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?**

In their 2004 article, "*Organizational failure: a critique of recent research and a proposed integrative framework*"[[1]](#footnote-1), Mellahi & Wilkinson propose an integrative approach to any analysis of organisational failure whereby, save in extreme situations, both external and internal organisational factors play a part in business failure. In the Flow Management scenario, the available facts suggest that in that particular case, it is primarily internal factors, rather than factors over which company management has no control, which have played the principal role in bringing the position to the critical point which it has reached in late 2013. In particular, the accounting errors in the annual accounts for 2012, which resulted in an overstatement of €4.4 million[[2]](#footnote-2) and the "spreadsheet error" coupled with the failure to check real costs against the cost price calculation are difficult to attribute to anything other than internal factors. On the other hand, we are told that external factors, market demand and forecast "hiring and leasing days" accord with reality. There is no evidence of the existence of any technological, regulatory, economic or demographic changes[[3]](#footnote-3) which might have challenged the group's business model, or of increased competition in the market. However, there does appear to be a marked absence of adequate internal financial reporting systems and controls: evidenced by the fact that management does not appear to have any accurate means of assessing the group's financial situation at any one time – hence the fact that whilst they identified a loss of €5.4 million in mid-November 2013, they were apparently completely unaware at that point that that represented part only of the loss for the group which meant that the total losses for the year 2013 across all the subsidiaries, in fact amounted to €23.1. Even then, that figure understated the loss for the year which was, in fact, €36.4million once the actual results for 2011-2013 were restated.

It is unclear from the scenario, what the tenures of the CEO and CFO respectively have been and whether long-tenure may have contributed to the failure in the way that Mellahi & Wilkinson describe[[4]](#footnote-4). However, whether as a result of long tenure or of other factors[[5]](#footnote-5), it does appear that the CEO and CFO have not been able to apply a critical eye to the internal processes of the Group but have been content, without testing or verifying or auditing, simply to continue in the same way that things have been done, with existing systems and the same sources and scope of the information provided to them[[6]](#footnote-6). It does not appear to be the case that Flow Management Holding BV ("**Flow Holding**") or Flow Management Work BV ("**Flow Work**") enjoy the services of an independent, non-executive director. In a closely held Group in particular, an experienced independent non-executive director, capable of approaching the business with a fresh eye, of testing information and with no vested interest might have encouraged a more robust approach to systems and controls.

There is also a suggestion that the company may have been undercapitalised: the shareholder shows a reluctance to invest manifested by the suggestion that in order to improve the solvency ratio, assets should be sold rather than equity increased [page 2][[7]](#footnote-7).

So far as the prevention of the financial distress is concerned, in addition to the appointment of an experienced, independent non-executive director, clearly a robust, detailed, timely and accurate system for the provision of financial and other information from all members of the group to senior management at holding company level might have allowed the financial crisis to be avoided by providing the means of monitoring financial performance to senior management on a regular and ongoing basis. That, in turn, may have allowed senior management to anticipate any financial issues and to identify much more speedily the fact that the prices charged to customers were not covering costs.

1. **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*?**

In their article *Resolving Financial Distress:* *Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions[[8]](#footnote-8),* Prof. Dr Jan Adriaanse and Hans Kuijl identify three principle advantages of informal reorganisations[[9]](#footnote-9) compared to formal reorganisations to which they ascribe the labels "Flexibility", "Silence" and "Control". Other commentators (Jose Garrido[[10]](#footnote-10); David Cowling[[11]](#footnote-11)) add to that list of advantages and discuss the disadvantages. Those advantages and disadvantages might be broadly summarised as follows.

First, because an informal reorganisation is not constrained by strict statutory or regulatory provisions, it allows for bespoke solutions which may be tailored to the specific situation. In appropriate circumstances, it may deviate by mutual agreement from the statutory priorities to reflect the relative positions of creditors, to provide for new funding to take priority and to allow elastic timelines for the actions to be taken by the company with respect both to the restructuring of its business operations and financial restructuring. A workout situation makes it possible to treat creditors within the same class diﬀerently, for example, to provide for full payment of critical creditors that rank lower than others (for instance, suppliers and other trade creditors). That same fact means that the provision of new money for the company, and the granting of fresh security is not constrained by the rigid requirements of a formal process.

Outside a formal process, an out-of-court workout may allow for greater ease of negotiation, both between debtor and creditors and between the creditors inter se. Garrido[[12]](#footnote-12) suggests that a workout provides a better environment for negotiations, because it is "less confrontational" than formal insolvency proceedings. Certainly, in the less formal context, the parties are free to choose the form, content and frequency of their mutual engagement. They may also self-select the best financial, business and legal advisers for the particular circumstances without the constraints that statute and regulation often imposes on that choice within a formal framework.

Garrido[[13]](#footnote-13) also suggeststhat out-of-court workouts may have the advantage of speed over a court-based process, avoiding as they do, any delay as a consequence of procedural delays or filing formalities. Whether or not that is a real concern[[14]](#footnote-14), because the process of the workout remains essentially under the control of the creditors, it does allow for early, often time-critical intervention and action and brings with it the potential for a speedier resolution than a statutory timetable might allow.

