**Yuri Saunders Case Study 1**

**Question 1**

1. The root of organisational financial distress is a well explored area of academic research. In that regard studies have identified a variety of causes existing both internally and externally of the firm[[1]](#footnote-1). Generally, bankruptcy has been found to arise from various sources: those that are internal (the Voluntaristic View) such as factors related to the managerial style, the specific characteristics of the firm, unavailability of resources and external or environmental sources beyond the organization’s control[[2]](#footnote-2) (as posited by industrial organization (IO) and organization ecology (OE) scholars)[[3]](#footnote-3).
2. There also appears to be consensus that a very young or “adolescent” organisation is more prone to failure than an older organization[[4]](#footnote-4). Additionally, a firm’s age plays a significant role in ascribing the causes of its failure[[5]](#footnote-5). That is, many factors which are relevant to the failure of a younger firm appear to be less relevant to the failure of older firms. Jovanovic’s thesis was that business owners increase their managerial capabilities as they run their businesses and get to know their real costs and necessary income better year-by-year[[6]](#footnote-6). Simply put, a more experienced manager is likely to perform better than a less experienced one.
3. With respect to external factors, Mellahi and Wilkinson in summarizing the discourse note that there is a deterministic perspective inherent to the impact of environmental factors on an organisation[[7]](#footnote-7). Those factors are grounded by the Schumpeterian thesis of ‘creative destruction’ in that changes of a technological, regulatory, economic or demographic nature make the demise of some organisations all but a foregone conclusion.
4. More relevant to an analysis of the Flow Management Holding BV group of companies, in my opinion, is Threat Rigidity Effect Theory as contended for by Staw et al who argue that individuals, groups and organizations tend to behave rigidly in threatening situations and seek to maintain the existing status quo[[8]](#footnote-8). In support of their thesis they give as examples the following instances of managers ignoring the evidence to the detriment of their organisation:

“The Penn Central Railroad, for example, continued paying dividends until cash flow dried up completely (Altman, 1971); Chrysler Corporation, when faced with the oil crisis and rising gasoline prices, continued large (but efficient) production runs on its largest and most fuel-inefficient cars until inventories overflowed (Business Week, 1979; Fortune, 1979); the Saturday Evening Post continued to raise its prices as circulation dropped (Hall, 1976).”[[9]](#footnote-9)

1. On 16 November 2013 Flow Management Holding BV’s (“Flow”) four main creditors met with Flow’s Board regarding the fact that the reported pre-tax profit to September 2013 of €8 million was in fact a loss of €5.4 million and misreporting in the annual accounts mean that €3 million must be downgraded by €8 million. That event was the first distinctive and therefore the most important sign of financial distress within the group of companies. That Flow was forced to assemble its creditors impromptu to make a report, a first presumably, is demonstrative of that.
2. The following were attributed as the causes of the distress:

1. large management bonuses (€ 3 million) paid to the CEO and CFO of Flow;

2. a contingency gain in three years was recorded in 2012 but was wrongly booked as being realised in 2012.

3. in 2012, in anticipation of a book profit in 2013, a € 2.8 million book profit is made. This book profit was neither realised in 2012 nor in 2013;

4. the 2013 loss is the result of a ‘formula error' in a spreadsheet as the company failed to periodically check the real costs against the results of the cost price calculation (the prices charged were too low, resulting in a loss.)

1. All of the causes are Voluntaristic in nature. Separate to “1.”, which is likely the easiest to identify and “fix”, all the causes are attributable to the competency of Flow’s management information system. It was therefore incumbent upon Flow’s management to immediately take steps to ensure that going into the future that weakness was addressed.
2. To make matters worse, it later turns out in early December that the €5.4 million loss is in fact only the loss of Flow Management Work BV and that the foreign subsidiaries have also made a loss of €6.3 million. On 20 December 2013 the adjusted result for the years 2011-2013 is worse than anticipated with a total loss for that period of €33.1 million. The aforementioned revelations were further indictments of Flow’s information management system. Notwithstanding that, none of Flow’s December 2013 responses to the crisis took aim at remedying that particular internal failure which does align with Staw et al’s Threat Rigidity Effect hypothesis[[10]](#footnote-10). Although a new CFO was retained in January 2014, it is clear that that did not solve the information management problem, it at that time perhaps being systemic.
3. That the situation is largely unchanged as of 2015 is evidenced by the fact that a profit of €9-10 million was forecast in 2014, however, at the end of October 2014 an expected loss for that year of €39 million was announced and the “new” company incurred operational losses of nearly €9 million in 2015 despite prior forecasts of a breakeven result.
4. In my view the financial distress does appear to have been, largely, preventable. Had a proper information management system been implemented from the beginning it is likely that Flow would not have been in distress. Furthermore, if Flow had, for example, appointed an independent auditing team following the initially revealed 2013-2014 information management weaknesses, management may have been able to arrest the problems facing the group.

