2021/2022 GIPC Case Study 1

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

According to research on turnaround literatures and in pragmatic case studies, organisational failure that causes company's decline or financial distress can be classified in various spectrums and perspectives based on different school of thoughts as follows:

- the board view on company's decline or financial distress is a combination of internal and/ or external factors;
- In the research paper of Mellahi & Wilkinson, 2004, the integrative theoretical framework is a combination of external factors as described in "Environmental Factors" and "Ecological Factors"; the internal factors as described in "Organisational Factors" and "Psychological Factors"; the outcome and impact are different in environments and business sectors;

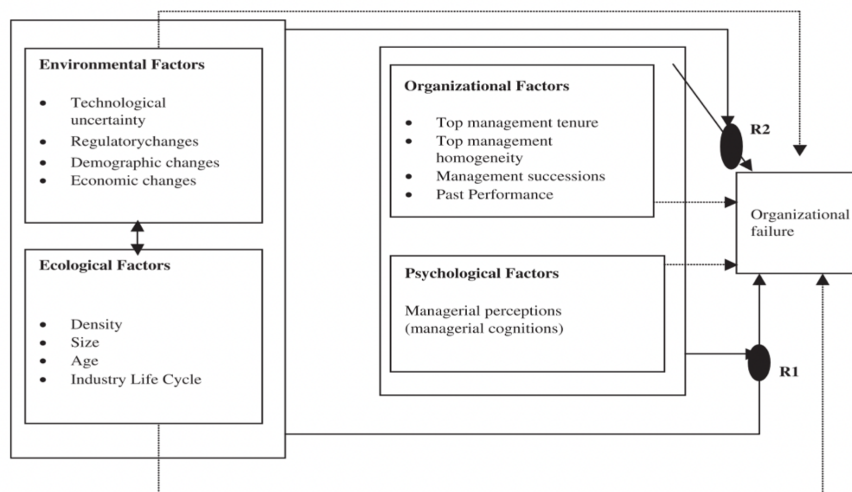

Figure 2. An integrative framework of determinants of organizational failure.

- "Environmental Factors", such as major environmental disaster or economic crisis, and "Organisational Factors", such as management misbehaviour, can have independent effect in extreme situations on company failure;

- Therefore, the financial distress of Flow Management can be examined and questioned in view of the organisational features (internal factors) that cause the failure in the specific circumstances; also under which environmental circumstances and ecological factors (external factors) that contribute to the failure.
- Flow Management's decline as the influence of external factors in respect of economic changes and industry life cycle (competitive advantages) and their impact on pricing strategy (price too low) and market penetration;
- Flow Management's decline as the influence of internal factors are: accounting errors – contingency gains, profits not realised; system errors – formula errors in pricing formulas; Management errors – discovery of losses in later periods (management's self interest) in relation to compensation/bonuses (towards short term incentives); operational errors; staffing levels too high contributing to poor profitability; balance sheet mis-management leading to deteriorating debt to equity ratio (minimum solvency rate 5% not achieved).
- Other research arguments: deterministic - IO/OE industry matters more than the company and failure is caused by external factors that management has little or no control. OE is based on statistical tools in specific industries that are in traditional business sectors that ignore the question why some companies in the same industry facing the same industry-level constraints fail but others succeed; overly deterministic management is powerless and /or rational actors) ; voluntarist - OS/OP is based on the assumption that management is the principal decision-makers; company's failure is directly related to personal decision-based characteristic i.e. self interest that overextended the organisations assets, not responding to change, an executive who is either too powerful or poorly informed, and the taking of unnecessary risks that failure is linked to internal inadequacies in dealing with external threats (over reliance on internal factors).
- Flow Management's overall decline can be argued as the result of voluntarist that management is the principal decision-makers; company's failure is directly related to personal decision-based characteristic linked to internal inadequacies.

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?

Formal Reorganisation includes all possibilities of reorganisation laid down by the insolvency law or which take place using legal methods and possibilities. An informal reorganisation is 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/ group in financial difficulties (declining entity) within the legal framework, the entity requires business and financial restructuring.

