CASE STUDY 1 – STEVEN WHITE

1. **What were in your opinion the causes of financial distress at Flow Management? Could the financial distress have been prevented? If yes, explain how. If no, why not?**

The Mellahi & Wilkinson[[1]](#footnote-1) study analyses a number of different approaches to arrivie at what the writers describe as *“an integrative framework of the determinants of organizational failure*”. That framework broadly divides into what are essentially groupings of external factors affecting businesses (termed ‘environmental’ and ‘ecological’ factors) and internal factors (being ‘organizational’ and ‘psychological’ factors)[[2]](#footnote-2).

In the case study, the factors affecting Flow Management BV (**FMH**), and leading to its financial distress from November 2013 appear to be primarily internal in nature. Specifically, there is no evidence which suggests that external factors are significantly in play. For instance, there are no environmental factors highlighted such as regulatory, technological or demographic change within FMH’s markets, nor is there any indication that ecological factors such as industry life cycle or the size or density of the competitive field are changing in any of FMH’s areas of business. To the contrary, we are told that there is evidence that there is *“market demand and the forecast for so called “hiring and leasing days” are consistent with reality*”. Although this is said in the study to be the management expectation circa November 2013, that view is consistent with the conclusions reached only a few weeks later by the independent turnaround consultant in December 2013. In summary, the business is viable, and can feasibly achieve the market share and turnovers estimated for it. The fact that the majority of customers also do not react negatively to price recalculations in late 2013 (adjusting the price cost calculation) implies a certain degree of robustness and confidence in the market.

We are further told that there are also at least “*three parties active in the same industry”* in May 2016, each with apparently sufficient financial resources to consider acquiring the Flow Management BV II (**Newco**). This would *prima facie* indicate that the primary market for leasing trucks and private cars is not in general decline, albeit this factor should be treated with a degree of caution, as it might also reflect a superior debt to equity ratio and less comparative financial overextension for these businesses. This was a point of note in the ABI discussion relating to the relative positions of Hertz and its competitor, Avis, in the face of the collapse of the US car rental market following March 2020, where the latter found itself overleveraged when dealing with a temporary and unprecedented market collapse[[3]](#footnote-3).

On the information available, the prime causes of FMH’s financial distress were as follows:

1. The financial structure was suboptimal in that the debt to equity ratio for FMH was too high to allow flexibility for the business at a time of financial distress;
2. Management did not have access to accurate financial figures and this hampered their effectiveness; not only would they have been poorly informed when making decisions as a result but early warning indicators may well have been missed. This is due to accounting errors where anticipated book profits were not realized and contingency gains were incorrectly booked, thus fundamentally affecting FMH’s pretax profits up to September 2013 and recasting retrospective losses in 2012;
3. The above factor seems to have led to large management bonuses being wrongfully issued when otherwise they likely would not have been issued; and
4. There were crucial internal systems errors which led to the loss in 2013 (the errors in the pricing formulas). This is perhaps the most fundamental failure as it is said to have led directly to the 2013 loss and was caused by an entirely avoidable human error.

Arguably, staffing and contractor ratios were also too high as both fixed and variable costs (notably they were reduced as part of the immediate remedial measures without apparently negatively impacting the business) but this does not seem to be a key factor rather than one which would have reduced the degree of distress if managed more effectively. To a certain extent, there are always efficiency gains that can be made in most businesses. However, the estimated savings in this case (some €3.3 million) are significant. Reductions in the costs structure may have been undertaken earlier had management had access to better information systems.

In terms of other metrics, the solvency rate (equity/total assets) was too low in November 2013 (3.9%[[4]](#footnote-4)) and well below the 5% mark later set by lenders as a ‘minimum’ and required as a base level for Newco in July 2015.

In conclusion, there were serious accounting and systems errors at FMH which combined lead to the company’s financial distress in November 2013. This can usefully be seen within the context of the OS/OP literature analysis in Mellahi & Wilkinson which places an emphasis on a number of factors more crucially related to the issue of *“who makes a decision*”, rather than the external context[[5]](#footnote-5). These factors include financial overextension and an executive which is too poorly informed[[6]](#footnote-6). In short, management failure leading to poor performance. While, as Mellahi & Wilkinson stress in proposing their integrative framework, this must be seen within the context of external factors (and in some cases the management failure may be in its response to those external factors), in the present case internal factors appear to be the determining influences.