**Question 2**

1. The advantages of a formal restructuring (requiring court proceedings), in my view, outweigh those of an informal (taking place entirely out of court) one. Certainly, court proceedings ought to be the last option given their general unpredictability and, depending upon the client, the potential considerable costs involved. In all the circumstances an outcome that can be controlled is preferrable to one that is left to the vagaries of the adversarial system, or, a rigid statute.
2. In an informal restructuring everything is ‘on the table’. The parties are free to craft a solution to the debtor’s crisis limited only by the outstanding debt relative to the viability of the enterprise following modification of the debtor’s business profile. The effect is that so long as there is mutual agreement among the stakeholders (debtors and creditors) intricate provisions may be drafted to reflect the relative positions of the creditors as well as the priority of new funding which would jump start profitability if that were in fact assessed as a realistic possibility.
3. While some jurisdictions’ insolvency laws offer such possibilities, certainly, the Turks and Caicos Islands’ (“TCI”) Insolvency regime does not. Our Insolvency Ordinance under Part III (Company Arrangements) only permits of the possibility of a debt restructuring under strict circumstances which leave the door open so wide for a disenchanted creditor to complain by application to the court[[11]](#footnote-11) that it is inexorably more convenient for the parties involved to proceed by way of mutual agreement if possible.
4. Additionally, an informal restructuring takes place without the scrutiny of the outside world as opposed to a formal one in which the provisions of the relevant insolvency law regime when triggered usually take place under the scrutiny of the Court. Again, a TCI Company Arrangement, the nearest comparator to an informal restructuring, though premised on taking place outside court, is so likely to end up there when dealing with unagreeable creditors that directors embarking on such a course likely do so having that in mind. The detriment to a public procedure being, as described by Adriaanse & Kuijl[[12]](#footnote-12) that “*suppliers, financers, and (potential) clients will often approach the company with an increased degree of reserve, which may lead to unwillingness to enter into new contracts (or only be prepared to do so under the most stringent of terms). In addition, in a public context, a race to collect can easily develop; creditors ‘tumble over each other’ as they seek to get paid in advance of their sister creditors. This frequently also involves petitioning for liquidation of the debtor (in order to enforce payment)”*. In TCI this last benefit may be less important for directors as most corporate entities are either not going concerns, or, those that are do not have much if any local presence as going concerns. Despite that fact there may, however, be occasions where news of an offshore entity’s financial position could transcend the local scuttlebutt and become a concern if it were publicized in the jurisdiction where the entity operates.
5. An informal restructuring will also leave the debtor’s management in control of the company and all need not stop as regards the company’s business upon the appointment of a trustee or Insolvency Practitioner. In that regard the stakeholders of the debtor itself will be able to manage the restructuring and the speed thereof. The restructuring process will therefore be quicker than a TCI Company Arrangement which on top of the structuring of the arrangement itself[[13]](#footnote-13) will involve the multiple formalities which are required by the Insolvency Ordinance to be satisfied (Part III of the Ordinance). There is also still a requirement to appoint a Supervisor under a Company Arrangement who ultimately has control of the process. The Supervisor for example will have to present, among other things, a summary of the affairs of the company[[14]](#footnote-14), their opinion as to whether the arrangement has a reasonable prospect of being implemented[[15]](#footnote-15) and make proposals as to any necessary modification or alteration of the arrangement that they consider necessary[[16]](#footnote-16).
6. Perhaps the final advantage of an informal restructuring is its costs. A Company Arrangement, the most closely analogous concept to an informal restructuring in TCI, still requires the retainer of an Insolvency Practitioner to act as the Supervisor[[17]](#footnote-17). Such a retainer is a cost that could be saved for the payment of debts to the creditors. Far more expensive even is a full-blown liquidation. Even if a liquidator is appointed voluntarily, as is possible in TCI[[18]](#footnote-18), the individual will also have to be an Insolvency Practitioner[[19]](#footnote-19) and the same challenge in relation to expense will present itself.
7. The most glaring disadvantage, however, of an informal restructuring is that of operating outside the protection of the legislative moratorium. The debtor will therefore still be exposed to individual collection efforts by creditors which may overwhelm it and prevent constructive efforts to effect a restructuring plan. This is so in TCI, both in respect of a Liquidation[[20]](#footnote-20) and an Administration[[21]](#footnote-21). Disappointingly, however, a moratorium is not available upon effecting a Company Arrangement and therefore proceeding in that manner does not carry that particular advantage over an informal workout.
8. Another disadvantage is the obvious one that an informal restructuring relies on the mutual agreement of all the parties involved which relies on the creditors and debtors being able to corporate to their mutual advantage. It goes without saying that this exercise becomes more difficult the more creditors and classes thereof are involved in the restructuring.
9. Finally, an in-court restructuring may be preferable if access to further financing is necessary for the proposed restructure and the existing creditors either refuse, or, are simply unable to provide that financing. New lenders aware of the debtor’s distressed situation may be unwilling to commit financing without court protections such as orders of the Court in relation to the priority of repayment following the restructure etc.

**Question 3**

1. The following articles present models of best practice or aspects thereof in relation to steering companies through financial crises:
2. Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions?, *Review of Central and East European Law, 31(2), 135-154*.

(for convenience “Adriaanse et al”)

1. Pajunen, K. (2006). Stakeholder Influences in Organizational Survival. Journal of Management Studies, 43(6), 1261-1288.

(for convenience “Pajunen et al”)

1. Sudarsanam, S, Lai, J., (2001), ‘Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis’, British Journal of Management, Vol. 12, 183-199.

(for convenience “Sudarsanam et al”)

1. Schmitt, A., Raisch, S. (2013). ‘Corporate Turnarounds: The Duality of Retrenchment and Recovery’, Journal of Management Studies, 50(7) p. p. 216-1244.