Adriaanse & Kuijl use the word "silence" to describe the absence of publicity which attends an informal workout and in contrast with "public" in the formal context. "Privacy" might be another term for this, reflecting the fact that the company's distress is not widely advertised. Publicity risks bringing with it a number of adverse consequences: a reluctance on the part of the company's existing and potential suppliers, financiers and clients to deal with the company at all, or only subject to the most stringent of terms; a "race to collect", that is an avalanche of creditor claims requiring immediate payment, each creditor competing to ensure that they are paid in priority to the others, and ultimately, enforcement action whether against the company's assets or by way of winding up petition[[15]](#footnote-15). Adriaanse & Kuijl suggest that this can result in a self-fulfilling prophecy-effect of a public procedure. An example from England demonstrates this very clearly[[16]](#footnote-16): Taylor and Sons Limited  (note the plural of "Sons") was a limited company, incorporated in England and Wales in 1900 but with a business which traced its roots back to the 18th century. The business was a profitable one, although the company had faced some difficulties and was in the course of a financial restructure with the support of its bankers. In January 2009, the High Court in London made a winding up Order under the provisions of the Insolvency Act 1996 against a company called "Taylor and Son Limited" (the "Son", here, being in the singular). However, as a result of an error at Companies House, the Order was registered not against Taylor and Son Limited, but against Taylor and Sons Limited with the result that that company was shown as being in liquidation. The supposed liquidation of the company was then broadcast, both by word of mouth by people who accessed the register and via various products supplied by Companies House to customers including credit reference agencies, Experian, Dunn & Bradstreet and Equifax. The result of this error was the collapse of the company's business: some of the company's 3000 suppliers cancelled order, others demanded to be paid up to date before supplying any further goods or services rather than allowing credit which actually extends to 90 days, its principal customer, Corus, to which the company supplied services which generated an income of £400,000 a month cancelled its contract, the company ran out of cash and its bank refused to lend it any more. The company collapsed into administration and the business was sold by the administrators to a third party. The managing director of the company ultimately sued Companies House and the Registrar of Companies and was awarded damages reflecting the loss which the error, and the publicity, had caused.

Where the objective is thesurvival of the debtor's business,a Court procedure, particularly one which imposes a this party liquidator, receiver, examiner or administrator, may make that less likely not merely because of the attendant publicity which tends to accompany such an appointment (as to which, see above) but also because it often displaces existing staff and management who have the experience and knowledge of the business. In a workout, the debtor’s management will usually remain in place (with targeted replacements or additions where appropriate) with no formal controls on their activity. There is therefore a level of continuity which a formal process will often interrupt or curtail. This advantage is identified by Adriaanse & Kuijl under the heading "Control": reflecting the fact that, during an informal restructuring, existing management can continue to run the business. Apart from the saving of costs which this represents, there is a potential benefit to existing owners who will be in a position to determine the speed and outcome of the process themselves. In addition to that benefit, the debtor in possession model also carries the benefit to creditors that existing experience and knowledge of the business is retained which, with such changes as may be necessary, may also contribute to the salvage of the business.

Lastly, the costs of formal insolvency are higher: not just in monetary terms but in terms of time reputation. Workouts are generally thought to be less costly, even where multiple creditors are involved and numerous advisors engaged.

So much for the advantages. In terms of the disadvantages of an out-of-court as opposed to a formal procedure, the primary disadvantages are the absence of a stay on creditor action, and the inability to bind dissenting creditors. In the absence of a formal framework, to provide otherwise, a workout requires the cooperation of all the company's creditors since the basis of the workout is contractual. Not only does this bring the inherent difficulty in dealing with what may be a large number of creditors but this fact allows for holdouts by individual creditors, not possible within the framework of a formal process in which roles are defined by state and regulation. A holdout may derail the compromise and consequently, the ability to do so confers upon each creditor leverage which their class and amount of debt would not carry in a more formal context. This can lead to uncertainty of outcome, to be contrasted with the certainty which accompanies a formal process. In addition, the contractual nature of a workout, requires the debtor’s consent, which may or may not be forthcoming and if forthcoming may be subject to conditions, whilst in formal insolvency procedures no such cooperation is required.

Further, although the less confrontational nature[[17]](#footnote-17) of a workout may facilitate better communication and cooperation between debtor and creditor, the provision of information depends on the willingness of the debtor and its management to provide and to provide it in a timely and comprehensive fashion. Participants in a workout lack the power which will usually accompany a formal process to requisition documents and information. This may mean that it is more difficult, in a workout, to obtain a clear and accurate picture of the debtor's situation, an difficulty which appears to have been encountered in the Flow Management workout.

An informal workout may involve a degree of risk to creditors*.* In his paper, David Cowling[[18]](#footnote-18), points out that in pursuing an informal workout, participants forego the protection which the formal procedures afford and that, not just the directors of the company[[19]](#footnote-19) but creditors too may face liability when they play an active role in an informal restructuring. In particular, creditors who, in the course of a workout, participate in the corporate decision making process and management of the business run the risk of being regarded as de facto or shadow directors of the company[[20]](#footnote-20). Where the dividing line falls between the position of "watch –dog" or adviser and that of a shadow director is not one which is clearly defined[[21]](#footnote-21). Consequently, there have been cases where creditors have crossed that invisible line and have been deemed to have acted as a shadow director[[22]](#footnote-22). However, the cases where this has occurred are the exception rather than the rule and the case law makes clear that where a lender is simply acting to safeguard its own interests as a creditor of a company will not, without more, be deemed to be a shadow director[[23]](#footnote-23). Cowling's conclusion is to similar effect –

*"The case law suggests that creditors are entitled to apply commercial pressure on their debtors in order to protect their interests as long as the debtor directors are free to decide whether to comply with that pressure. This would appear to give creditors a wide ambit, however, in order to prevent or defend shadow directorship claims, creditors must ensure that they have negotiated and communicated with their debtors at arm's length at all times. Essentially, creditors must be careful to only offer advice and make recommendations, not participate in management decisions, the day-to-day running of the business or negotiations with third parties. A creditor can indicate the terms upon which it will continue to financially accommodate or support the debtor, but should not instruct or direct the board to adopt a particular strategy. …. Creditors should be aware of potential claims and of the distinction between creditor and director."*

Lastly, whilst foreign courts may recognise and give effect to formal proceedings, a workout involves no such advantage. Where a debtor's business and assets are situated in more than one country, a workout may require international activity so as to secure a globally successful outcome of a restructuring.

