**Table of Contents**

[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? 1](#_Toc86993157)

[2. 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? 3](#_Toc86993158)

[3. 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. 5](#_Toc86993159)

[Adriaanse and Kuijl 5](#_Toc86993160)

[Sudarsanam, S, Lai, J 6](#_Toc86993161)

[Schmitt and Raisch 9](#_Toc86993162)

[4. 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? 11](#_Toc86993163)

[5. 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)? 12](#_Toc86993164)

[6. 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, o you see any alternative (informal) possibilities? 14](#_Toc86993165)

[7. Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015. 15](#_Toc86993166)

[8. Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process? 16](#_Toc86993167)

[EIR Recast 16](#_Toc86993168)

[UNCITRAL Model Law 17](#_Toc86993169)

[Others 17](#_Toc86993170)

[Non-legal issues 17](#_Toc86993171)

[9. 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] 18](#_Toc86993172)

[The Dutch Scene 18](#_Toc86993173)

[The Indian Scene 19](#_Toc86993174)

[10. Appendix 20](#_Toc86993175)

###### 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?

Flow Management as a group were making losses at three levels: holding company, the main Dutch operating subsidiary, and other foreign subsidiaries. I attempt to answer the question in case-study in terms of Mellahi & Wilkinson, 2004 (M&W) below, but first a criticism by M&W is in order. They state, “case study research on organizational failure has clearly informed the current state of knowledge, without the analytical leverage provided by ecological and environmental approaches to large organizational populations it would not be possible to draw conclusions regarding the broad environmental dynamics that set the context within which managers in individuals organizations operate”.

True to M&W criticism of case-studies, the Flow Management one too, does not dwell on the broad environmental dynamics other than the fact that there are at least three other players in the industry. Thus, the industrial organization (IO) and organization ecology (OE) aspects cannot be applied strictly based on information given and create hindrance to use the framework of interaction as suggested by M&W. The analysis in the next few paragraphs is based on the voluntaristic view i.e., organization studies (OS) and organizational psychology (OP) and thereafter I attempt usage of M&W framework.

M&W quote Barmash that “corporations are managed by men; and men, never forget, manage organizations to suit themselves. Thus, corporate calamities are calamities created by men.” M&W also quote Macoby and in turn his description of narcissistic managers of ignoring words of caution seems to be true in this case though not explicitly stated in case. Several of the middle range theories of OS/OP school can be observed here.

Groupthink – It’s the tendency of small groups to make sub-optimal decisions. Once groupthink sets in host of vulnerabilities come to the fore which includes collective rationalization, over estimation of the group’s chances of success and biased information processing. The result of groupthink, alongside observation of Barmash can be seen at the Flow Management Holdings BV (FMH), wherein contingency gain of three years and book profits were included in financial accounts in violation of accounting rules (conservatism). Thereafter, based on the resultant inflated profits management bonuses too were distributed.

Upper Echelon Theory – The character of key decision makers influence strategy and heterogenous groups are more effective than homogenous ones. The need for equity capital was apparent; however, the top management did not infuse any and later provided subordinated debt which increased the accounting interest burden. Infact, in one instance the CFO of shareholding company offered to sell 350 cars to increase solvency. This is like Marks & Spencer case wherein management failed to diagnose cause of failure. It seems management without detailed analysis was convinced about the wisdom of organizations’ ways. Another example was that no external party was tasked to study the cost price calculation problem; the accounting firm was to investigate the procedures and the turnaround consultancy was studying a narrow sliver for viability i.e., turnover and market share.

Threat Rigidity Effect Theory – This too is observed in the case study as status quo was maintained despite discovering the problem at Flow Management Work (FMW). A kind of cognitive inertia was established; management dependent on their mental models that they fail to notice changes in material conditions, an example from case is in January’14 the intention was to restructure foreign subsidiaries, at end of March’14 the idea was to sell shares of companies in non-Benelux countries, but nothing happened till July’15 when restructuring agreement was signed. Brown and Starkey psychodynamic factors namely fantasy too seems to be in play here as price increases and cost rationalisations that were identified in December 2013 were not implemented till October 2014. An element of denial and rationalization too can be noticed as the management never offered to return the excess bonus awarded; in effect disclaiming responsibility and possibly justifying their behaviour.

A combined outcome of all the aforesaid three theories is the likely reason for error in the spreadsheet used to calculate cost price. It is highly improbable that the error got introduced in 2013. It is likely that the error is carry forward of 2012, because of which the restated loss was higher by €1.1M but did not come to fore due to aggressive accounting by management. Moreover, the forecasted accounting numbers were fluctuating wildly which exhibits that the status quo accounting systems had a deeper structural problem.

Thus, based on the limited information of case strictly from OS/OP perspective if management had been prudent and did not suffer from hubris, steeped itself into diligent analysis, was amenable to change existing status quo and restructured timely it is possible that financial distress may have been prevented.

However, M&W nudge us that for better understanding it is necessary to understand the external factors i.e., deterministic role of environment. According to their framework environmental or organizational factors can have an independent effect on failure in extreme cases only. The framework states that the same internal environment will yield different results in varying environments. Thus, at the very minimum it begs us to ask two pertinent questions;

1. Why were there losses across all geographies? Was there an overarching factor that resulted in losses across and
2. Why was the management not able to pass on price increases & effect cost rationalisations? Were there any external factors inhibiting this process?

The case-study has “missing-information” of external environment but substituting the missing with a common-sensical environment variable, one reaches a conclusion that even if management would have acted in text-book manner the financial distress could not have been prevented.