Advantages and Disadvantages of Informal Workouts:

- Depends on how sophisticated the insolvency legislation and the influence of Formal Bankruptcy Procedure in the jurisdiction(s) of the declining entity.
- Informal workouts are often facilitated by the parties' knowledge that the formal framework and processes are there, can remain a backstop, and be defaulted too, if necessary.
- Parties may be more inclined to enter into informal discussions and negotiations, work it out amongst themselves; bearing in mind the framework that is at play, where it could be a more expedient process, and also likely to have less negative impact and adverse publicity.
- Ability to cram down engaged creditors and to encourage them to be more reasonable in informal negotiations.
- Flexibility: Possibilities within the framework of informal reorgs are better and more flexible than in a formal workout. Not constrained by what is in the legislation.
- Silence: Procedure not made public. Suppliers, financers, and potential clients will often approach the company with an increased degree of reserve.
- Control: Management can continue to fully run the company independently
- Time and costs: those involve can determine speed and outcome of reorg themselves / save costs of legal fees.
- Depends on how sophisticated the creditor pool is as well and relationship with them.

Depending on the sophistication and influence of creditors and their objectives, the influential but irrational creditors involved in the turnaround process may pro-long the time in the negotiation, execution and completion of the informal turnaround strategy/process and, in the worst scenario, leading to failure of the informal restructuring. In such circumstances, formal but flexible liquidation framework may provide a more structured and organised restructure process. For example in Cayman Islands: the appointment of joint-liquidators allows external liquidator (professional) in dealing with creditors at the cutoff date/appointment date and the other joint-liquidator represented by management of the declining entity/whiteknights/ influential stakeholder who maintains operational control working together under the legal framework may speed up the time in the negotiation, execution and completion of the turnaround strategy/process of the declining entity (both business and financial restructuring).

3. **Were the turnaround/reorganisation approaches as presented in the reading material (Article 2: Kalle Pajunen, Article 3: Adriaanse and Kuijt, Article 4: Schmitt and Raisch, Article 5: Sudarsanam & Jim Lai) applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.**

Article 2: Kalle Pajunen, 2006

The article primarily addresses the issue on Stakeholder Influences in organisation turnaround and survival based on a theory and a historical case study in relation to direct resource dependence ("RD") and network position ("NP") base of influence.

- the most influential stakeholders in organisation's survival: internal management failure led by the ex-CEO and ex-CFO; the poor direction of the Board of Directors of FM Group.
- The handling of Governing Stakeholder ("GS"), Potential Stakeholder ("PS"), Minor Stakeholder ("MS"), multiple stakeholder roles and their influence in dealing entity.

- RD influence in financial distress (positive vs negative): Owners and creditors (multiple stakeholder roles); Management; Other stakeholders. The Banks shift from Creditors to become both shareholder and creditors of FM II; the CEO also shift from management to both management and shareholder of FMII.
- NP influence in financial distress such as Banks A and B vs Banks B and C, CRO and the shareholder, new management (positive vs negative).
- Shift of influence - current vs new influential stakeholders from decline to turnaround stages amongst GS, PS and MS as IS (positive vs negative). The debt conversion of the Banks changed the RD and NP of FM Holding vs FM II.

The application of the 6 positive propositions (P1-P6) in FM Group's financial distress:

- P1: the more secure the continuing support of GS, the company is more probable to survive. FM's shareholder (GS); management (new management and CRO); the Banks (IS) all provide continuous support to the informal restructuring of FM Group;
- P2: frequent and open communication between management and GS enhance the support of GS that increase the company's probability to survive. FM's shareholder (GS); management; the Banks are all strive for communicating;
- P3: personal relationships between management and GS enhance the support of GS that increase the company's probability to survive. FM's shareholder (GS); management; the Banks all maintain good relationship in handling changing information.
- P4: unlocked brokerage position between management and GS enhance the support of GS that increase the company's probability to survive. FM's management assumes the brokerage position in FM Group from decline to turnaround.
- P5: consensus on long-term goals among GS enhance the support of GS that increase the company's probability to survive. FM's goals in scenario 1, 2 and 3 extends over 2 years.
- P6: GS' association of management with good firm performance gets positive support of GS that increase the company's probability to survive. Despite the changing forecasts and actual profitability, FM's management have strived for good performance.