1. **Were the turnaround/reorganization approaches as presented in the reading material (see e.g. Adriaanse & Kuijl, 2006, Pajunen, 2006, Sudarsanam, S, Lai, J., 2001, Schmitt, A., Raisch, S., 2013) applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.**

Certain elements of the turnaround presented in the reading materials were applied in the approaches adopted in the Flow Management case. However, there appears to have been a greater emphasis on short and medium term objectives of stabilisation, retrenchment and conservation than on the longer term objective of sustainable recovery and growth[[24]](#footnote-24).

The company did recognise the importance of identifying key primary[[25]](#footnote-25) and secondary[[26]](#footnote-26) stakeholders at an early stage [pages 1 and 2] [[27]](#footnote-27) in order to engage their support. It appears to have communicated speedily and efficiently with the main clients, achieving their support for the proposed price increases. However, although the Banks agree a temporary standstill in December 2013 on the strength of the company's plan to cut costs and increase revenue [page 3], the flow of information to the banks, and the accuracy of that information, during the process is sub-optimal: we are told that the banks are not happy with the constantly changing information given by the company [page 5]. Pajunen[[28]](#footnote-28) emphasises the critical role which key stakeholders play in ensuring the success of a workout and the importance of frequent and open communication in ensuring the continuing support of those stakeholders[[29]](#footnote-29). The information flow and the accuracy of that information is clearly important in building – or rebuilding – trust between the debtor and the creditor and trust is an essential factor in cooperation and cooperation in turn essential to a successful resolution[[30]](#footnote-30) and the company might have achieved a swifter, potentially better, result from the Banks had its communications been better in these respects.

The company also acted swiftly in taking steps to implement strategies directed at reducing costs and increasing revenue[[31]](#footnote-31). Cash inflow is improved by price increases, and expenditure is reduced, both in the short and in the longer term, by making 130 employees and independent contractors redundant [page 3]. Savings are also made by improved loss recovery, higher excess premiums and savings on car repairs. There is also a suggestion that certain assets, in the form of 350 cars were to be sold, but it is unclear whether this in fact happened. At some point, it does appear that surplus assets were sold [page 6, October 2014] generating cash flow. Fresh working capital, of €25 million is apparently secured is secured[[32]](#footnote-32).

With respect to the underlying causes of the company's problems, an independent accountancy firm is called in to investigate the company's internal procedures [page 2]. At the same time, an independent turnaround consultancy is engaged to advise on the business's viability and capability of achieving estimated turnovers [page 2]. Both forms of analysis are considered by Adriaanse, & Kuijl[[33]](#footnote-33) to be a necessary precursor to the company and its stakeholders forming a view of the long term prospects of the business. However, although the Turnaround Consultancy advises that the company is viable, its final report does not appear in the short term to have generated a reorganisation plan from the company which is realistic and achievable[[34]](#footnote-34). Further, although improvements are predicted to the management information systems on the heels of the independent accountants' investigation which will improve the reliability of the figures [page 3] that does not, in the event, appear to have happened to the extent anticipates since the forecasts continue to be highly inaccurate [pages 5 (June 2014) and 6 (October 2014)].

All the aforementioned positive steps take place swiftly following the initial identification of the problem in late 2013. However, momentum is not sustained and it ultimately takes over 18 months for a restructuring agreement to be put in place[[35]](#footnote-35).

With a view to the longer term of the business, the company does implement changes to its senior management: a new CEO of Flow Holding is appointed in mid-April 2014. However, although the Banks also lack confidence in the CFO [page 3] and, in January 2014 the company announces that it will appoint a new CFO, it is not clear whether that actually occurred. However, the appointment of the new CRO in June 2014, does assist in restoring the Banks' confidence in the company's management [page 5]. All of Adriaanse & Kuijl, Sudarsanam & Lai[[36]](#footnote-36) and Pajunen emphasise the role that management change plays in a workout – Sudarsanam & Lai go so far as to identify management change as "*a precondition for a successful turnaround"*.

What does not happen during the workout or, indeed, under the terms of the Restructuring Agreement, is an injection of fresh equity capital. The only contribution ahead of the Restructuring Agreement which the shareholder makes is in the form of a deposit of € 10 million in the company by way of an interest bearing unsecured loan with the interest obligations being added to the principal sum of the loan. Although the materials do not specifically identify capital investment from shareholders as a material factor in building trust and confidence in the course of a work out, it cannot assist in that process if the owners of the business are themselves reluctant to invest. The scenario makes it clear that the Banks expect the shareholder to invest in the equity. Their initial request, in December 2013, that the shareholder pay off the equity to improve the solvency rate is met only by a proposal by the shareholder that the rate be improved by reducing the assets by selling cars and not by a payment by them. The Banks continue to request that the shareholder strengthen the equity capital position but, in spite of various promises, the only new capital invested by the shareholder is in the form of loans.

