed, though there was some degree of co-ordination among the banks in the bank consortium, save for the issues with Banks C and D.
2. What was notable is the fact that despite the lack of an actual coordination committee, the banks managed to collectively exert pressure on Flow Management Holdings to appoint a CRO, have the company agree to furnish 10m Euros in tax refunds as additional security, and have the management of Flow Management Holdings improve the quality and accuracy of the financial and operational information coming from the group.
3. Therefore, in effect, I would say that the banks overall managed to achieve a decent level of co-ordination in their interactions with the debtor.

*Fifth Principle: During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.*

1. There appeared to have been a genuine attempt by the debtor to furnish the relevant creditors access to information regarding its assets, liabilities, business and prospects, including allowing access to independent third-party professionals (for e.g. an independent accountancy firm and an independent turnaround consultancy agency). These independent parties helped to provide updated information on the financial position of the group, as well as an analysis of its business prospects and viability. A review of the management information system was also conducted and steps to improve the system appear to have been taken.
2. It did take a bit of time in order for the quality of information to improve, as the existing management of Flow Management Holdings remained in place for a while (see Mellahi and Wilkinson’s “*threat rigidity effect theory*”) until the eventual appointment of the CRO (which then probably expedited the quality and speed of the information flow).

*Sixth Principle - Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.*

1. It is unclear from the case study whether the sixth principle was followed, though it is observed that the contents of the eventual agreed financial restructuring agreement reflected the relative positions of the financiers involved. Among other things, it would appear that the secured creditors received part of their claim on liquidation, whereas the other unsecured or subordinated creditors received nothing. This would appear to be consistent with the relative positions of the different classes of creditors in a liquidation scenario – as the group appear to be either insolvent or very close to insolvency.
2. The 120-day standstill agreement signed in the middle of August 2014 appears to only have applied to the banks, and the standstill did not appear to have affected their relative positions vis-à-vis one another.

*Seventh Principle - Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.*

1. Within the bank group there appeared to have been parity of information, though the quality of the information, particularly in the earlier phases of the reorganisation, was lacking. The banks within the bank group also appeared to have kept the financial and operational information about the group confidential.
2. However, this information did not appear to have been shared with the wider group of creditors (either unsecured or subordinated).
3. It is interesting to note that there were press releases issued by the group (see press release by the CRO at the end of June 2014; press lease on 31 October 2014) even though the group is not publicly listed. One reason for this could have been that given that much of the negotiations in the informal reorganisation had mainly involved only the bank creditors, there was a need to update the wider group of stakeholders, for example employees as well as trade creditors, given the scale and geographical scope of the group’s operations. Some of the proposed restructuring measures also involved possible price increases / spending cuts as far as labour costs, so there might have been a need to keep this wider stakeholder group engaged and informed about the progress of the group’s restructuring, and also to manage these stakeholders (for e.g. any trade unions etc).