(for convenience “Schmitt et al”)

1. Adriaanse et al argue that for various reasons an “informal reorganistion” is often the more advantageous route through organisational crisis relative to a “formal reorganistion”. By “informal reorganization” what is meant is “all possibilities of reorganization laid down by the (insolvency) law or which take place by using legal methods and possibilities”[[22]](#footnote-22). An informal reorganization, however, is “a reorganization route which takes place outside the statutory framework with the objective of restoring the health of a company in financial difficulties within the same legal entity”[[23]](#footnote-23). It is quite clear from Flow’s financial crisis that no formal steps were taken to reorganize the group. The management of the crisis was dealt with completely informally. No doubt Flow’s management considered many, if not all, of the reasons advanced by Adriaanse et al as being conclusive in that decision, that is, the flexibility[[24]](#footnote-24), privacy[[25]](#footnote-25) and the retention of control[[26]](#footnote-26) which an informal reorganization affords.
2. The Flow Management group performed both a business and a financial restructuring. An analysis, consistent with Adriaanse et al’s 2nd phase[[27]](#footnote-27) was conducted in November 2013 wherein a plan of action was drawn up identifying the issues causing distress. Subsequently, in December 2013 measures were implemented designed to stabalise[[28]](#footnote-28) and reposition[[29]](#footnote-29) the company. Although recruitment of staff followed in 2014 in an effort to introduce reinforcement processes, it was not really until the restructuring agreement was signed In July 2015 that the group could be said to have been reinforced in tandem with significant financial restructuring.
3. Pajunen et al have developed a stakeholders’ influence identification model using communication archives of the Finnish pulp and paper industry firm, Kymi Corporation, which entered and exit reorganization following financial distress between 1908 and 1912. From that model they extrapolated several propositions regarding the basic function of stakeholder management in organizational survival[[30]](#footnote-30). Proposition 1[[31]](#footnote-31) is simple insofar as it posits, in short, that governing stakeholders should be kept on board throughout the reorganization process by management. Looking at the Flow as a whole, one would have to conclude that the governing stakeholders, identified as the shareholder and the creditors (banks A-D), were ultimately assured during the crisis. That is evidenced by the fact that the shareholder, although forced to replace the CEO of Flow Management Holding BV with its board, was nevertheless willing to contribute significant capital towards effecting the reorganisation. It is true that banks C & D seemed to at times waver, however, they ultimately stuck with the process to the end.
4. Pajunen et al’s 2nd proposition[[32]](#footnote-32) is that frequent and open communication between management and stakeholders will tend to enhance the continuing support of stakeholders and increase survivability. From the material presented there is no indication that the two groups (management and stakeholders) communicated anything less than frequently and earnestly. Where perhaps Flow’s management can be faulted is in the repeated promulgation of inaccurate data and analyses to its shareholder and the banks (its governing stakeholders). That is in my view what caused the breakdown in confidence between management and the shareholder resulting in the CEO’s replacement in April 2014 and the Banks’ general lack of confidence in the Flow group around that time; it ought to have been dealt with[[33]](#footnote-33). The aforesaid observations lead directly to Pajunen et al’s 4th proposition[[34]](#footnote-34) that “in an existence-threatening crisis, management’s unlocked brokerage position between governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders”. That is, although there was earnest and frequent communication between management and the governing stakeholders, that communication often tended to detract from or undermine the confidence of the governing stakeholders in Management as it was often unproductive.
5. While there is little contained in the scenario regarding the personal relationships between Flows managers and governing stakeholders (Pajunen et al’s 3rd proposition[[35]](#footnote-35)), or, explicit consensus between management and the governing stakeholders regarding the long-term future of Flow (Pajunen et al’s 5th proposition[[36]](#footnote-36)), I believe it can at least be agreed, as is reflected in the executed July 2015 restructuring agreement, that there was in fact ultimately a consensus that for the rest of the group to survive the holding company, Flow, had to be liquidated. That liquidation and the transfer of the shares of Flow’s subsidiaries can be presumed to have been done in the long-term interest of the group of which Flow was a part.
6. Pajunen et al’s 6th proposition[[37]](#footnote-37) is somewhat more difficult to reconcile with Flow’s reorganization process insofar as it speaks to governing stakeholders actively associating management with good firm performance which in turn positively related to those stakeholders’ continuing support. From the difficulties discussed above (the poor information management and the replacement of the CEO and other CFO) it is hard to say that the governing stakeholders *must* have associated management with “good” firm performance. In my view what maintained the creditors’ confidence was the fact of the shareholders’ association with management which led them (the creditors) to place faith in the company until the restructuring agreement was settled.
7. Sudarsanam et al aim to fill the empirical gap in the effectiveness of particular turnaround strategies by asking whether companies that recover from financial distress adopt different strategies than those that continue into decline, whether the two groups differ in the intensity and timing in the deployment of those strategies and which of them contribute to corporate turnaround[[38]](#footnote-38).
8. The results of the study indicate that both recovery firms (those that eventually recover from distress) and non-recovery firms (those that don’t) start with nearly the same order of importance of strategies with operational restructuring, capital expenditure and acquisition being the most frequent[[39]](#footnote-39). Comparing that to Flow Management, while there was some operational restructuring in the form of the price increases, improved loss recovery and the retrenchment of 130 staff, there was no capital expenditure or acquisition.
9. One year after the distress period began the most frequently adopted strategies in non-recovery firms were still “cutbacks” such as dividend cuts, operational restructuring and asset sales[[40]](#footnote-40). Flow Management adopts the same strategies insofar as the entire business mix is reevaluated and they have planned to sell shares around. There is still no capital acquisition by Flow Management. Recovery firms similarly employ asset sales but to a greater degree. Operational restructuring drops, however.
10. Continuing on two years following the onset of distress, the aforementioned trends deepen and it is clear that Flow Management falls squarely into the bracket of having employed, for the most part, the strategies of non-recovery companies. That is, the restructuring agreement effects the sale of shares, the liquidation of substantial assets and a transformative debt restructure. There is also no possibility of a dividend issue at this stage and the company is still trying to break even. It is difficult to recommend to Flow’s management the vastly different strategies adopted by recovery companies at this time such as capital expenditure and asset acquisition as they simply could not afford it, their stakeholders would likely balk (the shareholder and the creditors) and they are simply too consumed with staying afloat to make sound decisions in this regard. This perhaps reflects the fact, as admitted by Sudarsanam et al, that there may not be a causal link between the strategies adopted by firms and the end result (recovery or non-recovery)[[41]](#footnote-41). It is also postulated, as I have argued in relation to Flow, that the level of intensity of restructuring in later years may be influenced by the failure to recover in the initial years of distress[[42]](#footnote-42). So for example, non-recovery firms may be less able to issue new equity in the second year than in the first and may be forced to cut or omit dividends or restructure debt more intensively in the second year[[43]](#footnote-43).
11. Schmitt et al have a simple thesis. Whereas corporate turnaround research has described retrenchment and recovery as inconsistent forces that should be addressed separately, it has not been tested whether they are in fact interrelated and should be integrated thereby permitting turnaround firms to create benefits that exceed the costs of integration. Schmitt et al therefore performed an empirical study of 107 Central European turnaround initiatives and found evidence for their assumed duality between retrenchment and recovery. They have taken the definition of retrenchment activities as those designed to reduce assets and/or improve operational efficiency whereas recovery activities are those that transform and reposition the firm for sustained growth and profitability.
12. Schmitt et al’s findings indicate that the interaction between retrenchment and recovery activities has a positive effect on turnaround performance[[44]](#footnote-44). In truth, Flow’s management did integrate both retrenchment and recovery activities to the benefit of the organisation. For example, from the outset in December 2013, Flow’s management’s method of tackling the crisis included measures designed to both cut costs (retrenchment of staff, price increases) together with methods targeted at improving competitiveness. In the latter regard, a new CFO was retained, evaluations were at least planned regarding how turnover could be increased (page 4) and the range of products offered were reconsidered (page 4). The remainder of the restructuring exercise took a similar approach with financial and operational restructuring taking place together with recovery activities. The Restructuring agreement is testament to that insofar as it includes aspects of debt restructuring[[45]](#footnote-45) as well as an attempt to hive off the most productive elements of the group[[46]](#footnote-46) to go forward together as a streamlined entity[[47]](#footnote-47).