- As we can see in FM's case, P1, P2, P3, P4, P5, P6 are all applicable in influencing the success of FM's turnaround and restructuring in scenario 1, scenario 3 and scenario 2.

Article 3: Adriaanse and Kuijt

The advantages of informal reorganisation as discussed in Adriaanse and Kuijt's article as discussed in question 2 are mostly applicable to FM's decline and turnaround. In view of the willingness of FM's shareholder (GS); management; the Banks all working towards the goals as stated in scenario 1, 2 and 3, despite a tactful and a a short spell opposition by Bank C and D, FM's turnaround and restructuring in scenario 1, scenario 3 are relatively successful; while scenario 2 is promising but yet to be completed.

Article 4: Schmitt and Raisch

Retrenchment (cost efficiency) and recovery (improving market position through strategic change) form a duality – they are contradictory and complementary but mutually enabling Scholars from different school of thoughts argued (based on specific assumptions) that one or the other or both interacting enhances performance. Some scholars argued that one to the other should be addressed sequentially and vice versa.

- Discussion about Learning tensions, organising tensions and performing tensions – but in FM case we do not have recovery actions here these are not apparent.
- Discussion about learning complementarities, organising complementarities and performance complementarities – those use integrative measures can benefit – in FM case we primarily have just one side of activity.
- Schmitt and Raisch agreed that both should go hand in hand – in FM case actions were not taken in accordance with this study.

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?**

The break away of Bank C and D may jeopardise the negotiating power of the 4 banks acting together. Scenarios 1-3 requires the major creditors/the Banks acting together to achieve the best outcomes; Scenario 4 is forced sales through liquidation that the Banks have little control over the process. Back C and D provided FM Group the additional working capital of € 32.5 million that were not secured and they may not be keen to co-operate with Banks A and B in terms of loan size and influence. Banks A and B will suffer more if FM Group falls into liquidation and forced sale position with the problem on the securities (pledges) of the assets established with the Banks. If the standstill agreement is not reached by the Banks as required by the shareholder, they will not continue with the support and funding of FM Group. On the other hand, it seems the Banks are playing the strategy to put Bank C and D in the opposing position to force the shareholder and management to be quick to commit and implement the restructuring and the capital injection to restore/improve the insolvency ratio; as well as avoidance of liquidation that is not to the best interest of the shareholder and management as a whole.

As adviser to Bank C and D, I certainly will promote and uphold the 8 INSOL Principals and The World Bank's ICR to encourage the 2 banks to act in the best interest of the Banks and the FM Group as a whole; provided the restructuring scenarios are feasible, management is willing to co-operate in the execution and implantation of the restructuring plans in a timely manner and to protect the interest of creditors; the shareholder is willing to restore the insolvency ratio with additional funding. Also, Bank C and D need to be prepared to take up the shifting role from passive stakeholder to be active/influential stakeholder.

As adviser to Bank A and B, I certainly will promote and uphold the 8 INSOL Principals and The World Bank's ICR to encourage the 2 banks to act closely with the FM Group to improve the targeted outcome that management is willing to co-operate in the execution and implantation of the restructuring plans in a timely manner and to protect the interest of creditors; the shareholder is willing to restore the insolvency ratio with additional funding. Also, Bank A and B need to be prepared to take up the shifting role from significant

stakeholder to be influential stakeholder. I also endorse the strategy for Banks A and B to buy out banks C and D with a the required discount in order to reach the standstill agreement; the appointment of CRO ('Chief Restructuring Officer') in the board of directors of FM Holding to oversee the restructuring process. The overriding balance between the timeline, risks and the going concern value versus forced sale value of the strategic option.