So, within this framework, might the financial distress have been prevented? Again, arguably yes. A more robust and competent CFO may have ensured tighter (and more accurate) accounting systems. More robust financial management should also have seen the pricing formula error averted, since this would simply have involved periodically checking the real costs against the results of the cost price calculation. Had this last issue been rectified it appears that a loss would not have been recorded for 2013. What is unclear, however, is the overall effect on the financials had the contingency gain been properly booked (presumably its effect would have been diluted by attribution across the three years) and the book profit calculated more accurately. It is also not known from the case study how FMH came to have such a low solvency ratio. There may be a good explanation for this which has not been presented. Alternatively, the ratio might be symptomatic of longstanding structural financial issues.

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?***

The answer to this question will depend on what the applicable formal bankruptcy/insolvency procedure is and its relative sophistication, and will therefore vary from jurisdiction to jurisdiction. A good starting point is the Dutch, CIS, CEE/SEE region comparison study by Adriaanse and Kuijl[[7]](#footnote-7). This broadly defines formal reorganisation in its preamble as ‘including all possibilities of reorganisation laid down by the (insolvency) law or which take place using legal methods and possibilities’[[8]](#footnote-8). In contrast, an informal reorganisation is described as a reorganisation route which takes place:

*“….outside the statutory framework – therefore, in the shadow of the law – with the objective of restoring the health of a company in financial difficulties within the framework of the existing legal entity. An informal reorganisation consists primarily of business restructuring and financial restructuring”.[[9]](#footnote-9)*

The key advantages of informal reorganization identified by the authors are summed up in the terms *“flexibility, silence and control”[[10]](#footnote-10)*. These terms are described thus: *flexibility* refers to the unrestricted character of informal reorganizations; namely that the range of possibilities are wider and more flexible than in a formal process and this therefore allows for a ‘tailormade’ solution; *silence* is essentially that the restructuring is an informal process and not a public (usually court) driven process and can take place in relative silence; and *control* is an important factor for management that they can continue to run the company whilst restructuring talks are underway and/or the agreed plan is implemented. Control in this context is also relates to the speed and timing of the process, as well as its outcome.

Anecdotally, flexibility is often regarded as the core advantage. There is a relationship in this regard between the relative informality of the process and the fact that it takes place within ‘the shadow’ of a statutory framework, i.e. the parties remain aware that there is a formal backstop (insolvency process) which can be resorted to if necessary in the event that the prospects of an informal restructuring dwindle or if there is a need to focus minds (often of management and key stakeholders) and to progress more efficiently. The possibility of a less favourable return in a formal liquidation can of course be a powerful factor in influencing parties to engage in cooperation and an informal corporate work out. The ability to ‘cram down’ in some jurisdictions within a formal insolvency process may also encourage potentially dissenting creditors to engage in informal negotiations. As further identified by Adriaanse and Kuijl, such a process may also save costs[[11]](#footnote-11). At the same time, in appropriate cases, particularly those involving sophisticated parties, informal discussions may progress more quickly and more candidly than they would under a form of court supervision. The absence of too much publicity, or at least a greater ability to potentially control the narrative can be a great advantage. For example, in the present case, press releases were issued by the CRO presumably to try and ‘control the narrative’. As noted by Adriaanse and Kuijl, a more open formal process can lead to a ‘race to collect’ from creditors, or a self-damaging spiral of negative effects upon management and missed opportunities[[12]](#footnote-12). There can also be a stigma attached to formal restructuring proceedings, especially where they progress under the auspices of the winding up of the company. The existence of such a stigma has been put forward as an argument, albeit largely unsuccessfully, in a number of Bermuda cases involving Asia based companies to avoid provisional liquidation, including more recently Re Up Energy Development Group Ltd [2018] Bda LR 100.

The disadvantages of an informal reorganisation are the flipside of some of these advantages. In this way ‘flexibility’ may not suit all stakeholders, especially those who would prefer a court supervised process or who are concerned that some creditors may seek to improve their positions while discussions are underway (for instance, in the absence of a formal standstill agreement). ‘Silence’ can also have the same effect where suppliers and others will be warier of the company. Where management is seen as the problem in some quarters, the prospect of the reins of the company remaining in the same hands will not be encouraging. Where the creditor pool is less sophisticated, or where the quality of the relationships between the parties are poor, a formal process may be preferable in terms of speed, efficiency, outcome and cost. As identified by the drafters of the ‘INSOL Statement of Principles for a Global Approach to Multi-Creditor Work Outs II’ (**INSOL II**), co-operation, communication, often by representative committees, and the appointment of professional advisors underlie the effective implementation of the majority of those principles when approaching an out of court work out. Conversely, where those factors are absent, the advantages of informal negotiations and discussions will likely be lost.