This is because an extreme event in the form of “Ubers” had taken to the street around 2012; an aspect of threat which the upper echelon group thinkers would have dismissed initially and in a rapidly changing environment (associates as drivers and not employees, incentivised payments, payments outside of collective union agreements, possibility of private individuals providing taxi service etc.), by the time they decided to act the organization capacity to act was undermined i.e., rigidity had taken effect. The press releases by a private company also alludes to such a scenario. The press releases were possibly to draw the attention of regulators and law makers to the disruption brought in business by such newcomers. Thus, in the era of unprecedented extreme change the financial distress could not have been prevented.

###### 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?

* Formal bankruptcy procedures (“FBPs”) include all possibilities of reorganization laid down by the insolvency & bankruptcy law (“I&B”) or which takes place by using legal methods. Out of court restructuring (“OCRs”) takes place outside the statutory framework, in the shadow of law. However, OCRs to be effective need existence of I&B to act as an indirect inducement or a deterrent.
* OCRs are flexible and thus bespoke solutions can be arrived at between company, management, and creditors. FBPs are rigid and are to be carried out in accordance with law.
* OCRs take place in relative silence without stigma of bankruptcy. This allows company to carry out business as usual and does not lose its bargaining powers vis-à-vis suppliers and clients. FBPs require public announcements and notices which result in unwillingness of various stakeholders to deal with company and creates a vicious cycle of self-fulfilling prophecy
* OCRs allows debtor to be in control even in creditor friendly insolvency jurisdictions. FBPs irrespective of who is in creditor i.e., debtor or creditor usually requires appointment of an overseeing authority i.e., an insolvency professional / administrator / trustee etc.
* OCRs save on legal costs, reduces burden on courts and can be accomplished at a pace decided between creditors and debtors whereas FBPs are expensive
* OCRs are easier when the company has few large bankers and/or financiers. FBPs are preferred where the company has too many dispersed creditors
* Whilst OCRs is being attempted the debtor may require financing. The priority of such financing needs to be decided contractually. Additional financing under FBPs is dictated by terms of I&B.

OCR vs FBP in India

India had a history of numerous OCR frameworks before the insolvency code was enacted in 2016. The perceived misuse of OCR, including allegations of corruptions, and the consequent investigations veered the financiers to FBP. However, the delays in FBP, primarily arising due to the infancy of code, coupled with effects of Covid-19 has moved the needle back slightly and financiers in some cases are favourably considering OCR.

OCR in India is not “truly” informal; it is governed by Reserve Bank of India (RBI) which is India’s central bank and is the regulatory authority for banks. The relevant notification of RBI is called, “Prudential Framework for Resolution of Stressed Assets” and allows for restructuring, sale of loan exposure or change of ownership amongst others. For aggregate loan exposures of INR 15 billion and above the guidelines mandates a resolution plan in 180 days failing which there are penalties, provides for inter-creditor agreement (ICA) and allows cram down i.e., a decision by 75% by value and 60% by number is binding on all.

Appended are the disadvantages and advantages of OCRs vs FBPs in India

* India has a unique clause in its I&B, i.e., the persons who were in control of a company that was subjected to FBPs are barred to submit a resolution plan for the company. In case of FBPs this effectively deals a *fait-accompli* for owners whose business may have gotten effected due to external factors. OCRs provides a way out wherein the owners can still hold on to their businesses provided the lenders/financiers are of the opinion that the distress is not due to current management / ownership. In the current post-covid environment, in several cases, bankers feel that a known devil is better than an unknown angel.
* OCRs can be invoked even before a default takes place; thus, allowing to act in advance and utilise those extra days which are very crucial when a company is in financial distress. FBP kicks-in not only after a default but also after the default is admitted by the court. Thus, crucial days are wasted in which bleeding of debtor could have been stopped. (A draft law for pre-pack framework which can be invoked before default and will be categorised under FBP is on table, but it has not been legislated; this OCR advantage will cease once it is legislated.)
* OCR being governed by RBI leaves out other providers of finance that are not governed by RBI such as mutual funds, insurance companies, public markets etc. Thus, such entities sometimes refuse to be part of ICA and are not bound by cram-down. This is a major disadvantage of OCR. On the other hand, all types of providers of finance are bound by FBP.
* OCRs do not provide for moratorium though the signatories to ICA agree on a stand-still. This creates the risk of a non-RBI governed financial creditor or an operational creditor filing an application for FBP. Such a scenario can be spoilsport to the agreement if any between the RBI governed financial creditors and corporate debtor. FBP on the other hand has certainty of moratorium and thus gives the window for restructuring the affairs of debtor without any enforcement risk.
* OCRs in most cases do not provide for debt waiver; it is predominantly debt and interest payment deferment. This may thus not be an ideal scenario where the capital structure of corporate debtor is not robust. Therefore, in cases where the capital structure needs a change, FBP may be preferable, as it gives the incoming resolution applicant a chance to wipe of unsustainable portion of debt.

However, in the post-covid world of excessive liquidity, OCRs are possible for certain industries as they have been able to raise equity from PE investors.

###### 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.

On a macro level several approaches of Adriaanse and Kuijl as well as Sudarsanam and Lai were applied though several suggestions were not adhered to. However, application of Schmitt and Raisch was not evidenced to the same extent. Appended below is analysis of each of the authors.

Adriaanse and Kuijl

The case of Flow Management was an informal reorganization in the shadow of law outside the statutory framework. The authors suggest that it is impossible and undesirable to carry financial restructuring without operational restructuring; an attempt was made to restructure operations, however the effort was delayed as no progress was made till June 2014 and thus FMW continued to have losses.