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)? (Article 6: INSOL Statement of Principles)**

1st Principle ("1stP") - 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.

2nd Principle ("2ndP") – 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

3rd Principle ("3rdP") - During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors.

4th Principle ("4thP") - The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty.

5th Principle ("5thP") - 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.

6th Principle ("6thP") - Proposals for resolving the financial difficulties of the debtor and arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.

7th Principle ("7thP") - 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 be treated as confidential.

8th Principle ("8thP") - provision of additional funding during the Standstill Period or under any rescue/restructuring proposals, the repayment of such additional funding should be accorded priority status as compared to other indebtedness or claims of relevant creditors.

The explicit and implicit application of the **8-Principle** in the workout process of Flow Management are summarised as follows:

- **5thP 7thP** **16 November 2013** the four banks (A,B, C and D) of FM Holding were invited by the board of Flow Management Holding for a meeting to explain the **causes of the losses and negative corrections** (communication by management to influential stakeholders) the steps to remove the causes. With the business structure and proper operation, management expected that a profit will be made again from January 2014.
- **1stP 2ndP 4thP** Banks agreed to discuss the FM's situation on 1 December 2013.
- **5thP 7thP** an accountancy firm was appointed to investigate the procedures within the company; FM Holding must report on the actual costs and turnover each month;
- **1stP 2ndP 3rdP** the shareholder was asked to pay off the equity capital so the solvency rate (equity/total assets) returns to a minimum of 5% (currently this is 3.9%).
- **5thP 7thP** The shareholder company - represented by its CFO - proposes to sell 350 cars in order to improve the solvency rate.
- **against 1stP 2ndP 3rdP; 4thP** The Banks preferred an actual settlement in money.

- **5thP 7thP In December 2013,** FM's management provided **the restructuring plans** to the Bankers: to increase profit by € 15 million in the short term; the independent turnaround consultancy agency endorsed the viability of FM's market share to achieve the estimated turnovers and to provide final report for Bankers'/influential stakeholders' evaluation.
- **2ndP 4thP** Banker's actions must be taken jointly and in a controlled manner including the shareholder of FM must take measures with regard to FM's management (the CFO in particular); and put pressure on FM's shareholder to raise € 35 million for the repayment of part of the debts (originally planned on 31 December 2013) and to inject € 12.5 - 15 million strengthening the equity capital ratio; and Bankers started charging default interest to put healthy pressure on FM**.**
- **5thP 7thP** 20 December 2013 the (adjusted) actual results for 2011-2013 are announced. The total loss turned out to be even higher than stated on 1 December 2013; Solvency rate at 0.1%; enough cash to fulfil the current obligations until the end of April 2014;
- **2ndP 4thP** the Banks gave their permission to reschedule repayment of € 35 million on 31 December 2014 and demanded the shareholder to contribute at least € 12.5 million; the Banks attempted to solve this problem as soon as possible.
- **5thP 7thP** plans to implement the management information system to improve reliability of the financial figures/information**.**
- **5thP 7thP 8thP** In January 2014, the shareholder announced to make a decision within short term about the strategy of FM Holding; the possibilities to continue restructuring the foreign subsidiaries and to strengthen the balance sheet by injecting risk-bearing capital. Trust is put in the company with the appointment of a new CFO.
- **1stP 2ndP 3rdP 4thP** The Banks concluded that the company's management and the shareholder constructively work together on a solution; a joint approach from the Banks is desired and a standstill agreement be signed by in order to achieve this (management and the shareholder only formally commit themselves if the Banks act in concert).