The broad analysis above is reflected in the exercise of considering the general advantages and disadvantages of an out-of-court restructuring in Bermuda.

There are two formal routes to dealing with restructuring of debt within this jurisdiction, and both have their roots in the Companies Act 1981 (**CA 1981**). The first is provisional liquidation under part XIII of the CA 1981 and the second is a scheme of arrangement pursuant to sections 99 and 100 of the same statute where there is a ‘compromise or arrangement’ with creditors or members (or any class of them). The latter is essentially used to implement a distressed financial restructuring by varying the rights of relevant stakeholders and can also (and commonly do) occur as a component part of a restructuring liquidation[[13]](#footnote-13). This concerns a company being place into provisional liquidation, occasionally by a creditor but more usually by the company itself, but for the purposes of restructuring and not winding up (although in some instances the result will be the winding up of the company, i.e. where restructuring does not succeed or where a ‘newco’ company is created, and the ‘oldco’ is dissolved at the conclusion of the proceedings). Provisional liquidation in Bermuda has grown out of a ‘creditor friendly’ approach by the Bermuda Court to what is fairly outdated legislation based upon the repealed English Companies Act 1948. As noted extrajudicially by Dr Ian Kawaley, a recent former Chief Justice of Bermuda, this is something of a creative jurisdiction formed out of a broad interpretation of the court’s power to appoint provisional liquidators and to limit their powers in order to allow a debtor in possession restructuring[[14]](#footnote-14). It has been described as ‘part of a legal quid pro quo’ enabling the company to obtain the benefit of the automatic stay of proceedings upon the appointment of a provisional liquidator, while permitting the company’s management team to remain in place to pursue restructuring[[15]](#footnote-15).

The key advantages of a Bermuda provisional liquidation are as follows:

1. A stay of all claims, both relating to continuation and commencement, against the company becomes effective on the appointment by the court of provisional liquidators (referred to as the statutory moratorium). This prevents dissenting minority creditors from forcing the winding up of the company in the interim;
2. Although provisional liquidators will be appointed, their powers will usually be strictly limited by the order appointing them and their role will be ‘light or soft touch’ (often framed in terms to ‘monitor, advise and assist the board of directors of the distressed company’ while restructuring options are explored). In this way the current management of the company remains in place and drives the restructuring process; and
3. The effect of (i) and (ii) above is to allow time and space to explore, implement and promote a financial restructuring which may allow the company to return to solvency while giving creditors the comfort that management is operating under the supervision of a provisional liquidator and the court (to which periodic reports are made), and with the default position of formal liquidation if the restructuring does not progress.

The second route is a Bermuda scheme of arrangement. The main advantages of a scheme are:

1. The scheme can be passed by a majority (75% in value) of each class of creditor or member present and voting at the scheme meeting;
2. Once passed, the scheme will be binding on that class; and
3. A scheme can take place outside a provisional liquidation on a ‘standalone’ basis, thus avoiding any stigma or other negative effects on the company, or as part of a restructuring provisional liquidation.

Both a provisional liquidation and a scheme of arrangement are potentially powerful ways of dealing with or limiting the options of dissenting creditors. The disadvantages of a provisional liquidation are that to some degree an element of flexibility is lost. While the court is generally very accommodating and flexible, there is a surrounding ‘jacket’ of a public judicial process and hearing dates for periodic updates, directions for the filing of reports by the provisional liquidators and so forth. The statutory moratorium is also less effective where the key stakeholders are secured creditors, as the moratorium does not prevent them from enforcing their security rights. In this way engagement with secured creditors in an informal process, and agreement on a standstill with all key creditors, may be more effective. The formal processes are also much more ‘open’, with court filings, public hearings and rights (albeit not unrestricted) for the public to apply to access certain filings on the court file.

1. **Were the turnaround/reorganization approaches as presented in the reading material applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.**

As this question specifically references the supplied reading material, each of the four studies will be addressed in turn.