The authors describe four overlapping phases of business restructuring:

* Stabilizing i.e., a phase that requires steps to be undertaken to increase cash flow by instituting cutbacks and optimising revenue.

In the case, the steps to be taken were identified by Flow Management they were not implemented properly.

* Analysing i.e., a phase that entails drawing up a realistic reorganization plan with inputs from providers of capital, both debt and equity. To give credence to the plan usually external consultants are deployed and may involve infusion of subordinated capital.

In the instant case a reorganization plan was proposed though working out final contours took time, sub-debt of €10M was infused with a slight delay, external accountant firm was appointed to investigate procedures, independent turnaround consultant was hired to analyse market share and turnover and in May 2014 a Chief Restructuring Officer was appointed.

* Repositioning, the third phase requires that the value destruction process stops and the first steps towards reorganization are taken with timely reporting to interested parties.

In the case the first steps taken towards re-organization were half-hearted i.e., analysis but no action. However, transparent reporting did start both to lenders and the shareholder i.e., Lease Group Holding in the United Kingdom.

* Reinforcing, the last phase requires reinforcing not only the balance sheet but also the management and thus necessitates evaluation of current management

The evaluation of management was undertaken, banks wanted replacement of CFO though in April 2014 the CEO of FMH was replaced. However, reinforcement of balance sheet was of a lower quantum than required. However, in July 2015, indirectly through financial restructuring i.e., debt waiver, the balance sheet was reinforced.

* Financial restructuring in terms of informal reorganization means that creditors voluntarily commit to revised terms of funding including debt-equity swap. Also, if new funding is required it is provided by debt or equity holders.

In the first instance i.e., December 2013 the creditors deferred repayments and pressurised shareholders to infuse money which the shareholders did with some delay by way of subordinated debt. However, once the restructuring agreement was signed it provided for debt remission, both of working capital and other loans, converting of risk avoiding capital to risk bearing capital by taking ownership of Flow Management II BV, and cancellation of claims of shareholders and holding company. During the process there was transparency by the company with financiers though the numbers were diverging from forecasts again and again.

The authors also list out success factors from the experience in Netherlands and United Kingdom. Basis those factors a focus should have been business restructuring i.e., appointing turnaround consultants not only to analyse turnover and market share but also to implement the revenue enhancement and cost reduction measures. Furthermore, there should have been a more active attitude of management and shareholders and risk-bearing capital should have been infused in time. Finally, there was a breach of trust between the creditors and company and amidst creditors due to variance in numbers. Thus, a concerted effort should have been made by all the stakeholders to create trust amongst them.

The authors also list out of advantages of informal reorganization. Some of them were evidenced in the case but one of them i.e., “Silence” was surprisingly missing

Flexibility – The process is less rigid, companies, entrepreneurs and creditors can reach mutual agreement and tailor-made solutions can be devised. This was evidenced by the contours of final restructuring agreement wherein all the operating companies were transferred to a new entity with bankers as shareholders, the holding company shell was to be liquidated and presumably a sustainable debt was left on the balance sheet with the excess being written-off.

Silence – Informal reorganizations take place outside the limelight of public procedures and thus are conducted in silence. Silence helps in negotiating terms with suppliers and customers as the case would have been in business-as-usual scenario. It may also lead to a race-to-collect and thus the situation turns into a self-fulfilling prophecy.

Surprisingly, for a private company, Flow Management chose press releases to communicate that the company was loss making. This was possibly a reason because of which the planned operational reorganization steps of price increases and cutbacks could not be implemented. Thus, the management should have remained quiet on the losses.

Control – The last advantage is that management can continue to run the company independently in an informal reorganization which saves costs (legal) and determines the speed alongside outcome of reorganization. This was evident in the case too.

Sudarsanam, S, Lai, J

The authors primarily raise a few questions on strategies of recovery and non-recovery firms i.e., whether the firms that recover adopt different turnaround strategies, do they differ in intensity and timing of strategy and which strategies contribute to corporate turnaround?

The authors draw a conclusion that recovery and non-recovery firms adopt similar strategies, but their strategic choices differ. The recovery firms are focused on growth story, investment and acquisition whereas the non-recovery firms are internally focussed on operational and financial restructuring.

In the authors opinion fall of a firm usually is on account of problems of management and strategy and on the basis other studies in the field the authors state that restructuring strategy will depend on amongst others capital structure, bank relationships, block shareholders, and managerial shareholding.

In the case of Flow Management there was no external world view. Till the very end the companies were focussed on operational and financial restructuring. No strategic choices were made to change the business model, tie-ups, acquisitions, mergers. The management could not bring in a fresh perspective.

Top management change is widely perceived as a panacea for turnarounds. In the case-study too, banks in December 2013 were wanting measures against CFO, in April 2014 the CEO was changed and in May 2014 a chief restructuring officer (CRO) was brought in. However, in the authors opinion based on stock market reaction there is no conclusive proof of top management changes on turnarounds.

According to authors empirical studies support overlapping two stage approach between efficiency/operating turnaround (operational restructuring) and entrepreneurial/strategic stage (asset restructuring) for a successful turnaround.