- **3rdP 8thP** despite the difficulty on the signing of the standstill agreement, on **15 April 2014** the CEO of FM Holding is replaced by the shareholder and at the same time agreed to deposit € 10 million (unsecured loan injection) and to lend another € 27.5 million (additional unsecured loan injection) to FM Holding.
- **2ndP 4thP 6thP** 15 May 2014 Bank A and B purposed the buy out banks C and D with a 15-20% discount in order to act more decisively now to achieve the standstill agreement.
- **5thP 7thP** 15 May 2014 FM's management continued with the restructuring plans (business restructuring and financial restructuring).
- **1stP 2ndP 3rdP 4thP** 15 May 2014 the forecast profit for 2014 (profit forecast of € 9-10 million announced 21 February 2014 for FM Group) turned to a loss of € 8.5 million and € 30 million profit is expected in 2015 **-** the ranges (positive/negative) are € 4 million and € 10 million respectively. The Banks (instigated by bank A) announced they wanted to appoint the '**Chief Restructuring Officer ("CRO")**' as a step forward for scenario 3.
- **5thP 7thP** June 2014, the shareholder made a restructuring proposal in order to effectuate financial restructuring at FM Work so that the **equity capital and solvency rate**, is improved from negative -/- 9.5% to 5% again.
- **2ndP 4thP** June 2014 the shareholder proposed to contribute at least € 27.5 million (additional unsecured loan) due to going concern sale (at that moment no interested party) not an option and a liquidation scenario will probably have low proceeds (a maximum of 55% of the total in outstanding debts), Banks A and B are open to negotiations with regard to the proposal, provided that the shareholder injected at least € 35 million (additional unsecured loan by 2 instalments).
- **5thP 7thP** end of June 2014 the CRO announced that a the forecast loss of € 27.5 million for 2014 (original forecast € 8.5 million in 15 May 2014; expected profit of € 30 million in 2015) and a liquidity shortage is imminent; a delay in the reorganisation in respect of price increases and cutbacks among other things.

- **1stP 2ndP 3rdP 4thP 6thP 8thP** Banks C and D threatened as a gesture/signal to the shareholder and management to hurry up. The shareholder proposed to deposit € 10 million (additional unsecured loan) in the short term and to contribute the remaining € 25 million (additional unsecured loan) in September / October 2014 with the condition the fund is truly needed and the standstill agreement is signed.
- **1stP 2ndP 4thP 6thP 8thP** Early August 2014, despite the constantly changing information (cons) by FM Holding's new management (including the CRO), there was a slight result improvement due to the reorganisation (pros) comparing sale scenarios verse liquidation scenario (going concern value vs forced sale value), the Banks concluded and signed the 120- day standstill agreement in mid-August 2014 (standstill to mid-November 2014).
- **1stP 2ndP 3rdP 4thP 5thP 6thP 7thP 8thP** In October 2014**,** 4 scenarios have been drawn up for the restructuring of FM Group.

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, do you see any alternative (informal) possibilities?**

In case the other creditors are not convinced to adopt the Statement of Principles, the other alternative "soft law" that we may consider for achieve the informal reorganisations and/or restructuring proceedings are:

1. The World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes ("**ICR**") (Revised 2021)
2. Wessels, B. and Boon, G., Soft Law Instruments in Restructuring and Insolvency Law: Exploring Its Rise and Impact (2019)
3. Barney R. and Stubbs, T. Corporate Debt Restructuring in Emerging Markets: A Practical Post-Pandemic Guide (2021)

I would like to highlight and discuss the key measures and updates of the World Bank's ICR. According to President David Malpass of the World Bank:

- orderly debt resolution processes are critical for businesses of all sizes, aiding financial stability, new investment flows, and the value of contracts and contract law.
- the severity of the COVID-19 crisis and global recession coincided with almost a decade of rising debt and a sharp decline in investment in 2020, it deepened the damage to businesses and consumers and their ability to make payments and service debts.
- the revised ICR is focused on helping policymakers build and improve the insolvency and bankruptcy systems that support micro, small and medium enterprises (MSMEs).
- the previous update to the Principles incorporated lessons learned from the complex issues that triggered the 2008 global financial crisis, while this latest update addresses the specific challenge of making insolvency systems more accessible for MSMEs which have been particularly hard hit in this crisis.