*Eighth Principle - If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.*

1. This was followed to some extent – for instance in January 2015 a total of 25m Euros was paid back to the providers of the additional working capital. Further, we are also told that under the restructuring agreement, the additional working capital which was made available on the transfer of shares was supposed to be refinanced in November 2016, though it was eventually delayed until July 2017 to prevent liquidation. It would thus appear that the providers of these additional working capital were accorded priority treatment.
2. It is unclear whether the 10 million Euros deposited by the former CEO of Flow Management Holdings was repaid in priority.
3. **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?**
4. As explained by Bob Wessels & Gert-Jan Boon, *Soft law instruments in restructuring and insolvency law: exploring its rise and impact* (2019) (“**Wessels & Boon**”), “*soft law*” instruments are developed by standard-setting organisations, mainly by international intergovernmental groups (*i.e.* usually states), or what the authors call “*informal standard-setters*”, *i.e.* by gatherings of insolvency practitioners, academics and/or judges, assembling best practices.
5. There does not appear to be any alternative international “*soft law*” instruments which can be used – the International Insolvency Institute (III) Committee’s Guidelines for Coordination of Multinational Enterprise Groups are focused on the coordination of formal insolvency processes – and is not applicable here.
6. One potential resource is the World Bank Toolkit, which not only covers tools for policy makers to develop corporate restructuring legislative frameworks, but also contains useful checklists and guidelines for both corporate debtors and creditors.
7. In particular, Chapter 2 of the World Bank Toolkit sets out some of the preconditions and practical steps that help productive workouts, as well as the tools needed to conduct an effective workout. Key steps and principles such as the need to create a standstill agreement, the importance of confidentiality, the need to properly value the debtor’s assets etc are all highlighted in the Toolkit. Further, the World Bank Toolkit also contains useful sample documents which are typically used in a workout, including sample confidentiality and standstill agreements etc.
8. Even if the other creditors were unwilling to adopt the Statement of Principles generally, they might be willing to enter into specific arrangements – for e.g. a confidentiality or standstill agreement if they consider it to be in their interests. This is where the World Bank Toolkit might come in handy, allowing the creditors to pick-and-choose whatever tools / sample documents which are useful for their purposes.
9. Although it is probably not entirely pertinent to the case study given that none of the companies in the Flow group are in Asia, I note that the Asian Bankers Association’s Informal Workout Guidelines, specifically its *Model Agreement to Promote Company Restructuring: A Model Adaptable for Use Regionally, by a Country, or for a Particular Debtor*, might also be helpful (particularly if any of the Banks are Asian banks), given that the Model Agreement is designed to be modified/adapted for use in different contexts. For instance, Clause 6 of the Model Agreement establishes the protocol and procedures to constitute a workout committee, and sets out the role of the chairman, the functions and powers of the committee, as well as how to conduct proceedings and pass resolutions of the committee, while Clause 7 sets out the steps for the implementation of a standstill.
10. Ultimately, I would observe that while there are various “*soft law*” options creditors can have recourse to, most of them espouse broadly similar (and universally applicable) principles to what is contained in the Statement of Principles. Whether they are adopted will depend on the appetite and level of sophistication of the creditors involved.
11. **Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015**
12. The effect of the 4 July 2015 restructuring agreement is as follows:
13. Flow Management Holding’s shares in its six (6) operating subsidiaries are hived off (*i.e.* transferred) to a new shell company, *i.e.* Flow Management II.
14. The shares of Flow Management II are then transferred to the bank consortium who financed the working capital of Flow Management Work, as well as a number of board members (including the CRO), presumably as an incentive payment for their roles in the restructuring.
15. In exchange for the shares in Flow Management II, the bank consortium wrote-off:
16. part of the debt owing by Flow Management Work for financing of its working capital, amounting to 97.5 million Euros; and
17. the debt owing by Flow Management Work for other loans amounting to 55 million Euros.
18. Thus, as far as the bank consortium is concerned, there is a debt for equity swap, *i.e.* they compromised the above debts in exchange for shares in Flow Management II.
19. As far as Flow Management Holding is concerned, given that it no longer owned the shares in its operating subsidiaries (presumably these are its only assets), it was liquidated. To facilitate the liquidation of Flow Management Holding, the restructuring plan required the banks and the shareholder to give up all claims against this entity. This included the claim by the shareholder for the 10 million Euro loan she deposited into Flow Management Holding as an unsecured loan at the end of March 2014.