Operational restructuring is the initial firefighting; the first stage being cost reductions, the second revenue enhancement and the final operational non-core asset reduction. The authors state that whether operational restructuring in itself leads to recovery from bankruptcy remains to be tested. In the case-study, the levers were identified for cost reduction (employees & contractors to be made redundant), revenue enhancement (price increase and loss recovery), and asset reduction (sale of shares outside Benelux, business mix evaluation). Based on empirical studies in the distress year operational restructuring is undertaken by 50% of the firms whether recovery or non-recovery. However, the difference is strongly suggestive in year after distress, at 49.3% for non-recovery firms and 35.1% for recovery firms. Furthermore, in terms of importance of turnaround strategy by peers in Distress Year + 1 (“DY1”) operational restructuring was number two strategy for non-recoverers whereas it was number three for recoverers. Thus, clearly the recoverers have moved away from operational restructuring in DY1.

However, management failed to implement the same for at least 6 months (June 2014) since the problem was identified and possibly thereafter too; they could not stop the bleeding, the proposed cuts without analysis seemed superficial. This exacerbated the decline. The only firm specific factor i.e., formulae error in spreadsheet was presumably corrected as the case does not mention formulae error as a reason for continuing losses in subsequent pages. The case is silent about intensity of restructuring as defined by authors as measured by restructuring cost. Thus, irrespective of the outcome basis empirical studies of “only operational restructuring,” a necessary but not a sufficient condition, it was not carried out properly and the company was still grappling with it in DY1; a sign of non-recoverers.

Vis-à-vis asset restructuring we do not see any examples in the case of divesting any business though there was a proposal to sell shares of companies of non-Benelux countries as well as branches; the only instance being contemplation of sale of surplus assets in October 2014, nearly a year after the problems were discovered. The authors concede that in case the industry is depressed, asset sales and divestments may not raise as much cash; a point buttressed by the fact that meetings with three other parties was not encouraging as they wanted to wait for liquidation. Moreover, statistically there isn’t any significant difference foreseen in recoverers vs non-recoverers; approximately ~40% for both in Distress Year (DY) and DY1. However, the second most important strategy for the recoverers were asset sales whereas for the non-recoverers it was operational restructuring; thus Flow Management were still focussed internally, an evidence of non-recoverers and were not able to envisage the larger landscape.

Other actions of asset restructuring too were not evidenced like discontinuing unpromising routes, capex to improve IT system that resulted in formulae error, forming alliances or joint ventures, initiating talks of mergers, acquisitions etc. Since the company continued to be in distress any new investment was practically ruled out. Also, statistically there isn’t much difference between frequency of recoverers and non recoverers in DY and DY1 for capex and acquisitions. However, in terms of importance of turnaround strategies over time in DY1, for the recovery firms the capital expenditure is the number one strategy adopted whereas for non-recovery firms it falls to number six. Again, a yardstick where Flow Management fails.

In summary, though we are not aware of broader macro environment, *prima facie*, asset restructuring was not carried out, neither asset divestment nor any asset investment. Though on a frequency basis, the factors are statistically similar, in terms of importance of turnaround strategy, Flow Management should have crafted a future oriented strategy, spent on capex and divested the assets which were not core to its operations. The CFO had offered to sell 340 cars; however, even the transaction for such a small divestment was not consummated though late in the day to stay afloat in October 2014 it did budget for sale of surplus assets.

The authors also examine financial restructuring as a key variable of corporate restructuring by re-jigging the capital structure to relieve strain of interest and debt repayments. This has two legs either enhancing equity or reducing debt. In the case-study despite the pressure from bankers, the shareholders did not infuse equity. In the opinion of authors in an economic downturn equity issuance may not be appropriate but operational restructuring will be effective. However, the aforesaid *maxim* may have been true when the study was carried out but was not true in the 2020 downturn when record equity issuances were made across the globe.

However, statistically only 15.5% of recovery firms issued equity in DY as compared to 23.2% of non-recovery firms. The figures were 22.7% and 27.5% respectively in DY1. Thus, Flow Management seems to have acted consistently with the data set.

Finally, at the time of signing restructuring agreement debt was restructured by way of debt-equity swap, remission of part working capital loan and all other loans including any claims from the shareholders. This in the opinion of authors, statistically has a strongly significant difference, in DY1 (July 2015) between non-recoverers and recoverers i.e., 14.5% of non-recovery firms restructure debt in and only 3.1% of recoverers do. This indicates that Flow Management should have pursued operational restructuring properly which they failed to do. Operational restructuring may have obviated the need of debt restructuring.

In summary authors note that though recovery and non-recovery firms may be implementing the same strategies it is possible that non-recovery firms are not implementing it properly as was evident in operational restructuring of Flow Management.

Moreover, economic and industry conditions may impede recovery. The authors use linear and logit regression to arrive at a conclusion that restructuring strategies explain a significant part of recovery, but a substantial part remains unexplained. Counter-intuitively, similarity is seen between strategies of recovery and non-recovery firms and thus how firms in specific industries achieve turnaround in response to industry specific causes of financial distress needs to be studied.

It seems that higher intensity of operational restructuring and resorting to debt restructuring may be detrimental. They single out severity of distress as one control variable that effects recovery: the less severe the distress the easier the recovery and vice-versa. Finally, recovery firms adopt more forward looking expansionary and external market focused strategies whereas non-recovery firms are preoccupied with internal changes

Vis-à-vis, Flow Management we are not aware of economic conditions and the severity of distress. We also are aware that restructuring strategies do not explain substantial part of recovery nevertheless Flow Management should have implemented operational restructuring with seriousness in the DY. This may have avoided the debt restructuring in DY1 and possibly resulted in a better outcome.

Schmitt and Raisch

As mentioned at the beginning of the answer the turnaround approach of Schmitt and Raisch was not applied in the case of Flow Management. The case-study focussed only on retrenchment and that too was not implemented properly. Elements of recovery were completely absent. Thus, the duality perspective of turnaround could not have been applied. Conceptually, what the authors suggest is summarised below.