Ultimately, the reorganisation takes the form of an effective takeover by the Banks of the 6 operating subsidiaries (the "**Subsidiaries**") in exchange for a write down of the existing debt. The shareholder also receives a stake and writes off all of its claims against Flow Work and the other Subsidiaries. Whilst this organisational and financial restructuring does allow for a fresh start, and renders the business a more attractive target for a purchaser, in the absence of a long term strategy, there must be a question whether recovery is sustainable. Although, in early 2014, a plan is drawn up which would include an evaluation and reassessment of the entire business, it does not appear that that was ever implemented. Schmitt and Raisch argue that the integration of a recovery strategy alongside the necessary retrenchment has a positive effect on turnaround success. Similarly, Sudarsanam & Lai cite the survey in Chapter 4 of Grinyer, P.H.D.G.Mayes and P McKiernan (1988) *Sharebenders: the secrets of unleashing corporate potential[[37]](#footnote-37)*, which supports the view that firms which look to the long term positioning and performance of the business make strategic changes through diversification, acquisition and investment do dramatically better than others which restrict themselves to operational cost-cutting strategies. More focus on the longer term strategy for the business might have meant that the "new" company had better prospects than, in May 2016, it appears to have.

1. **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**

One of the disadvantages of an informal workout, as distinct from a formal, statutory or Court-supervised procedure, is that it relies entirely on the willingness of the principal creditors to cooperate, and this cooperation will often mean the sacrifice of specific individual self-interest. There are two obvious consequences of the requirement for cooperation: first, self-evidently, that in the absence of cooperation between the principal creditors, the informal solution will fail. This means that any one creditor can frustrate the process, whether by pursing enforcement against the company's assets or by winding up or otherwise and, since each creditor has such a power, this acts as a leveller amongst the creditors whatever the comparative values of their debt. Secondly, and in turn, that in the initial negotiating period, before a binding inter-creditor agreement is entered into, each creditor will jostle with the others with a view to achieving the best deal possible for itself and its own stakeholders. It may be that Banks C and D are doing just this: exercising their power of non-cooperation in order to obtain for themselves a stronger position with respect to their debts in the deal ultimately to be done[[38]](#footnote-38). It is equally possible, however, that the positions of Banks C and D, and of their stakeholders, are such as to create an asymmetry and a real divergence of interest between them and Banks A and B. For example, the exposure of Banks C and D to the company may be proportionately greater than that of the other banks. Conversely, their need to resolve the situation may be less urgent than the other banks – they may be able to afford to crystallise the losses and move on. Perhaps Banks C and D may genuinely believe (or be driven by their own stakeholders to adopt the position) that a liquidation is genuinely the only way to achieve a return of value. Perhaps Banks C and D have, quite simply, lost patience with the management of the Group, or don't trust them, and with the shareholder, and have ceased to believe that an out-of-court solution is capable of being achieved[[39]](#footnote-39).

It is worth noting that the scenario doesn't say that the Banks have established a representative coordination committee (as proposed by the Fourth Principle in the Insol International Statement of Principles for a Global Approach to multi-creditor workouts II[[40]](#footnote-40)). Nor do they appear to have appointed a single representative of all four to act as liaison between the company and the Banks. As a result, not only may different information be reaching the different banks, but the pre-existing relationships between particular banks and individual members of the management team may have a greater part to play than might be the case had the position been more actively managed in the early months of 2014.

In terms of the advice to be given to Banks A and B, my advice would be that they should continue the dialogue with Banks C and D in the first instance to identify what the underlying reasons are for their position, and whether rational or strategic[[41]](#footnote-41). If the hold outs are rational, perhaps because Banks C and D have lost confidence in a restructuring being achieved or because they don't trust the information being provided by the company or for reasons internal to their own businesses, then I would suggest that Banks A and B introduce one of the "soft law" sets of principles into the dialogue. Those principles might provide a focus for trust building discussion between the Banks and have the advantage of representing an internationally accepted protocol, external to the Banks and to the particular situation. The initial objective would be to agree a limited standstill to allow for further discussion with the company.

Mediation may also be a useful tool, allowing an independent mediator to facilitate the creditors' negotiations and to enable them parties to find common ground with a view to reaching an agreement while protecting their interests[[42]](#footnote-42).

If none of those conciliatory approaches work, or if the basis for Banks C and D's position is purely opportunistic or strategic, then it may be useful to remind them of the majority's ability to impose a binding restructuring plan on the minority, whether or not they consent, via a company creditors arrangement[[43]](#footnote-43), or, where the situation allows, a scheme of arrangement[[44]](#footnote-44) or similar.

If all of these fail, then the option which the scenario suggests Banks A and B are considering, the purchase of Banks C and D's claims at a discounted value, is an option too[[45]](#footnote-45).

1. **Which of the eight principles of the ‘Statement of Principles for a Global Approach to Multi-Creditor Workouts II’ can be found in the workout process of Flow Management (explicit or implicit)?**

**FIRST PRINCIPLE:** *Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a “Standstill Period”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case*

Whilst it is unclear what steps were taken to identify Banks A, B, C and D ("**the Banks**") as "relevant creditors" i.e. those creditors whose co-operation was needed to in order to make the workout succeed, it is clear that the cooperation of each of Banks was essential to ensuring a successful workout. There is no information about any other financial creditors and so it is fair to assume that the Banks are the "relevant creditors" in the circumstances posed in the scenario. Although not formalised, the Banks do agree in December 2013 that legal action should not yet be taken against the company, pending the final report from the consultancy agency, so that there is "standstill", and that action must be taken "jointly and in a controlled manner". An accountancy firm is called in to investigate the company's internal procedures and Flow Holding is required to report actual costs and turnover each month.

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

The Banks agree not to take any legal action against the company in the informal standstill period, although Banks C and D have a period where it appears they are considering departing from this agreement. There is no information about the Banks position either relative to other creditors or to each other, but it is fair to assume that this forms part of the basis on which the Banks have agreed to the informal standstill. There is a suggestion [page 6] that additional working capital has been provided during the workout, though it is unclear by whom, and that is repaid in priority to other dents in January 2015 outside the Restructuring Agreement, but that does not affect the relative positions of the Banks as at the commencement of the crisis in December 2013.