20. Flow Management Holding and the shareholder also cancelled any claims they might have against Flow Management II and its subsidiaries. The purpose of this is probably to ensure that Flow Management II is “*clean*” and free of any liabilities, which would then help facilitate an eventual sale by the banks of their stake in Flow Management II.
21. The additional loans provided by Banks C and D to Flow Management Work amounting to 32.5 million Euros were entirely written off - it is not clear from the Case Study but this could reflect the fact that these loans were unsecured and therefore “*out of the money*” in any event in a liquidation.
22. At the Flow Management Work level, a 240 million Euros claim by the bank consortium who provided the original working capital remains – this probably reflects the secured claims possessed by the banks against the assets of Flow Management Work.
23. Ultimately, the 4 July 2015 restructuring agreement created a new company to hold the valuable assets of the company, a significant portion of the debts against Flow Management Work (one of the operating subsidiaries transferred to the new company) were written off, the creditors who had secured claims were given equity in exchange for a partial compromise of their claims, and all claims against the new company and its subsidiaries were waived – all of these helped improve the solvency rate of the new company in order to facilitate a sale of the new company as a going concern.
24. The unsecured (and subordinated) creditors took a total write-off, and the shareholder lost the value of its investment in Flow Management Holding.
25. **Which (potential) legal and/or non-legal cross-border issues – if any – do you recognise in the Flow Management Restructuring process?**
26. Both Flow Management Holdings and Flow Management Work likely have their centre of main interests in the Netherlands, given that that is where the registered offices were, and (it would appear) the administration of the both companies were conducted out of.
27. Further, the other subsidiaries of Flow Management Holdings are incorporated in other jurisdictions: Spain, France, Australia, South Africa and USA etc. It may be possible that the banks had security interests against assets held by some of these foreign subsidiaries, and the banks and/or some of the other creditors of the group may also have direct claims against these subsidiaries. It is notable that at least three of these subsidiaries, *i.e.* Australia, South Africa and the USA are not EU States, and thus not party to the European Union Insolvency Regulation.
28. Given that many of the other creditors of the group (for e.g. trade creditors, suppliers, employees and independent contractors etc) were not directly involved in the informal restructuring negotiations with the management of Flow Management Holdings and Flow Management Work, and given the impact of the proposed operational restructuring measures (such as redundancies, price increases etc), there is a risk of legal action, including litigation and/or winding up proceedings commenced by these other creditors, including in the foreign jurisdictions where the group’s assets are located.
29. In the standstill agreement agreed to between the banks and Management Holdings and/or Flow Management Work, consideration should be given to restraining possible enforcement action by the banks outside of the Netherlands as well. Presumably these 4 banks would have a presence in the Netherlands and thus the Netherlands Court would have personal jurisdiction over them – thus a breach of the standstill agreement may be enforceable against the banks via the Netherlands Court, including recourse to injunctive remedies such as an anti-suit injunction (assuming such remedies are available under Dutch Law).
30. In my view, the more difficult issue relates to the other creditors with claims against the other subsidiaries of the group, in particular the Australian, New Zealand and US subsidiaries. These creditors do not appear to be part of the relevant group of creditors engaged in discussions with the group’s management, nor do they appear to be part of the negotiations regarding a standstill agreement. Accordingly, there is a risk that legal action, including employee claims / winding up proceedings / general litigation claims etc might be taken out against the relevant foreign subsidiary. Such actions could jeopardise the restructuring and reduce the value of the group’s assets.
31. Therefore, an assessment ought to be conducted on the risk of such legal/enforcement proceedings, and if the risk is high, then perhaps an application for a court order restraining such actions (i.e. a moratorium) might be necessary. Such a moratorium might also be required for Flow Management Work, insofar as it has foreign assets at risk of enforcement action. If so, then thought should be given as to whether the foreign asset is in a jurisdiction that has implemented the UNCITRAL Model Law on Cross Border Insolvency: if so, then one possibility is to commence proceedings in the Netherlands and recognising the proceedings as a foreign main proceeding in that jurisdiction. Otherwise, Flow Management Work can consider applying directly to the courts of that foreign jurisdiction for protection.
32. As for the foreign subsidiaries, the issue there appears to be that the financial restructuring appears to be conducted at the parent level, *i.e.* Flow Management Holding, and at Flow Management Work. So, depending on the specific laws of the relevant jurisdiction, there may be some difficulty in justifying a moratorium for the foreign subsidiaries themselves, unless the relevant laws allow a moratorium to be granted in respect of the subsidiary on the basis that there is a group restructuring going on. Even then, in jurisdictions such as Singapore which allows related-company moratoriums to be granted in support of a group restructuring, this is predicted on the subject company (i.e. Flow Management Holding) itself also applying for a moratorium. Thus, this might be a difficult challenge if there is a significant risk of legal/enforcement action by the creditors of the foreign subsidiaries.