The authors argue basis empirical data of 107 central European turnaround initiatives that Retrenchment (cost efficiency) and recovery (improving market position through strategic change) form a duality. They are not only contradictory and complementary but also mutually enabling. Integrating the two creates benefits exceeding the costs and thus enable turnaround.

Some scholars advise to adopt one of the two or to address them sequentially whereas some disagree with sequential, as retrenchment without understanding of recovery strategy may result in wrong costs to be retrenched. However, few have paid scant attention to interrelation between the two. The authors argue that interaction between the two is beneficial at all stages of turnaround. Retrenchment acts as a resource provider in the initial turnaround stage and is essential to regain stability in the face of strategic change in the advanced stage while recovery drives strategic change in advanced stage it is a means to direct retrenchment in the initial stage.

The authors further add that though recent studies indicate that retrenchment helps in successful turnaround the empirical evidence is ambiguous. Similarly, while theory suggest that recovery is essential for turnaround success there is very little empirical evidence. Some scholars peg retrenchments to rectify internal inefficiency and recovery to align strategy while others say focus on retrenchment hinders recovery activities, and another set theorises that simultaneous focus is problematic due to limited organizational resources.

The authors explain the existing three-pronged framework to understand the dualism; learning, organizing and performing. Learning tensions emerge through competing learning efforts i.e., Retrenchment is defensive but helps bring stability whereas recovery is proactive but disrupts and seeks adaptation. Organizing tensions surface when systems create competing structures to achieve desired outcomes. Retrenchment leads to centralisation with increasing managerial involvement and recovery requires decentralization, employee involvement and flexibility. Performing tensions arise from conflicting demands of stakeholders i.e., banks and shareholders want short-term improvement thus gearing towards retrenchment whereas employees consider retrenchment a short-term solution. Managers tend to choose one agenda over another, sometimes even aware of their strategies’ limitations but are unable to shift their attention to alternate demands.

Finally, the authors explain their alternate view of duality i.e., learning, organizing, and performing complementarities. The authors concede that because of contradictions the perspective needs additional costs and thus take a marginal approach to cost and benefits. Learning complementarities stem from ‘focus’ i.e., provide the resources required for successful recovery and ‘experimentation’ i.e., allows for imaginative solutions to retrenchment challenges. Organizing complementarities arise from ‘formalization’ i.e., stimulates knowledge sharing creating commitment to recovery and ‘participation’ i.e., respectful interaction with employees ensuring their involvement in increasing efficiency. Performing complementarities surface when managers combine ‘profit’ i.e., creating momentum to ensure stakeholder support for recovery and ‘breakthrough’ i.e., motivating employees to endure retrenchment due to prospect of long-term recovery. Turnaround managers can shift the benefit and cost curves to reap the benefits of retrenchment and recovery in turnarounds.

The authors concede that interaction between retrenchment and recovery vanishes under severe decline, and they have not tested their theories in the context of macro environment of industry condition, regulations and cultural environments. The authors haven’t answered as to what is the optimum level of interaction between retrenchment and recovery. Finally, the authors opine that duality due to their inherent contradictions may force the organizations for a moderate level of two opposing elements.

Thus, the managers and turnaround consultants at Flow Management could have used this duality framework. This would have enabled them to retrench effectively as it is possible that the envisaged retrenchments were not the right ones and the right retrenchment would have provided a base for future recovery. Participation would have ensured employee involvement as the company had a large direct workforce as well as possibly indirect (based on number of cars) and formalization would have helped sharing of best practices. Breakthrough would have resulted in motivated employees and possibly created momentum to garner profit.

###### 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?

Bank C and D were acting opportunistically by frustrating the process to get a standstill agreement as well as by threatening the cancellation of credit in June 2014. Banks C&D were uncertain about the shareholder infusing capital as well as had lost trust in the management of Flow Management on account of variance in numbers. Moreover, they had provided additional working capital of € 32.5M which had a junior charge compared to others. Thus, in the first instance they would have lost money in case of any financial restructuring / haircut. Furthermore, the securities/pledges on the assets were problematic. Thus, they would have lost their proportionate share as part of consortium too. By acting in such an opportunistic manner, they were trying to get the best outcome for their loans.

In case I would have been the advisor of other two banks I would have continued conversations/negotiations with Banks C & D but have stood my ground on the urgency of standstill. I would have told them that in this case Banks C & D may be junior charge holders but that may not be the case in any other case where they may be senior, and thus financial creditors as a group should adopt a fair approach. This approach is also in consonance with the first principle of INSOL International’s Statement of Principles for a Global Approach to Multi-creditors Workout -II. The first principle also states that “each creditor for itself” may lead to liquidation where the losses may be higher. Also, in terms of second principle I will reason that existing advantage in security structure will continue to reflect in the standstill agreement as is often the practice. Thus, their non-cooperation will not help them in any way

###### 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)?

***FIRST 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 sufficient (though limited) time (a “Standstill Period”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.*

The explicit standstill agreement was signed in August 2014 whereas the problems first appeared in November 2013. However, implicitly the standstill was in place since the very beginning; the €35M of debt was not paid on 31st December 2013 (“banks have given their implicit permission”) and scheduled repayment of €35M for 31st December 2014 was not planned in the cash flows. The June 2014 proposal from the company again presumed a standstill as it pushed out the payment of additional working capital due on 31st December 2013 to 2015, refinancing of remaining working capital was postponed till 2019, default interest was no longer charged, and waiver was assumed for other contractual obligations. Similarly, for other loans, refinancing of 2017 was pushed to 2020 and repayments were postponed from 2014 to 2017. Interest and waivers on similar lines as working capital.