**Question 4**

1. Although the information in the Flow Management fact scenario regarding banks C and D’s skepticism is scanty there are some hints as to an explanation for their reluctance. In January 2014 the stakeholders appeared to be at idem. The Banks placed trust in the company which announced that it would appoint a new CFO and the decision was made for the company’s management and the shareholder to constructively work together on a solution. Subsequently, a standstill agreement is proposed by the shareholder consistent with the Statement of Principles for a Global Approach to Multi-Creditor Workouts II (“the Statement of Principles”) but a month and a half later banks C and D have suddenly stopped cooperating. It is revealed later that generally and even more so for banks C and D, the banks’ lack of confidence stems from the developments of the past six months.
2. From a rational perspective, it may be that banks C and D’s skepticism arose from the fact that their debt exposure to the group around the time of the crisis was considerably more than banks A and B’s. In the 6-month period prior to banks C and D’s reluctance there was a revelation that there was a problem with the banks’ securities (pledges). That, of course, would suggest that if there were to be a liquidation C and D would wind up in the general body of credits which may make their recovery very minimal. Additionally, the other recent revelations regarding the profitability of the company and its systemic information management problems suggest that the company may never return to profitability. It may therefore be that banks C and D have become apprehensive about committing to a standstill agreement as it would limit their options at a very uncertain time. Given Flow’s fluctuating balance sheet it is not hard to see that a creditor would not be sufficiently buoyed with confidence to formally commit to placing trust (in effect) in the company by way of executing a standstill agreement[[48]](#footnote-48). It is to be noted that eventually banks C and D execute a standstill agreement following noticing a slight improvement due to the reorganization relevant to the information management system and Flow’s new management personnel.
3. Opportunistically, it is possible that banks C and D have cynically assessed that they would be in an overall better position if they were to create a situation, as they did, which would prompt banks A and B to buyout their interests. It is revealed that around April 2014 banks A and B are investigating just that with a 15%-20% discount to the debt. If banks C and D have surmised that the company is not recuperable and given the difficulties with the banks’ securities which would mean they may be liable to get very little on a liquidation, this strategy would permit them to recover a considerable amount more than they otherwise could.
4. Also opportunistically, banks C and D demonstrated in August 2014 that they are not unwilling to use their leverage to send signals to Flow and its shareholder. So, at the end of June 2014 when they become impatient regarding the implementation of the shareholder’s financial restructuring plan, they threaten to cancel their ongoing credit line as a signal to hurry the decision-making process. Similarly, it may also be that banks C and D’s reluctance to execute the standstill agreement earlier in the year was another way of sending a signal to the shareholder to speed up with respect to its decision regarding the strategy to be adopted by Flow as initially contemplated in January 2014. It is to be noted that the standstill agreement was only executed following “green shoots” in the form of the slight improvement due to the reorganization relevant to the information management system and Flow’s new management.
5. In advising banks A and D, I would start from the premise that adherence to the 1st of the 8 Statement of Principles is the wisest course of action. They, clearly being a portion of the relevant creditors, should be prepared to co-operate with the other relevant creditors (banks A and B) and the debtor to give sufficient time for further information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed. I would advise that opportunistically not to do so comes with avoidable significant reputational risk vis a vis the other relevant creditors, the debtor and future potential enterprise clients.
6. If banks A and D’s reluctance is not premised on some opportunistic motive but influenced by doubts about the recoverability of the debtor, then I would argue that given the fact that the company as at that time (February 2014) has only had a few months to assess its position, that it would be premature to resile from the process. In any event the appropriate way for banks C and to handle the situation would be to explain itself to the other creditors and pay attention to the feedback[[49]](#footnote-49).
7. It may be that if banks A and D are pessimistic about the prospect of recovery the best way of dealing with that would be to give less rather than more time (at least initially) to the debtor to analyse its financial situation in the standstill agreement. If subsequently there is cause to be optimistic then the agreement may always be renewed. So, a 120-day standstill agreement was initially executed in middle August 2014. It may be that it may have been more appropriate at that time (February 2014), to only extend an initial 90-day standstill period, or, a 60-day period.