The World Bank's ICR Principles has set out a range of benchmarks, based on international best practice, for evaluating the effectiveness of domestic ICR systems regardless of the size of the debtor. There has been, in recent years, an increasing recognition that addressing the needs of insolvent micro and small enterprises (MSEs) is vital for economic growth and entrepreneurship. MSEs often struggle to navigate an ordinary insolvency process, and typically lack the resources to cover the costs and fees of the proceedings. Additional common factors, such as creditor passivity in participating in the process as well as the commingling of business and personal debt of the debtor, has exacerbated the challenges of facilitating the rescue or exit of small businesses. These are some of the reasons why the ICR Task Force, which advises the World Bank Group Insolvency Team, recommended that it was necessary to address the insolvency of MSEs in the ICR Principles, by adding specific guidance and core concepts that any effective MSEs insolvency regime should ideally incorporate.

A number of specific challenges characterise MSEs insolvency. MSEs are frequently deterred from resorting to complex and expensive insolvency proceedings to tackle financial distress. Creditors have few incentives to deal with MSEs debtors through such proceedings, so-called “creditor passivity”. Information about MSEs debtors often is limited or does not exist, making it harder to assess business viability and discouraging creditor trust in MSEs debtors. MSEs often lack the resources to cover the costs and fees of an ordinary insolvency proceeding. MSEs are commonly financed with a mixture of business debt and personal debt taken on by the entrepreneur (potentially including personal guarantees too), which may result in severe consequences for entrepreneurs and their families, including social stigma. MSEs are also frequently operated by natural persons as sole proprietors, potentially putting both the business and personal affairs of the debtor-entrepreneur at risk.

Though country approaches may vary, effective insolvency systems for MSEs should aim to:

(i) lower the barriers to access, and encourage early utilisation of out- of-court restructuring procedures, hybrid procedures and in-court simplified insolvency proceedings;

(ii) design and implement a streamlined regime that reduces the complexity and costs of ordinary insolvency proceedings, providing for expeditious and flexible mechanisms to rehabilitate and/or reorganise viable insolvent or financially distressed MSEs, and to effectively liquidate nonviable ones;

(iii) establish favourable conditions and adequate safeguards for debt discharge and a fresh start for natural person entrepreneurs;

(iv) reduce the stigma associated with insolvency;

(v) promote entrepreneurship and growth increasing access to credit;

(vi) maintain basic safeguards for protecting the rights of creditors, debtors and all parties involved in or affected by MSEs insolvency proceedings;

(vii) implement an effective regime to prevent and sanction fraud, improper use and abuse of MSEs insolvency proceedings; and,

(viii) establish mechanisms of assisting MSEs to provide early signals of financial distress; increase financial and business management literacy among MSE managers and owners.

Key Objectives and Policies of Insolvency for MSEs

Though country approaches may vary, effective insolvency systems for MSEs should aim to:

- Lower the barriers to access, and encourage early utilisation of out-of-court restructuring procedures, hybrid procedures and in-court simplified insolvency proceedings.
- Design and implement a streamlined regime that reduces the complexity and costs of ordinary insolvency proceedings, providing for expeditious and flexible mechanisms to rehabilitate and/or reorganise viable insolvent or financially distressed MSEs, and to effectively liquidate nonviable ones.
- Establish favourable conditions and adequate safeguards for debt discharge and a fresh start for natural person entrepreneurs.
- Reduce the stigma associated with insolvency. Promote entrepreneurship and growth increasing access to credit.
- Maintain basic safeguards for protecting the rights of creditors, debtors and all parties involved in or affected by MSEs insolvency proceedings.
- Implement an effective regime to prevent and sanction fraud, improper use and abuse of MSEs insolvency proceedings.
- Establish mechanisms of assisting MSEs to provide early signals of financial distress to MSEs; increase financial business management literacy among MSE managers/owners.

Simplified Insolvency Proceedings

The law should establish simplified insolvency proceedings for reorganisation and liquidation of MSEs.

- All personal and business debts of a natural person should be included in simplified insolvency proceedings.
- Simplified insolvency proceedings may be made mandatory or optional for use by eligible debtors.