Though, charging of default interest in December 2013 was not in spirit of standstill it seems more like a pressure tactic; “healthy pressure on the relation”.

***SECOND PRINCIPLE:*** *During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced. Conflicts of interest in the creditor group should be identified early and dealt with appropriately.*

As explained in first principle above in December 2013, there was an implicit permission of standstill which would have been assuring to debtor’s management to try and achieve an orderly rescue as well as to creditors of coordinated action. In January 2014 “banks conclude that the company’s management and shareholder constructively work together for a solution”. However, this cooperation was fraying a bit in March 2014 because of “general lack of confidence in the Flow Management company considering developments of the past six-months”. Nevertheless the implicit standstill continued.

However, there may have be a slight aberration, strictly in terms of the principle, though not very clear from the case. The principle requires that no creditor will improve their position to other by obtaining security. It is not clear that whilst trying to perfect pledges some of the creditors were improving their position or all of them put-together were trying to rectify an omission the may have made; in the latter case there was no violation of principle.

Another violation was Banks C&D threatening to cancel the credit in June 2014 though it later emerged it was a negotiating tactic with debtor. However, this was a breach.

***THIRD PRINCIPLE:*** *During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.*

This was adhered to; there is nothing in the case to the contrary.

***FOURTH PRINCIPLE:*** *The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.*

There were only 4 creditors which obviated the need for coordination committee. The creditors received the same information and advice during the process, there were single set of advisors for all creditors i.e., accountancy firm, turnaround consultancy and later-on on the process the chief restructuring officer (“CRO”). (It is assumed that though CRO was appointed on insistence of Bank A she was independent) Possibly, a common legal advisor would have speeded the process as it would have been possible to articulate to Banks C&D an unbiased legal position.

***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.*

This was adhered to. Nowhere the case mentions otherwise.

***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.*

Assuming that the understanding of standstill agreement (case is silent on contours of standstill agreement) was distilled into a restructuring agreement it reflected the position of relevant creditors on stand-still date; “content of the financial restructuring agreement reflect the relative positions of the financiers involved”.

Furthermore, again and again a conclusion was reached that the position would be worse in formal insolvency; in December 2013, “bankruptcy of the company will negatively affect the proceeds of the assets”, in June 2014, “liquidation scenario will probably have low proceeds”, and in October 2014, “banks conclude that going concern situation seems to be the best one”.

***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.*

Though all creditors received the same information this was strictly not adhered to. Post the induction of chief restructuring officer press releases were issued and thus information about company was no longer confidential, potentially resulting in reduction of buyer interest.

***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.*

This too was adhered to. “In January 2015 a total of €25M is paid back to the providers of the additional working capital”. This implies that during the process additional working capital was given. Mathematically too it ties up. Figures in million Euros below.

|  |  |
| --- | --- |
| Particulars | Million Euros |
| Original working capital loan | 360 |
| Original other loan | 55 |
| Additional working capital | 25 |
| Shareholders subordinated loan | 10 |
| Shareholders subordinated on signing stand-still | 10 |
| Additional working capital paid back | (25) |
| Working capital waiver | (130) |
| Other loan waiver | (55) |
| Balance | 240 |

###### 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?

Most creditors are rational and will not force an insolvency and liquidation. However, it is possible that in certain situations the creditors are not willing to adopt the Statement of Principles not only because it is a soft law but also of very specific creditors circumstances:

* Creditor consortium is international in nature and very little probability exists of them being joint lenders for any project in future
* One of the creditors has lent as one-off for example, hypothetically he usually lends to retail sector but as an exception has lent to the corporate sector.

There aren’t any other soft laws in India which will persuade the creditors. However, as mentioned in question 2 above there is a framework of RBI, i.e., “Prudential Framework for Resolution of Stressed Assets”. This framework allows cram-down 75% by value and 60% by number and thus can be used as a tool. Moreover, the threat of insolvency/liquidation, which can be a long drawn down process may keep the dissenting creditors in check as they might end up losing more.

In terms of alternate informal possibilities in India

1. Buy the debt of other creditors at a discount
2. Structure the transaction so that the debt is taken over by an asset reconstruction company with a similar outlook. The transaction is usually concluded through a Swiss auction which will result in realization of best possible price for the dissenting creditors.
3. In case the management is confident of getting equity infusion in the company by dilution of stake, create a high-yield arrangement with a stressed asset fund to pay-off the dissenting creditors not agreeing to Principles, in the interim, till the time equity is pumped-in.

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

In a nutshell the essence of restructuring agreement was to ascertain sustainable debt based on the forecast given by Flow Management, determine the new optimum capital structure, convert debt into equity to achieve the optimum capital structure, yank of the ownership from the complex holding structure to a separate entity that is amenable to a going concern sale. The debt-equity conversion considered the seniority of security/charge held by the lenders.

* The first point was transferring all operating companies to a shell subsidiary called Flow Management II BV (FMII). This was primarily to detach the operating companies from the Johnson family group structure and create a standalone entity that can be sold as going concern. FMII continues to be Dutch company to take advantages of tax planning that a Dutch structure provides i.e., capital gains, dividend, interest etc.
* The shares of FMII are transferred to consortium of banks, board members and the CRO. This is debt-equity swap for the consortium of banks. The board was controlled by nominees of Johnson family; thus, original shareholders thru the board members continue to have a stake in FMII. Finally, granting shareholding to CRO will act as an incentive to realize best value for FMII.