**Question 5**

1. Principle 1, the allowance of a standstill period, was initially implicitly agreed in relation to the Flow Management Group so that information in relation to the group’s position could be obtained, evaluated and for proposals for resolving its financial difficulties formulated and assessed. When banks A-D (likely the relevant creditors given their level of exposure relative to others) learn about the group’s financial difficulties on 16 November 2013, no move is made by any of them to call in any debts, bring any claims (in litigation) or take formal steps such as suspension of payments (“*surseance van betaling*” in Dutch) or liquidation (“*faillissement*” in Dutch) available under Netherlands law. It is noted that just around December 2013, “although formally the banks have sufficient legal reason to terminate the credit agreements, this is not done”.
2. Between that time and about July 2014 there is talk about a standstill agreement but it is continually put off as a result of the disharmony among the banks and the rapidly changing financial situation of the Flow Management group. Even though the banks become increasingly frustrated around early August 2014 with the rollercoaster ride that is the group’s balance sheets and its information management system, there is reticence to taking formal steps and they instead place trust in the fact that there are positives to be observed in the group’s performance:

*“Although, the banks as a group are not happy with the constantly changing information given by the company, they are content about Flow Management Holding BV’s new management (including the CRO) and they notice a slight result improvement due to the reorganisation. They therefore decide to pursue a standstill agreement in the short term.”*

1. Following that decision, they draw up plans in respect of both selling the group and the formal steps noted above (“surseance van betaling” and “faillissement”). A formal 120-day standstill agreement is subsequently signed in the middle of August 2014. In effect, by the time of the formal standstill agreement Flow’s management had around 9 months of implied standstill[[50]](#footnote-50) and between that time and the execution of the restructuring agreement there was a further explicit standstill period of about 11 months.
2. There is no evidence that any of the banks took steps to enforce their claims against or take any action which might adversely affect the prospective returns to creditors (Principles 2 and 3). Although banks C and D became “uncooperative” in mid-February 2014, no such steps are noted to have been taken by them. As noted above, they eventually join with banks A and B in entering into the standstill agreement.
3. There was, however, no selection of one or more representative co-ordination committees by the banks (Principle 4). That may very well have assisted in preventing banks C and D from being tempted to withdraw from the process. A coordinator could have helped resolve the dispute by facilitating discussions and could have been delegated the authority to appoint a mutually agreed independent auditing team to review Flow’s books for themselves, thereby, getting around the problem of the debtor’s dysfunctional internal information management system.
4. Although the debtor was very open with the information shared with the banks over the relevant period (Principles 5 and 7), it was usually erroneous information and therefore the banks should have attempted to facilitate the review of the company’s accounts for themselves by way of independent advisers. That would have enabled them to properly assess the financial position of the debtor from the beginning of the crisis and better evaluate management’s proposals. There is no evidence that the debtor would have balked at such a request but in any event the banks did not suggest it. No issue of confidentiality arose likely because banks A-D are established financial entities accustomed to adhering to the principle of client confidentiality (Principle 7). No formal agreement was signed, however, which was a misstep.
5. There was consideration by banks A and B to buyout Banks C and D’s interests, however, it was purely constructive so as to enable the debtor more time in the event that C and D were considering going the formal route or selling to 3rd parties. Given the identity of creditors would not have been changed following such a debt sale, the status quo would not have been prejudiced (Principle 7). That consideration by A and B was therefore the ideal scenario in the circumstances (Principle 7).
6. It is clear that the forbearance of the banks in not jumping to formal measures was largely as a result of their view that that was the less desirable outcome relative to the restructuring of the group (Principle 6). That is reflected in the statement “*Although formally the banks have sufficient legal reason to terminate the credit agreements, this is not done. The reason is that – according to the banks – bankruptcy (i.e. liquidation) of the company (in Dutch: ‘Faillissement’) will negatively affect the proceeds of the assets. In addition, there is a problem with the securities (pledges) on the assets established at the banks*.” At page 3.
7. Although a significant amount of pressure throughout the relevant period was placed on the shareholder to inject New Money into the company, that ultimately did not transpire as a result of reluctance on the part of the banks to sign a standstill agreement and the rapidly changing situation. Even if the shareholder did inject New Money there was nothing for the relevant creditors to be wary of in that respect as their pledges on the company’s assets would have meant that their recoverability in the circumstances would not have been prejudiced (Principle 8).
8. It is noted in the restructuring agreement that banks C and D in the past provided Flow with additional working capital and waived an amount of €32.5 million, the entirety of the debt being written off. I do not believe that this can be characterized as New Money as referred to in the Statement of Principles (Principle 8). It was said to have been done in the past and not during the financial crisis. There is therefore no reason to question whether the funding was absolutely necessary, or, taken on without an assurance that it would not dilute the funds then available to be paid to the existing relevant creditors. Those funds certainly did not violate the premise of the standstill arrangement, whether while one was implied, or, when it became explicit.