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

Whilst there is nothing in the scenario which makes this explicit, it is implicit that the debtor does not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date. Whether this is the subject of a formal agreement is unclear.

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

Although there appears to have been a degree of coordination, it does not appear to have been the case that the Banks formalised their coordination in the way which the Fourth Principle contemplates. This may have been a result (or a contributing cause) of the divergence between Banks A and B on the one hand and C and D on the other in February 2014.

So far as professional advisers are concerned, other than the appointment of the turnaround consultant, nothing is said about professional advisers and it is unclear whether the turnaround consultant is appointed by the Banks or by the company.

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

Flow Holding is required to (and, it is implicit that it does) provide a report on actual costs and turnover every month. However, it would appear that that information is insufficient to give the Banks an accurate overview of the Group's financial position given that the announcement in June 2014 that a €27.5 million loss is expected for 2014 apparently comes as a shock to the Banks [page 5]. However, there is no suggestion that the company impeded the creditors in any way or that it does not provide information as asked and it cooperates in the appointment of the independent accountancy firm, the turnaround expert and the new CRO. It is implicit that the Banks are to receive, and do receive the report of the turnaround consultant and of the accountancy firm called in to investigate the company's internal procedures. The principal difficulty with the information provided is that it does not accurately reflect the true position.

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

The restructuring agreement signed on 4 July 2015 ("**the Restructuring Agreement**") is expressed to reflect the relative position of the financiers involved [page 6] and it is implicit that it reflects applicable law save to the extent expressly agreed to the contrary.

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

Nothing is expressly mentioned about confidentiality in the scenario, and there is no reference to a non-disclosure agreement, but it is implicit that the workout does not receive wide publicity or that information is broadcast more widely than necessary. It is unclear whether information and proposals are made available by the company to all the Banks directly or at the same time – which may be a consequence of their not having appointed a representative or a committee in accordance with Principle Four and which may conceivably have led to asymmetric information provision – but the proposals do appear to have been made to all four Banks.

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

It appears that €25 million was provided as additional working capital, fsoft though it is not expressed that this as part of the workout arrangements, it is a fair inference that this is the case, and it is paid back to the providers in January 2015 ahead of the restructuring agreement and ahead of other creditors.

1. **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?**

There are no country- or region-specific "soft law" instruments which would cover the British Virgin Islands ("**BVI**"). However, if the other creditors are resistant to the adoption of the Insol Principles, it might be worth referring to the World Bank Principles[[46]](#footnote-46). Some commentators have seen "soft law" instruments as a focus for building a "culture of trust-building workout negotiations amongst repeat players"[[47]](#footnote-47) and if that is right, in circumstances where a creditor or creditors have refused to adopt the Insol Principles, a discussion around those Principles or the World Bank Principles or some of the models used elsewhere in the world[[48]](#footnote-48) might in itself play a role in building trust in a specific case as well as flush out any particular concerns which may lie behind the refusal. Those discussions may allow for the development of a bespoke set of principles within the particular restructuring which may incorporate some only of the Principles and may add others to meet the particular circumstances.

As mentioned above[[49]](#footnote-49), it may be useful to use mediation as a means of facilitating discussions between the creditors and, if appropriate, assist them in developing a mutually acceptable tailor-made set of principles to apply in the particular case.

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

The restructuring agreement signed on 1 July 2014 ("**the Restructuring Agreement**") involves two, connected, processes, both (i) a business restructuring involving the creation of a fresh, debt free, company (Flow Management II BV ("**New Flow**"),) to act as a clean acquisition vehicle for the 6 Subsidiaries of which it will act as holding company in place of Flow Management Holding BV ("**Flow Holding**"); and (ii) a financial restructuring involving the writing down (and in many cases the writing off) of historic debt, both to external and internal creditors. The objective is to salvage the business and to create a more attractive target to potential buyers.

In terms of the detail –

1. New Flow, is incorporated as a subsidiary of Holding to act as the vehicle for the acquisition from Flow Holding of the shares in Flow Management Work BV ("**Flow Work**"), FMW Spain SL, FMW France SPRL, FMW Australia Ltd, FMW South Africa Ltd and FMW USA Ltd (together "**the other Subsidiaries**");
2. **Flow Holding**

*Business restructuring*

1. Holding transfers the shares in the Subsidiaries to New Flow;
2. Holding waives any liability incurred by New Flow in respect of this transfer along with any other debts owed to it by New Flow;
3. Holding transfers the shares in New Flow to the Banks and to Board Members of Flow Holding including the CRO;
4. Flow Holding waives all claims against the Subsidiaries;

*Debt restructuring*

1. Banks waive all claims against Flow Holding;
2. Lease Group Holding United Kingdom Limited ("**UK**") –
   1. waives all claims against Holding;
   2. Waives all claims against New Flow;
   3. Waives all claims against the Subsidiaries.

*Result*

Flow Holding is left as a shell, with neither assets not liabilities and is liquidated;

1. **Flow Work**

*Business restructuring*

The shares in are transferred by its existing shareholder, Flow Holding, to New Flow;

*Debt restructuring*

1. Flow Holding waives all claims against Flow Work (amongst others);
2. UK waives all claims against Flow Work (amongst others);
3. Banks C&D write off the entirety of a €32.5 million debt owed to them by Flow Work;
4. The Consortium of Banks waive €97.5 million of the €337.5 million debt owed to them by Flow Work, leaving a balance of 240 million;
5. A loan of €55 million in also cancelled.

*Result*

Flow Work's balance sheet is improved by the cancellation of (i) Bank debt of €130 million (32.5 + 97.5), (ii) a loan of €55m and (iii) unspecified sums owed to Holding and UK.

It continues to have Bank debt of €240 million.