This also implies that the shareholding structure of Johnson family will have loss that they may be entitled to carry forward and set-off whereas on the other hand gains if any on sale of FMII will accrue to individual board members. Also, the absolute priority rule has not been followed as equity holders / nominees get a stake whereas lenders lose money.

* The original holding company FMH which becomes a bare shell will be liquidated. There is no information in case-study on assets and liabilities of just the holding company except for a €10M subordinated loan along with accrued interest to be added to principal. It is possible that there are cross guarantees for the other loans provided to FMW. Thus, all obligations on FMH of shareholders and lenders were cancelled for a quick liquidation. However, in case there are other assets like buildings, furniture-fixture, office equipment, cash balance on books of FMH these will be liquidated, and the proceeds would go the secured providers of original working capital loan to FMW.
* Furthermore, FMH and its shareholders will cancel claims against FMII. The case study does not detail the nature of such claims but presumably these may be royalty payments from other subsidiaries, dividends declared/interest accrued, management fee etc. All such claims will stand cancelled. The thought behind this point and the previous one is that FMII should have no claims other than the sustainable debt of the company.
* Finally, the unsustainable debt was written off i.e., €32.5 million of junior debt, €97.5 million of consortium working capital loan and €55 million of other loan.

The results of restructuring were not as anticipated. After, the haircuts FMII should have been able to generate operating profits and service the debt. However, it still made operational losses. The profits were notional on account of debt write backs. Thus, in absence of real operational profits the chances of debt refinancing were bleak, and the banks had to postpone refinancing once again to July 2017.

###### Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process?

Flow Management restructuring process is an informal restructuring i.e., consensual in nature with all creditors and debtor agreeing to a plan and not a formal insolvency. A formal insolvency process will give rise to cross border issues. The restructuring took place in 2015.

The case study states that the shareholding company of FMH is a UK based company called Lease Group Holding United Kingdom Limited. Also, FMH acts as the centre of main interest (COMI) for the six operating companies. The case study also states that FMW has some foreign branches though it does not specify the locations. Thus, there are at least seven jurisdictions involved in the case study: United Kingdom, Netherlands, Spain, France, Australia, South Africa, and USA.

In terms of formal insolvency processes in 2015, EC regulation 1346/2000 was applicable (EIR 2000). In 2017, EU Regulation 2015/848 (EIR Recast) became applicable. Additionally, EU Directive on preventative restructuring 2019/1023 (DPR) came into being. The Dutch adopted a model of the same on 1st January 2021, called *wet homologatie onderhands akkoord* (WHOA). UNCITRAL Model came into being end of 1997 and has been adopted by USA in 2005, United Kingdom in 2006 and Australia in 2008. South Africa prescribes a reciprocity requirement and as no state has been designated as such the model law exists only on paper. Finally, we have the UNCITRAL Model law on Enterprise Group Insolvency of 2019 (EGI) which has not been adopted by any of the nation states.

Since different legislative instruments came into being in different time continuum it is assumed that all the instruments are available today whilst we contemplate the potential legal or non-legal cross-border issues. Furthermore, we study the same under three sub-headings i.e., Under EIR Recast, under UNCITRAL Model Law and others.

EIR Recast

EIR Recast is a binding instrument of private international law with main insolvency proceedings at debtor’s COMI and secondary where an establishment exists (limited to assets under the geography) with application of law of the state opening proceedings. It exists in conjunction with DPR. The designated court for proceedings would be in accordance with Dutch Bankruptcy Act and a judgement for insolvency will be recognized in member states.

* The case-study specifies that the COMI is in FMH Netherlands for six operating companies. On similar lines FMII too will assume that COMI of operating companies now resides in it. However, EIR Recast contains a registered office presumption for COMI which can only be rebutted if it can be proven that debtor’s affairs are conducted from another state and is so ascertainable by third parties. Thus, it is possible that a challenge may be made by in Spain or France vis-à-vis their COMI in Netherlands. (*Eurofood IFSC Ltd*). Also, as both FMH and FMII are residing in Netherlands presumably there will not be any litigation on forum shopping.
* Filing for voidable avoidable & preferential transactions (action Pauliana claims) will have to be made namely the claw-back of bonuses paid to CEO and CFO as well as perfection of securities undertaken by consortium of bankers
* The whole company has 3,000 people and 200,000 cars. It is possible that insolvency proceedings effect rights in rem; the cars may have registered charges in their territory. An owner of rights in rem can still exercise the right irrespective of insolvency. Moreover, for states in common law countries floating charge is common whereas it is not so in civil law countries
* The employment contracts will be governed by the law of member states and the term employment is interpreted broadly i.e., lasting relationship, subordination, and remuneration. Though, the case study suggests that there are 3,000 people, 200,000 cars imply that a lot of drivers may not be employees but may fall under the broader definition of employment contracts. Furthermore, the French have strong preference to safeguard labour rights.

Also, in the EU landmark case of Estro, the court ruled that a pre-pack procedure is continuation of undertaking as against liquidation and thus the rights and obligations of employees are automatically transferred to the transferee, in our case FMII; as a result all employees have to be absorbed by FMII. WHOA too prohibits amendment of employee contracts.