33. The UNCITRAL Model Law on Enterprise Group Insolvency might be relevant here, as it contains provisions on coordination and cooperation between courts, insolvency representatives and a group representative (where appointed), with respect to multiple insolvency proceedings concerning members of an enterprise group. Importantly, it allows relief to be granted upon the recognition of a foreign planning proceeding, including the staying of execution against the assets of the enterprise group member. That being said, it does not appear that any of Australia, New Zealand or the US has adopted the Model Law on Enterprise Group Insolvency.
34. The restructuring agreement also contemplates the transfer of shares in the operating companies by Flow Management Holding to a shell company, Flow Management II BV (“**Flow Management II**”). Given that the conflict of laws rules of most jurisdictions will usually point to the jurisdiction where the shares are issued as the law governing the transfer, there ought to also be an analysis on whether the transfer of shares do not raise any issues of local law.
35. A related issue that might arise is the need to comply with the applicable local labour/union laws, given the contemplated retrenchment of workers. There might also be strikes etc. These labour issues are both legal and non-legal, and will need to be dealt with in order not to undermine the enterprise value of the group.
36. **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?**
37. In my view, the feasibility of the option of calling for a moratorium is heavily dependent on the views taken by the Banks regarding this approach, given that they are the main/biggest/most significant (given their security interests) creditor group driving the restructuring.
38. As things stood in October 2014, it would appear that the Banks were dissatisfied with the pace of the restructuring so they would unlikely have been willing to agree to a formal moratorium, which may have delayed matters further (given the need to invoke the formal court processes etc). Further, given that the banks had already in the middle of August 2014 signed a 120-day standstill agreement, which would have expired only in December 2014, it would have made more sense for the parties to simply negotiate for an extension to the existing standstill agreement instead.
39. From the banks’ perspective, given that there does not appear to be any real need for a formal moratorium (since the Case Study does not mention the risk of any pending legal / enforcement proceedings by any other creditors), this will allow them to continue to place healthy pressure on the group to progress the restructuring and on LGH to inject further equity capital in order to convince the banks to formally agree to extend the standstill agreement and/or informally continue to forbear from exercising their formal legal rights. From a control / strategic perspective for the banks, keeping the restructuring informal would have ensured that they retained as much control over the restructuring as possible.
40. In any event, it would appear that under Dutch law, a moratorium can only be initiated by the debtor company: see European Monitoring Centre on Change: *Netherlands: Rescue procedures in insolvency*
41. Additionally, an application to Court for a formal moratorium is likely to also entail the need to publicly (in court papers etc) disclose confidential details about the restructuring proposals, which the banks, as well as the shareholder, might not have been comfortable with.
42. From the group management’s perspective, an application for a moratorium would only be a feasible option if they came to the view that they were likely to lose the confidence of some or all of their bank creditors (perhaps given the press release on 31 October 2014 that the expected loss for 2014 will rise to 39 million Euros), and there was a real risk that one or more of the banks might choose to take enforcement action. If so, then a formal moratorium might help to buy the group management some time to further engage the dissenting banks, provide the information requested for by the banks, and furnish additional security (as they did via the 10 million Euros of tax refunds) or inject additional equity capital.
43. However, the group’s management might be resistant to initiating a moratorium given that under Dutch law, a receiver is appointed[[4]](#footnote-4), who will govern the finances of the relevant company and is then given the mandate to negotiate with the creditors. Given the central role played by the shareholder in the restructuring (contributing additional capital; agreeing to share dilution etc), this might not be palatable to the group.
44. Further, in any event, the need for the receiver is also somewhat reduced given the appointment of a CRO and a new management, all of whom appear to be independent from the previous management and is likely to have a greater degree of trust from the creditors.

1. Report of the Independent Review into the Quality and Effectiveness of Audit [↑](#footnote-ref-1)
2. Pg 7 [↑](#footnote-ref-2)
3. See pg 54 [↑](#footnote-ref-3)
4. See Netherlands: Rescue Procedures in insolvency (European Monitoring Centre on Change: https://www.eurofound.europa.eu/observatories/emcc/erm/legislation/netherlands-rescue-procedures-in-insolvency) [↑](#footnote-ref-4)