**Question 6**

1. If creditors are unwilling to adopt the Statement of Principles it seems unlikely that they could be persuaded to adopt any other form of “soft law”. Notwithstanding that, it may make sense to point out that other forms of “soft law” make the same recommendations as the Statement of Principles. Although the different literature may cover the same subject matter and may offer relatively the same advice, it is always possible that a creditor may find one organisation more persuasive than the next.
2. While there are no applicable soft law approaches developed in the Turks and Caicos Islands, the ELI’s (European Law Institute), Instrument of the European Law Institute on the Rescue of Business in Insolvency Law (2017) (ELI Instrument on Business Rescue (2017)), which may be more persuasive to a Netherlands creditor, does strenuously note at Chapter 8 that a substantial amount of cooperation is required where a business is to be restructured :

*Much more cooperation is usually required where a business must be restructured. If a plan does not only provide for the adjustment of old debt and security rights (financial restructuring), but also for an adjustment of vital credit lines, supply or employment contracts (operational restructuring), a larger number of stakeholders must be brought together. The resulting complexity is further multiplied incases of corporate debtors if the restructuring would also affect their capital structure (e.g. in the course of a rearrangement of a complex structure with several layers of debt, equity and collateral) which usually requires the involvement of shareholders. Add an insolvent corporate group with subsidiaries and establishments in several jurisdictions to the picture and the need for efficient cooperation is at peak level[[51]](#footnote-51).*

1. That paragraph mirrors the advice provided in “the Statement of Principles for a Global Approach to Multi-Creditor Workouts II” and one will find that it is also consistent with other “soft law” on the same subject matter such as, UNCITRAL Legislative Guide on Insolvency Law Part 3 (Chapter II, F), Asian Bankers' Association Informal Workout Guidelines –Promoting Corporate Restructuring in Asia (2013 Amendment, pages 1-3) and The World Bank Principles for Effective Insolvency and Creditor Rights Systems (2016) (pages 9-12).
2. The nub of the advice for creditors C-D is that cooperation and coordination among them and with management is necessary to effect an informal reorganization; there is nothing gainsaying that. In advising creditors in a similar situation, if in the face of the substantial body of advice a creditor still does not want to cooperate, for example, for self-interested reasons, then it would be ideal to remove them from the equation. That was the effect of the eminently sensible proposal of banks A-B to buyout the debts of banks C-D. In doing so, Banks C-D could no longer negatively impact the process of formalizing a standstill agreement and the identity of the debtor’s creditors would not have changed consistent with the Seventh principle in the Statement of Principles.

**Question 7**

1. After much delay the Flow Management group, the shareholder and the group’s creditors entered into a restructuring agreement on 4 July 2015.
2. By the agreement a new company, Flow Management II BV, is incorporated to hold the shares of Flow’s subsidiaries (FMW Spain SL, FMW France SPRL, FMW Australia Ltd., FMW South Africa Ltd. and FMW USA Ltd. (“the Subsidiaries”)). Flow Management II BV, which is incorporated initially as a subsidiary of Lease Group Holding United Kingdom Ltd., “the shareholder”, essentially owns the Subsidiaries. The remaining subsidiary company Flow Management Work BV (The Netherlands) is to be liquidated.
3. The restructuring agreement then contemplates that the shares of Flow Management II BV will be transferred to the consortium of banks (A-D) that financed the original working capital of the company (“the Consortium”) and certain Board members of Flow Management Holding BV including the CRO. It can be presumed that this transaction is a “debt equity swap” in which the banks obtain the shares and in effect the benefit of the new company in exchange for cancelling Flow’s debt to them. It may also be presumed that the CRO, who was brought onto the Board of Flow Management Holding BV during a period of significant financial distress and the other Board members are owed funds arising from their retainer and the shares transferred to them are in consideration thereof. Alternatively, it may be that the shares are transferred to the CRO/Board members as a sort of bonus.
4. Flow is to be liquidated. Although it is stated that the liquidation is to take place in an undisclosed manner, all claims against it by the banks and its shareholder (outstanding loans etc.) will be cancelled. It can be assumed that the benefit of Flow’s liquidation will redound to the shareholder as it still owns those shares and the company’s debts have been cancelled under the agreement.
5. Flow and the shareholder will cancel all outstanding claims against Flow Management II BV thereby ensuring that the Consortium and the board members take the shares in that company free of any indebtedness to the shareholder and Flow arising from past loans etc. to the Subsidiaries.
6. The next phase of the agreement is the various cancellations/waivers of debts owed to the creditors. Banks C and D have agreed to a haircut in the amount of €32.5 million, wiping away the debt owed to them by Flow Management Work BV in respect of the additional working capital they financed. Their agreement to do so is likely partially in consideration of the transfer to them of some of the shares in Flow Management II BV (the “debt equity swap”). So too is the agreement by the Consortium to waive €97.5 million. The €55 million in other loans by sundry creditors to Flow Management Work BV is also cancelled and it can perhaps be presumed that most, if not all of that debt, was owed to the Consortium.

1. The Consortium have pledges on Flow Management Work BV’s assets and the restructuring agreement contemplates that they will be able to recoup whatever they can from the liquidation of that company. A €240 million debt is still owed to the Consortium. There are also debts still owed to the shareholder and other unsecured creditors. The assets which are pledged (to the Consortium) are the only secured ones in the company. The other interested parties (the shareholder, other creditors), although able to participate in Flow Management Work BV’s liquidation, will likely receive nothing following the sale of the pledged assets (considering the €240 million debt to the Consortium and unavailability of other assets).