* If need be, the insolvency professional can give an undertaking for not opening secondary proceedings in other member states to help him centralize decision making at the same time guarding rights of creditors

UNCITRAL Model Law

* In *Ralph Schmid v Lilly Hertel,* a view was taken that the territorial reach of EIR can be extended to territories outside Member States in this case Switzerland. However, it is unlikely that other jurisdictions will agree. Under Model Law an application needs to be filed for getting recognition under US, Australian and UK (no longer part of EU) law.
* The US courts determine COMI based on activities around Chapter 15 petition as against the regularity and ascertain ability in EIR Recast
* As reciprocity is not a condition the administrator in Dutch case can file an application for recognition in Model Law countries
* There may be a fear of enforcement while the application is being made

Others

* There may be a desire to protect local creditors in South Africa or a reluctance to recognize certain claims like taxes etc.
* We are not privy to the covenants of loan contracts. In case the covenants are English law the creditors may file under English Law to recover shortfall in accordance with the Gibbs rule.
* A protocol may have to be established between South Africa and other states on lines of Maxwell case, Lehman case, Nortel case or more recently the Halifax case.
* Lastly, if adopted by different jurisdictions, EGI may be implemented through a planning proceeding, it allows use of an undertaking that may enable the court to decline local non-main proceeding and thus save costs and help arrive a quick solution.

Non-legal issues

* Some jurisdictions levy capital gains in case assets situated in their jurisdiction are transferred to another party. Thus, there may be tax implication for assets moving from FMH to FMII.
* Directors may be held personally liable for their acts of omission.

###### 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 Dutch Scene

The two formal insolvency mechanisms under Dutch law are moratorium (“surseance van betaling”) and bankruptcy (“faillissement”). The first grants temporary relief from payment obligations, facilitates reorganization and enable going concern for debtor. The latter is liquidation procedure.

Considering that the standstill agreement was signed in the middle of August 2014, a final decision on modus-operandi of restructuring was not chalked-out, all financials’ creditors were on board (no hold-outs) and there was no threat of enforcement by any creditor (as with sale of assets sufficient incoming cash flows were expected) a moratorium which implies a formal insolvency process in October 2014 may not have been a good option.

A request for moratorium in today’s era would have been logical under WHOA, however, in 2014 due to lack of enabling provisions, the Dutch companies used a form of pre-pack. In prepackaged bankruptcy, before filing for moratorium, the company’s management / shareholder has a firm plan which may include continuing business in another company as was the case in Flow Management. Thus, the ideal time to seek moratorium would have been 4th July 2015. Moratorium is granted for 18 months, which can be extended and thus would have given the opportunity to implement the plan.

A moratorium in August 2014 may give rise to following complications:

* Though, the CRO was issuing press releases the matter was broadly private. Seeking moratorium would have made the matter public across jurisdictions.
* An independent administrator will be appointed to act alongside the directors. The directors as well as administrator barring a few exceptions cannot represent the company on their own but necessarily must act jointly. This may create hinderances in coming up with a firm plan; if a plan is not feasible than the company must enter bankruptcy
* Secured creditors and preferential creditors like tax and social security authorities are generally excluded from moratorium. Thus, there may be enforcement actions.
* This is primarily a car company with 200,000 cars. In certain cases of creditors, the right to retain property is a statutory remedy available who can refuse to surrender possession if the outstanding debt remains unpaid. For example, the garage owner may be entitled to withhold the car until he is paid for the repair charges.
* There may be proceedings against the directors for fraud; especially for the bonus paid to CEO and CFO despite not having profits.

However, if WHOA was in existence in 2014 moratorium may have been a good option because

* It is a scheme for companies who need restructuring but are not insolvent i.e., company will become insolvent if restructuring is not implemented. It is debtor in possession, the procedure is outside the court, there is limited court involvement and class cram down possible.
* The plan may be prepared by debtor, creditor, or shareholder. They may request court to appoint restructuring expert who has exclusive right to prepare plan once appointed and not responsible for running day-to-day business; so, the directors can keep running the business
* It provides option for a confidential procedure provided non-Dutch debtors has sufficiently close connection. It can be a public procedure too which will be recognized by member states
* It allows a plan to provide for restructuring of debt, capital instruments, debt-equity swap as well as issuance of fresh shares
* The rights of secured creditors can be amended, *ipso-facto* clauses are non-operative and onerous contracts can be terminated
* Restructuring expert can request court for a moratorium. A moratorium can be granted for 8 months and during the period no application for bankruptcy can be filed.
* Plausibility of structuring bridge financing by acquiring the existing secured obligation

The Indian Scene

Seeking moratorium is not recommended in India too if the debtor and creditor are in the process of settling through an informal out of court mechanism. This is primarily because moratorium is available only in formal insolvency process i.e., Insolvency and Bankruptcy Code 2016 (IBC). Under IBC, the current owners of corporate debtors cannot bid for a company if the account is in default for more than a year. Additional reasons for not availing a moratorium:

* It may entail a higher haircut for banks unless the asset is very good. In this case of a car company, it is highly likely that creditors will lose more under IBC.
* The bonuses to CFO and CEO will be treated as fraudulent and perfection of charges by the banks whilst the negotiations were on will be treated as preferential.
* The €25M additional working capital will not be treated as priority loan but will form part of the larger bucket of secured financial creditors.
* The distribution of proceeds received from successful resolution applicant may not take seniority of charge in consideration as there are only two categories of creditors for the purpose of IBC i.e., financial, and operational. Also, a part of the money received from resolution applicant will first go towards meeting costs of insolvency; thus, reducing the pool for creditors.
* Given the number of cars it is likely that a new class of creditors may have to be created for drivers that are other than the mentioned 3,000 employees. Large numbers forming a class is always cumbersome while resolving insolvency.

###### Appendix