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

Following the 120-day standstill agreement signed by the Banks in mid-August 2014 (ending mid-December 2014) and the 4 scenarios drawn up in October 2014 as well as communication with and information provided by FM current management and the CRO, the Banks concluded that a going concern situation seems to be the best one i.e. going concern value through organisational restructuring is better than forced sale value through liquidation. A study is held into the possibilities of a Debt equity swap (scenario 3). It is also scrutinised what the **role of the current shareholder** would be in view of the shift of Governing Stakeholders' influence ("GS influence").

In January 2015 a total of € 25 million is paid back to the providers of the additional working capital in scenario 1 (shareholder's € 30 million down to € 5 million net if paid back fully to shareholder; Banks' € 45 million down to € 20 million net if paid back fully to Banks**;** perhaps shareholder and Banks agreed to share the paid back proportionally that was not provided).

On 4 July 2015, a Restructuring agreement was signed as a reflection of the confidence and trust of Banks for the company's decline to turnaround under scenario 3 organisational restructuring and to sell the new holding company FM II according to scenario 2 in a going concern situation. Turnaround under organisational restructuring is outlined as follows:

1. all operating companies of FM Holding BV (old parent of 6 subsidiaries) are to be accommodated in a new holding company FM II (new parent of 6 subsidiaries);
2. the shares in holding company FM II are transferred to the Banks (A, B, C, D) (the % of holding in FM II by each of the 4 banks not specified in the case material) which has financed the original working capital of main subsidiary FM Work BV (Banks' WC **€ 360 million including interest of € 10 million as indicated in item 5. and 6. below and Other Loan € 55 million as stated in item 7. below**), as well as to a number of board

members of FM Group (including the CRO) (the % of holding in FM II by each of the board member not specified in the case material). This reflects the shift of GS influence;

3. FM Holding will be liquidated in an undisclosed manner (as discussed above, perhaps shareholder and Banks agreed to share the paid back proportionally; shareholder's remaining loan - original € 30 million and the Banks' remaining loan - original € 45 million). All claims against FM Holding will be cancelled by the banks and the shareholder; the providers of the original working capital posses pledges on most assets of FM Work will receive part of their claim on liquidation;
4. FM Holding and its shareholder will cancel all claims against FM II and its subsidiaries;
5. Banks C and D provided FM Work with additional working capital waived the debt amount of € 32.5 million ('haircut') in exchange for ? % of share holding in FM II of 6 subsidiaries;
6. Banks provided FM Work with working capital waived the debt amount of € 97.5 million (haircut) and € 240 million claim against FM Work remains (assuming interest of € 10 million was included);
7. the Other Loan amount of € 55 million in FM Work is cancelled in full (haircut).

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

FM Group comprised of 4 companies in the (the registered office; also the admin of the company is regularly conducted – See EU Insolvency Regulations and UNCITRAL Model Law on Cross Border Insolvency) and 4 companies are governed by the UNCITRAL Model Law. The two texts seem very similar – ie. both talk about the COMI and cooperation etc. While this may cause potential conflicts in practice and/or legal compliance, it is evident that different jurisdictions on similar law instruments can be harmonised to achieve the desired outcome in the view of public interests. For eample, the courts in different jurisdictions can direct the liquidators (or parties to a transaction) to come up with a protocol for addressing the differences.

There are four legal issues to consider:

- Until either a standstill or restructuring agreement is finalised, there may be a risk of enforcement action commencing in jurisdictions other than home jurisdiction.
- The restructuring sets out a transfer of the shares of 6 subsidiaries to FM II as 'New Parent' and may give rise to regulatory considerations/approvals in respective jurisdictions.
- A formal liquidation process is contemplated for FM Holding under Dutch law. Bearing in mind the fully consensual nature of the restructuring agreement, this would not give rise to recognition of the 'stand alone' winding up of FM Holding in other foreign jurisdictions.
- In relation to the restructuring agreement, consideration would need to be given to enforcement/dispute resolution – bearing in mind the stakeholders and the jurisdictions potentially involved an arbitration clause is preferred.
- The Model Law is probably not relevant as this is an enterprise group situation. The Model Law is applicable where FM Holding has actual assets in the foreign jurisdictions.