1. **The other Subsidiaries**

*Business restructuring*

The shares in the other Subsidiaries are transferred by its existing shareholder, Flow Holding, to New Flow;

*Debt restructuring*

1. Holding waives all claims against the other Subsidiaries;
2. UK waives all claims against the other Subsidiaries;

*Result*

The other Subsidiaries balance sheets are improved by the cancellation of unspecified sums owed by them to Holding and UK.

1. **UK**

*Business restructuring*

1. Shares in the Subsidiaries, of which UK is the indirect parent, are transferred to New Flow;
2. UK acquires shares in New Flow alongside the Banks and certain Board members including the CRO;
3. UK
   1. waives all claims against Holding;
   2. Waives all claims against New Flow;
   3. Waives all claims against the Subsidiaries.

*Result*

1. Prior to the restructuring carried out pursuant to the Restructuring Agreement, UK held 100% of the shares in Flow Holding and through it controlled the Subsidiaries. The effect of the restructuring is that UK now holds shares in New Flow but it is not the sole shareholder. It is unclear whether UK continues to hold a controlling interest in New Flow but given the level of Bank debt, and the fact that we are told that the restructuring agreement reflects the relative positions of the financiers involved, that would appear unlikely.
2. UK receives no direct cash payment for the Flow Holdings shares.
3. Consequently, the asset side of UK's balance sheet will have been diminished to the extent of the book value of the Flow Holding shares and the debts owed to it by Holding, the Subsidiaries (and New Flow). However, UK's holding of New Flow shares have been added on the positive side.
4. UK continues to hold 70% of the shares in Lease Cayman real Estate Ltd and 60% of the shares in Lease and Truck Repair Sweden Holding Ltd.
5. **New Flow**
6. New Flow is a newly incorporated company;
7. It acquires and now holds the shares in all the Subsidiaries;
8. Such liabilities as New Flow may have incurred in its short life, whether in respect of its acquisition of the Subsidiaries' shares from Flow Holding or otherwise, are waived;
9. In the meantime, working capital (which is due to be refinanced in November 2016) is provided to New Flow and it continues to trade.

*Result*

New Flow is in a good position to carry forward the business and a more attractive target for a purchaser than Flow Holding pre-restructuring.

1. **The Banks**
2. The Banks acquire shares in New Flow which now holds all the issued shares in the Subsidiaries.
3. The position of the Subsidiaries has been improved (i) as a result of the waiver by Flow Holding and UK of any debts owed to them; and (ii) as a result of the cancellation of (i) Bank debt of €130 million (32.5 + 97.5), (ii) a loan of €55m in Flow Management.
4. The Banks have, together, written off debt of €130 million (it is unclear whether the loan of 55 million is also Bank debt but if it is, the figure of €130m should be correspondingly increased) but the prospects of recovery of their debt are improved with the prospects of a sale or more profitable trading.
5. **Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process**

The Subsidiaries are spread around the globe and each operates under local company (and, presumably other local) laws [page 1].

As a practical matter, negotiations with key local clients, managers, employees and others will require coordination and an investment of time. In addition, obtaining information from all the subsidiaries may take extra time and the assimilation and interpretation of that information may also take time, particularly if it is available only in a different language or if it has been prepared in accordance with local accounting or other conventions. For the creditors, it will be necessary to understand the differing market and other conditions under which each Subsidiary carries on its business and to identify the impact which such conditions may have on the particular company's business.

The transfer of the shares in each of the Subsidiaries by Holding to New Flow will have to be carried out in compliance with the relevant provisions of local company law. Those laws are liable to be different in the six different jurisdictions and may require authorisation by different organs of the individual company, different public or other filings and different consents and permissions. In order to ensure that the transfer is effective in respect of each company, local legal advice will be required in order to ensure that the transfer takes effect as and when planned.

Similarly, there may be other considerations attendant on the particular situation of each company: for example, certain of the Subsidiaries may be subject to contractual, statutory or regulatory provisions of which a change of control at shareholder level might cause the relevant company to be in default or might require prior notice or consents or which might expose the relevant company to penalty. For example, if there are in existence any guarantees given by Holding, for example, of liabilities under a lease of real estate, then those would need to be identified and dealt with in order to ensure that there was no issue under the restructured group. Similarly, given that the business involves the leasing of trucks and private cars, there may be licenses and contracts of insurance in place which would need to be reissued on the transfer to New Flow.

Local employment laws may affect the ability of the Subsidiaries to make employees redundant and/or the terms on which they may do so. Local employment law advice would have to be sought as to this and the associated costs.

Whilst the Banks may agree a standstill at holding company level, we are told that the foreign subsidiaries have made losses of €6.3 million. In the absence of a local moratorium or an agreed standstill with local creditors, in the absence of a negotiated standstill agreement with those creditors there is nothing to prevent local suppliers executing against the assets of those companies.

There may also be local tax consequences as a consequences of the restructuring.

1. **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]**

BVI law, as currently in force[[50]](#footnote-50), provides for a moratorium on enforcement by creditors only after the point at which liquidators are appointed. The appointment of provisional liquidators does not operate so as to impose such a moratorium. There is no provision in the BVI Act to protect the company against execution by creditors between the date on which a petition is filed and the date of the winding up order.

The BVI Court does have a limited power to stay proceedings under section 174 of the BVI Insolvency Act 2003[[51]](#footnote-51). However, such a stay extends only to proceedings pending against the company in the BVI High Court[[52]](#footnote-52), the Eastern Caribbean Court of Appeal[[53]](#footnote-53), the Privy Council on appeal from the BVI High Court or in another Court or tribunal in the BVI and it is available only where the company concerned is incorporated or has been continued into the BVI. Such a stay is therefore of very limited value, operating as it does only to stay proceedings which are on foot in the BVI. It does not have extra territorial effect and it does not operate as a stay on enforcement outside BVI Court proceedings. Furthermore, it is available only after a winding up petition is presented. In the BVI, as elsewhere, the filing of a winding up petition is a public act, and one which is generally broadcast to the world shortly after filing via Offshore Alert (which, amongst other things, provides details of suits filed in the BVI Courts and elsewhere via a subscription internet platform).