**Question 8**

1. The fact scenario as presented contains several potential legal cross-border insolvency law issues. Those issues relate primarily to a supposition that a liquidation of Flow Management Holding BV (“Flow”) becomes necessary and a liquidator (in Dutch: ‘vereffenaar’) is appointed in that respect. Flow holds the shares in several subsidiaries across several foreign jurisdictions including Spain, France, Australia, South Africa and the USA. Having obtained an order for Flow’s liquidation in Netherlands (in Dutch: ‘Faillissement’) the liquidator will have to ‘deal’ with those shares which would require, ideally, orders being made in the foreign jurisdictions recognizing the Dutch liquidator’s appointment. Once that is done the liquidator would be free to realise Flow’s assets in those jurisdictions.
2. In respect of Spain and France, both countries are signatories of the European Union’s “European Insolvency Regulation Recast” (“EIR Recast”) which provides a common platform of rules relating to international jurisdiction, the recognition of insolvency judgments, applicable law in insolvency matters and cooperation between insolvency practitioners. The EIR Recast provides for the immediate recognition of judgments/orders concerning the opening, conduct and closure of insolvency proceedings which fall within the scope of the EIR Recast (s. 65). Judgments/orders handed down in direct connection with such insolvency proceedings are similarly recognised immediately and automatically (Article 19). Orders appointing a Dutch liquidator in respect of Flow FMW will therefore be immediately recognised in France and Spain which would permit the direct dealing by the liquidator with the shares of FMW Spain and FMW France.
3. Australia and the United States on the other hand have both almost verbatim adopted the UNCITRAL (United Nations Commission on International Trade Law) Model Law on Cross-Border Insolvency Law[[52]](#footnote-52). The UNCITRAL Model Law was adopted by the Commission in 1997 and focuses on the legislative framework necessary to facilitate cooperation and coordination in cross-border insolvency cases, with a view to promoting the general objectives of:

“(a) Cooperation between the courts and other competent authorities of the enacting State and foreign States involved in cases of cross-border insolvency;

(b) Greater legal certainty for trade and investment;

(c) Fair and efficient administration of cross-border insolvency pro-ceedings that protects the interests of all creditors and other interested persons, including the debtor;

(d) Protection and maximization of the value of the debtor’s assets;

(e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.”[[53]](#footnote-53)

1. The Model Law as enacted in those jurisdictions would permit a foreign representative to apply to the court for recognition of the foreign proceeding in which the foreign representative was appointed (Article 15). The application must contain, among others things:

“(a) A certified copy of the decision commencing the foreign proceeding and appointing the foreign representative; or

(b) A certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or

(c) In the absence of evidence referred to in subparagraphs (a) and (b), any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative.” (Article 15(2)(a)-(c))

1. And will be recognised if:

(a) The foreign proceeding is a proceeding within the meaning of subparagraph (a) of article 2; [*a collective insolvency proceeding, as a ‘Faillissement’ would be*]

(b) The foreign representative applying for recognition is a person or body within the meaning of subparagraph (d) of article 2; [*as a Dutch liquidator (‘vereffenaar’) would be*]

(c) The application meets the requirements of paragraph 2 of article 15; and

(d) The application has been submitted to the court referred to in article 4 [*the courts with jurisdiction in Australia and the USA to hear such proceedings*].”[[54]](#footnote-54)

1. The effect of recognition would be that, among other things, the commencement or continuation of individual actions or proceedings concerning the assets, rights, obligations or liabilities of Flow’s subsidiaries in Australia and USA will be stayed[[55]](#footnote-55) and the Dutch liquidator would be entitled to relief. The relief that would be sought in this case is that the Dutch liquidator be entrusted with the administration or realization of the debtor’s assets in Australia and the United States under Article 21(1)(e) of the Model Law.
2. In respect of the subsidiary in South Africa, although that jurisdiction has adopted the Model Law in the Cross-Border Insolvency Act 2000, the provisions thereof continue to be dormant as it was implemented with reciprocity requirements that were so stringent that neither the Netherlands nor any other country would qualify to take advantage of them.
3. It would, however, be open to the Dutch liquidator to rely on South African jurisprudence deciding that there is a general discretion by the South African courts to assist foreign insolvency proceedings either ‘as if’ they were domestic insolvency proceedings or by analogy to them[[56]](#footnote-56).
4. As Professor Alastair Smith of the University of Pretoria sets out in his article “*Assisting foreign insolvency practitioners in cross-border insolvency: some foreign insights into South African law Singularis Holdings Ltd v PricewaterhouseCoopers (Bermuda) [2014] UKPC 36 (10 November 2014), [2015] 2 WLR 971*”[[57]](#footnote-57), the south African courts have as a matter of private international law allowed the recognition of foreign liquidators as the debtor’s own local representative. They can dispose of the local assets as though within their home jurisdiction. The South African court might still set conditions protecting local creditors or recognising local law as recognising a foreign liquidator in this sense “carries with it the active assistance of the Court” [[58]](#footnote-58), otherwise, a costly mêlée of local creditors’ execution upon the property would follow[[59]](#footnote-59).
5. As a practical example see ***Lehane N.O v Lagoon Beach Hotel (Pty) Limited and Others*** (15678/2014) [2015] ZAWCHC 3 (23 January 2015), which discusses the Order of Steyn J which authorized a Dublin foreign representative, once he had furnished security, to administer the South African debtor’s estate. The foreign representative was accorded all rights under South Africa’s Insolvency Act 24 of 1936 as though a South African court had issued a sequestration order on 29 July 2013, the date on which the Irish court appointed him as official assignee.
6. A final issue apparent on the facts is that bonuses were wrongfully paid by Flow leading up to the financial crisis. It was in fact the CEO and the CFO who were paid the bonuses, presided over the woeful information management system of the company prior thereto and who were eventually replaced in the restructuring. Under Dutch law there is the possibility for a liquidator to initiate “claw back” proceedings, which are referred to as “Actio Pauliana” in the Netherlands. Such proceedings would permit the liquidator to make the claim that the payment of the bonuses at the time were prejudicial to the company’s creditors and should be rescinded[[60]](#footnote-60). The liquidator would have to prove in such a claim that Flow deliberately disadvantaged the creditors by the payment of the bonuses and that that was known to the opposite parties in the proceedings[[61]](#footnote-61). Given that the CEO and CFO would have been well informed of the company’s position it appears that the bonuses are in fact liable to be rescinded.