According to scenario 2, buyer may not want to acquire FM II including the Banks' remaining loan of € 240 million; the buyer seems to favour liquidation process in securing control over the FM Group with hair cut on the € 240 million loan. According to Lehman Brothers experience, when more than 1 liquidators are involved in cross border liquidations, there should be protocols between the liquidators (if so appointed in respective country) for the parent/subsidiary companies. In case there are conflict of interests escalated to different courts in different jurisdictions, the courts can direct the liquidators to come up with a protocol for addressing the interests of different camps of creditors.

If the selling of FM II does trigger liquidation process i.e. scenario 2 failed to attract intended buyer for the Banks to exit from the share swap arrangements in scenario 3, perhaps the restructuring from the outset should be revamped to consider the formal liquidation path instead of the informal restructure path. The joint-liquidators arrangement in Cayman Islands is a good legal process with appropriate control and flexibility as comparable to most informal restructuring.

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]

FM Group put forward 4 scenarios in October 2014 as follows:

1. a going concern option if the company proves viable, with shareholder and banks agreeing to an additional 180-day 'stand still' or refinancing. The starting point here is that the shareholder contributes another € 30 million and the banks will transfer security rights of € 45 million to the shareholder;
2. selling FM Holding BV if viability is not sufficiently proven. A buyer must be found soon;
3. a Debt equity swap (conversion of debts into shares) with or without the cooperation from the shareholder;
4. a moratorium or restart following liquidation, with the company being sold in a 'controlled' manner. However banks must be willing to provide a bridging loan.

On 31 October 2014, FM announced in a press release that the expected loss for 2014 will rise to € 39 million, and that a € 10 million loss for 2015 is forecast, followed by a slight profit in 2016. Although the provision of information has improved, the banks are at that moment disappointed with the progress of the reorganisation. The company will provide € 10 million of tax refunds as additional security. As a result of the sale of surplus assets, **sufficient incoming cash flows** are expected so that additional deposits seem unnecessary.

- Banks harsh stance is slightly modified because of FM's competent management and the potential for successful workout. Slight change to the hope/certainty continuum as a result.
- Based on the management's communication with influential stakeholders, the banks evaluate that the going concern value as stated in scenario 1, 2 and 3 will be higher than scenario 4 and/or the forced sale value through liquidation and the bridging loan combined.
- For moratorium, the aim of the measure is to help FM to survive by weathering current but temporary financial difficulties and entails a delay in payment by the group to their

creditors. In view of FM's financial restructuring that requires more time to implement successfully, scenario 4 is not the best option.

- In addition, a debtor must make the request to court to enter the moratorium procedure, a creditor cannot do so; the moratorium proceedings may delay the restructuring.
- A judge and a receiver will be appointed by the court to govern the finances of FM and has a mandate to negotiate with creditors regarding payments on behalf of the group, this may compromise the flexible and viable financial restructuring. Informal reorganisations have the advantage that they can take place outside the public domain.
- The Dutch moratorium is limited to a maximum period of 18 months.
- Despite Banks getting impatient in view of the constantly changing projections and shifting timelines and bankruptcy of the company will negatively affect the proceeds of the assets and the proceeds will be substantially lower (or even zero) in the event of liquidation.
- Shareholders get a fresh start without necessarily increasing exposure greater than the banks. Strong bargaining position in favour of the Shareholders.
- Retrenchment is absolute from day one providing scope for rebuilding and recovery plans to be immediately initiated. Restructuring of management with no punitive exit payments.
- Influential Stakeholders have confidence in the company's financial restructuring versus the trust in management in executing successfully in respect of scenario 1, 2 and 3.
- the flexibility and opportunity to negotiate a workout agreement through informal restructuring outweigh the costs and benefits of formal moratorium arrangements.

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