Accordingly, even if Flow Holding or any of its direct or indirect subsidiaries were a BVI company, a moratorium is, in practice, available only within the context of a formal winding up after liquidators have been appointed. As a means of providing a formal standstill within which an orderly sale might be effected outside a liquidation, BVI law therefore provides no solution.

In more general terms, leaving aside the question of BVI law, a formal moratorium does suggest a Court imposed regime, often with an independent office holder as supervisor, administrator or examiner, or, at the very least, an agreement between creditors within the context of an insolvency statute. It will often be premised on an admission of insolvency, which may itself trigger contractual defaults, which may impact the underlying business, and necessarily involves publicity. It would therefore lose for the company many if not all of the attributes which make an out-of-court restructuring attractive[[54]](#footnote-54). Further, on the facts presented in the scenario, a moratorium is likely to have to be separately achieved across all six subsidiaries as well as Flow Holding. It is therefore likely to involve significant cost. For all of those reasons, a moratorium is unlikely to have been a good option at the time – particularly given that the principal creditors, that is, the Banks, are continuing to support the company, have agreed a 120 day standstill and the company appears to have been able to continue operating in the interim.

1. Mellahi, K., & Wilkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews*, 5(1), 21-41. [↑](#footnote-ref-1)
2. €1.6 wrongly booked in 2012 and €2.8 million in anticipation of an unrealised profit. [↑](#footnote-ref-2)
3. See Mellahi & Wilkinson (supra) page 23 col. 1 and 32. [↑](#footnote-ref-3)
4. Ibid. page 29 col. 2. [↑](#footnote-ref-4)
5. Noting in particular the fact that the CEO and CFO received a very substantial bonus by reference to the year 2012. [↑](#footnote-ref-5)
6. See also Mellahi & Wilkinson (supra) page 30, col. 1 "Curse of Success". [↑](#footnote-ref-6)
7. References in this document to numbered pages between square brackets thus are to pages so numbered in the scenario. [↑](#footnote-ref-7)
8. 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. [↑](#footnote-ref-8)
9. Defined Ibid. as "*a reorganization route which takes place outside the statutory framework*". Garrido, J (2012) in the World Bank Study (see footnote 10 below) defines an informal workout as a procedure disconnected from any kind of judicial intervention. [↑](#footnote-ref-9)
10. Garrido, Jose M.. 2012. Out-of-Court Debt Restructuring. World Bank Study. World Bank. https://openknowledge.worldbank.org/handle/10986/2230. [↑](#footnote-ref-10)
11. Cowling, D (2011) "Potential Directorial Liabilities of Creditors in a Workout" *Insol International January 2011*. [↑](#footnote-ref-11)
12. See Garrido, J (2012) footnote 10 supra. [↑](#footnote-ref-12)
13. Ibid. [↑](#footnote-ref-13)
14. My own experience suggests that the Court can act with speed and focus where necessary. [↑](#footnote-ref-14)
15. Garrido, J (2012) (see footnote 10 supra) also points out that an informal workout tends to carry less stigma than formal insolvency. [↑](#footnote-ref-15)
16. *Philip Davison Sebry –v- Companies House & Anor* [2015] EWHC 115 (QB) https://www.bailii.org/cgi-bin/format.cgi?doc=/ew/cases/EWHC/QB/2015/115.html [↑](#footnote-ref-16)
17. See Garrido, J (2012) footnote 10 supra. [↑](#footnote-ref-17)
18. "Cowling, D (2011) footnote 11 supra. [↑](#footnote-ref-18)
19. Who may be exposed to liability for wrongful trading and other breaches of their fiduciary obligations. [↑](#footnote-ref-19)
20. In the BVI, the definition of a "director" prescribed by the Business Companies Act 2004 extends to "a person occupying or acting in the position of director by whatever name called" and a person in such a position is subject to all the duties and liabilities of a director under that Act. [↑](#footnote-ref-20)
21. See *Re Tasbian Ltd (No 3), Official Receiver v Nixon* [1991[ BCLC 792 at 802 per Vinelott J. [↑](#footnote-ref-21)
22. David Cowling gives a number of examples in his paper: *Standard Chartered Bank of Australia v Antico* (1995) 38 NSWLR 290; *Ho v Akai Pty Limited* (In Liquidation) (2006) 24 ACLC 1526; *Re a Company (No 005009 of 1987) ex parte Copp* [1989] BCC 13 (though in that case, which was decided on an application to strike out, Knox J merely held that the claim that a bank had acted as a shadow director was not obviously unsustainable and as such passed the strike out test, rather than reaching a final decision on the point). [↑](#footnote-ref-22)
23. *Re PFTZM Ltd* [1995] BCLC 354 "*what is looked for is some active role in managing the company and interfering with its running by way of instructing or directing the board to act in a particular way and the board following those instructions…. [I]f a lender simply imposes conditions on a borrower before it makes a loan then this is unlikely to be sufficient to substantiate a claim that the lender is a shadow director. What is required is a more positive involvement on behalf of the lender … The dividing line for a bank may be between simply giving professional advice which is directly within the exception provided by the IA 1986, s 251 and exerting substantive control of the company so as to protect its own position." Bailey & Groves: Corporate Insolvency - Law & Practice Para. (LNUK, 5th Edition, 2017)* para . 17.23. [↑](#footnote-ref-23)