**Question 9**

1. A moratorium in the Turks and Caicos Islands in respect of corporate Insolvency proceedings is only available in the following circumstances:
2. Upon the filing of an application for an Administration order under section 74 of the Insolvency Ordinance 2017 and which terminates on (a) the dismissal of the application or (b) if an administration order is made, upon the discharge of the order;
3. Upon the appointment of, a liquidator under sections 159 or 170 of the Insolvency Ordinance 2017 and a provisional liquidator under section 171. Under those sections, unless the Court otherwise orders, no person may commence or proceed with any action or legal proceedings against the company or its assets or enforce, or continue to exercise or enforce any right or remedy over or against the assets of the company and no share in the company may be transferred[[62]](#footnote-62);
4. In a Company Arrangement under Part III of the Insolvency Ordinance, there is no automatic stay, nor is one provided for by application.
5. As the above provisions set out a moratorium stays all individual claims/enforcement efforts by individual creditors of the debtor. In the case of an Administration order, the moratorium provides an opportunity for the Administrator to assess the situation and plan for the rescue of the company[[63]](#footnote-63), or, if that is not a possibility to consider how to realise the company’s assets in the best interests of the creditors[[64]](#footnote-64). The idea being that this would be in preference to a liquidation where no attempt is made to rehabilitate the company but only to take possession of, protect and realise its assets for the benefit of the creditors[[65]](#footnote-65).
6. While any of the creditors[[66]](#footnote-66) may have sought appointment of a liquidator on the basis that Flow is insolvent[[67]](#footnote-67), a moratorium upon the appointment of a liquidator (so, option “2” above) would not have been a good suggestion in my view. By October 2014, Flow had shown signs of continuing viability insofar as a slight improvement is noticed by the banks in August 2014. Furthermore, the shareholder was still actively searching for options, there were legal difficulties in respect of the Pledges on the assets as well as the fact that it had already been determined that a liquidation would negatively affect the proceeds of the assets. A liquidation as thought by banks A-D in respect of a Netherlands winding up would have been equally inadvisable under TCI law.
7. A moratorium pursuant to an Administration Order would have been a less “ham-fisted” manner of proceeding, however, the only benefit of doing so as opposed to putting a standstill agreement in place among the creditors and adopting a wait and see approach for a short while, would have been if there were creditors with proceedings in train. In Flow’s case the fact scenario suggests there were not.
8. It may be argued that an Administration order would have been useful because Flow’s management could not be trusted to do what an Administrator would be tasked with doing upon assuming control, that is, assessing the situation so as to make a plan for the rescue of the company. I do not believe there is any direct evidence that Flow’s Management was corrupt, or, engaged in fraudulent activities. Although Flow’s information management system is atrocious, there are notwithstanding alternative means of ascertaining a clear picture of Flow’s financial and operational standing than appointing an Administrator. In October 2014 it was open to the creditors, as a group, to negotiate and appoint a coordinating committee to organise the retention of professionals to audit and appraise the company, if even on a preliminary basis[[68]](#footnote-68). That manner of proceeding, in my view, outweighs its cost relative to the cost and time spent appointing the Administrator and the time taken by the Administrator to form the required view considering that Management would have been in a better position in that regard. This is even if management does cooperate with the Administration process as it is possible that they may not.

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13. TCI Insolvency Ordinance 2017; s. 25(1)(c) [↑](#footnote-ref-13)
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15. TCI Insolvency Ordinance 2017; s. 13(1)(c) [↑](#footnote-ref-15)
16. TCI Insolvency Ordinance 2017; s. 45 [↑](#footnote-ref-16)
17. TCI Insolvency Ordinance 2017; s. 25(2)(b) [↑](#footnote-ref-17)
18. Part XV of the Companies Ordinance [↑](#footnote-ref-18)
19. Part XV of the Companies Ordinance [↑](#footnote-ref-19)
20. TCI Insolvency Ordinance 2017; s. 175 [↑](#footnote-ref-20)
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46. It is noted that Flow Management BV is the main partner in the group at the bottom of page 6 of the fact scenario. [↑](#footnote-ref-46)
47. Paragraph 1 of the outline to the restructuring agreement [↑](#footnote-ref-47)
48. INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II; page 11 [↑](#footnote-ref-48)
49. INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor

    Workouts II; as suggested at page 11 [↑](#footnote-ref-49)
50. INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II; see page 9 in which the standstill period is defined as:

    *“Any arrangement under which the debtor is given a temporary breathing space in which information can be gathered and assessed and, where appropriate, further terms negotiated should be treated as a standstill for the purposes of these Principles and the Commentary.”* [↑](#footnote-ref-50)
51. ELI, Instrument of the European Law Institute on the Rescue of Business in Insolvency Law

    (2017) (ELI Instrument on Business Rescue (2017)); Chapter , Para 580. [↑](#footnote-ref-51)
52. In Australia this was effected by the Cross‑Border Insolvency Act 2008 No. 24, 2008 and in the USA by Chapter 15 of the Bankruptcy Code [↑](#footnote-ref-52)
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60. Netherlands Bankruptcy Act; article 31 [↑](#footnote-ref-60)
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67. TCI Insolvency Ordinance 2017; s. 5: “Insolvent” is defined, among other things, as an inability to pay debts as they become due [↑](#footnote-ref-67)
68. Fourth Principle of the Statement of Principles [↑](#footnote-ref-68)