24. Which Schmitt, A., Raisch, S. (2013) IN ‘Corporate Turnarounds: The Duality of Retrenchment and Recovery’, *Journal of Management Studies*, 50(7) p. p. 216-1244 propose should be integrated. [↑](#footnote-ref-24)
25. Banks A, B, C and D. [↑](#footnote-ref-25)
26. Main clients. [↑](#footnote-ref-26)
27. See Pajunen, K. (2006). Stakeholder Influences in Organizational Survival. *Journal of Management Studies*, 43(6), 1261-1288. [↑](#footnote-ref-27)
28. Ibid. Proposition 1. [↑](#footnote-ref-28)
29. Ibid. Proposition 2. [↑](#footnote-ref-29)
30. Bob Wessels and Stephan Madaus term "Strategic hold-outs" *Rescue of Business in Europe: A European Law Institute Instrument* OUP 2020 – 1.2.1.3, 233-5. [↑](#footnote-ref-30)
31. Variously considered in the materials as part of a process of stabilisation (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.), retrenchment (Schmitt, A., Raisch, S. (2013). ‘Corporate Turnarounds: The Duality of Retrenchment and Recovery’, *Journal of Management Studies*, 50(7) p. p. 216-1244.) and Operational Restructuring (Sudarsanam, S, Lai, J., (2001), ‘Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis’, *British Journal of Management*, Vol. 12, 183-199). However described, and with whatever emphasis, the strategies put forward by the commentators include broadly similar elements. [↑](#footnote-ref-31)
32. This appears from the statement on page 6 that that sum, provided as additional working capital, was paid back in January 2015 in priority to the repayment of the other Bank debt. [↑](#footnote-ref-32)
33. *Review of Central and East European Law*, *31*(2), 135-154, 3.1.2 Phase II "Analyzing". [↑](#footnote-ref-33)
34. Cf. Adriaanse, & Kuijl p. 142. [↑](#footnote-ref-34)
35. The commentary to the Insol Principles points out the importance of speed in the context of a workout: "delay prolongs commercial uncertainty, increases the costs of the process and potentially erodes value" and, in the commentary to Principle I goes further and suggests that delay "is likely" to prejudice the prospects of a successful outcome. [↑](#footnote-ref-35)
36. Sudarsanam, S, Lai, J., (2001), ‘Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis’, *British Journal of Management*, Vol. 12, 183-199. [↑](#footnote-ref-36)
37. *1988, Basil Blackwell, Oxford*. [↑](#footnote-ref-37)
38. What Bob Wessels and Stephan Madaus term "Strategic hold-outs" *;* Bob Wessels**,**Stephan Madaus**,**Gert-Jan Boon Eds *Rescue of Business in Europe: A European Law Institute Instrument* OUP, Recommendation 1.22. [↑](#footnote-ref-38)
39. What Wessels and Madaus term "Rational hold-outs". In this respect, the scenario [page 4] does mention that at the end of March 2014, there is a general loss of confidence in the Flow Management Company amongst the banks, considering the developments of the past 6 months "although most specifically felt by the bankers of C&D". Pajunen emphasises the importance of frequent, open and active communications with stakeholders in ensuring their continuing support during a workout. [↑](#footnote-ref-39)
40. Insol International, April 2017 [↑](#footnote-ref-40)
41. See Wessels and Madaus supra at paras 1.2.1.1 and 1.2.1.2. [↑](#footnote-ref-41)
42. *Mediation in Restructuring and Insolvency* Bob Wessels Eurofenix, Spring 2016, 24. [↑](#footnote-ref-42)
43. By a majority in value of creditors voting as a single class under Part I, Division 2 of the Insolvency Act 2003. [↑](#footnote-ref-43)
44. With court sanction and the approval of a majority in number representing 75% in value of the class of creditors concerned under s. 179A of the Business Companies Act 2004 or by a majority. [↑](#footnote-ref-44)
45. And preferable to that debt being sold to a third party which may have different strategic objectives and who will certainly lack the relationship with the company which the Banks have had. [↑](#footnote-ref-45)
46. World Bank. Principles for Effective Insolvency and Creditor/Debtor Regimes, 2021 Edition. https://openknowledge.worldbank.org/handle/10986/35506. [↑](#footnote-ref-46)
47. Rescue of Business in Europe, European Law Institute**,**Bob Wessels**,**Stephan Madaus**,**Gert-Jan Boon Eds. *OUP 2020*, Recommendation 1.22. [↑](#footnote-ref-47)
48. For example, the Asian Bankers Association Informal Workout 2005. [↑](#footnote-ref-48)
49. Under Question 4. [↑](#footnote-ref-49)
50. Part III of the Insolvency Act 2003 does provide for Administration on the model of the Insolvency Act 1986 (as originally enacted) with an associated moratorium. However this has never been brought into force. [↑](#footnote-ref-50)
51. *"Where an application for the appointment of a liquidator of a company has been filed but not yet determined or withdrawn, a person specified in section 170(2) may—*

    * 1. *where any action or proceeding is pending against the company in the Court, the Court of Appeal or the Privy Council, apply to the Court, the Court of Appeal or the Privy Council, as the case may be, for a stay of the action or proceeding; and*
      2. *where any action or proceeding is pending against the company in any other Virgin Islands court or tribunal in the Virgin Islands, apply to the Court for a stay of the action or proceeding."*

    [↑](#footnote-ref-51)
52. As defined in s. 2 of the Insolvency Act 2003. [↑](#footnote-ref-52)
53. Interpretation Act 1985 (Cap. 136)(as amended) s.42. [↑](#footnote-ref-53)
54. See the answer to question 2 above. [↑](#footnote-ref-54)