Starting with Schmitt and Raisch[[16]](#footnote-16), the paper examines the relationship between the strategies of retrenchment (seeking to increase efficiency through cost and asset reductions) and recovery (improving a firm’s market position through strategic change in order to reposition the business for sustained growth and profitability). This is in relation to a corporate turnaround which is defined as *“managerial responses to decline (Rosenblatt et al.,1993) under conditions of high uncertainty and ambiguity”[[17]](#footnote-17)*. The authors’ central thesis is that the two form a duality; they are in tension but not necessarily opposing and can be summarised as *“both contradictory and complementary”*. Where the two are integrated, this creates benefits for turnaround firms that exceed the cost of their integration[[18]](#footnote-18). As part of this argument, the authors have identifie that:

1. Prior research has paid little attention to the interrelationship between retrenchment and recovery;
2. However, some scholars have suggested that the two approaches may be mutually reinforcing and their integration beneficial;
3. There is a school of thought that the two should be addressed sequentially, although the contrary view is that one cannot be considered in isolation from the other as retrenchment cannot take place without an understanding of the intended nature of the recovery phase;
4. The purpose of retrenchment activities is to reduce assets and/or improve operational efficiency to increase profitability and strengthen the firm’s industry position. Examples given (which are distinct from downsizing) are asset reduction (i.e. plant closures or divestments) and costs efficiency (i.e. reducing headcount and implementing efficiency improvements); and
5. Recovery activities refer to strategic changes that transform and reposition the firm for sustained growth and profitability (i.e. market penetration, product launch, market entry, acquisitions and structural change).

Turning to the question of whether the above turnaround approaches have been applied in this case, it is clear that any such application has been partial and incomplete.

In terms of retrenchment, management did give early consideration to improving costs efficiency and thereby increasing profitability. These initial efforts at the end of 2013 focussed upon spending cuts; specifically, in relation to reducing labour costs and savings of 3.3 million euros were duly identified. Further savings of €3.9 million were identified in relation to improved loss recovery, higher excess premiums and savings on car repairs. The reforms, however, seem rather inchoate, and by May 2014 the plans were still being formalised. At that stage an asset reduction strategy (sale of the non-core companies outside the Benelux countries) was proposed. It is noted in the case study that implementation of these retrenchment measures or certainly some of them had been delayed and not put into effect by mid 2014. It does not appear that the asset reduction strategy was seriously implemented, although there is a brief refence to the sale of surplus assets in October 2014 (potentially to the value of €10 million, as we are told that this meant tax refunds in this amount as additional security was not required). While there are signs that the appointment of a new CEO and CRO had a beneficial effect, it is unclear to what extent the retrenchment measures have been successful. By August 2014 it is note that there has been *“a slight improvement due to the reorganization”*.

As to recovery strategies, in May 2014 there seems to have been some consideration of this as there is mention of plans being drawn up to increase turnover and to assess/evaluate the entire business mix and product range. It does not appear that these planned reviews were fully implemented (or at least there is no mention of that in the study).

In short, there has been an attempt at retrenchment but it has been done in a piecemeal manner and its effectiveness has been hampered by a delay in implementation. The reorganisation has also been largely one sided, as although recovery plans were considered alongside retrenchment, at least in the later stages; echoing, albeit vaguely, the integrated duality approach advocated by Schmitt and Raisch, the activity has primarily been focused on retrenchment. It also looks like the Newco business, whilst refinanced and restructured (and perhaps more efficient), has not made major strategic changes to increase profitability and ensure sustained growth. This could have been done differently by drawing up retrenchment plans with clear implementation timetables, and carrying through on the strategic review of business mix and developing, or abandoning, or even entering into new areas of product range accordingly.

In the Pajunen study[[19]](#footnote-19), the focus is on the identification and management of key stakeholders during a restructuring. The fundamentals of the approach advocated by the authors are as follows:

1. The first task is to identify and categorise stakeholders by applying a model for stakeholder identification. This model combines consideration of resources and influence. This is not a binary model but a matrix of low to moderate resources and influence[[20]](#footnote-20). Nonetheless, key stakeholders will be ones without whom the corporation cannot survive. More remote or peripheral stakeholders will be those who influence or are influenced by the firm, but who are not essential to its survival;
2. A stakeholder’s position in the matrix may alter between the period of decline of the business and its turnaround; and
3. The second stage is management of stakeholders to ensure organisational survival. This is based upon six propositions set out in the paper.

In the present case, during the period of decline the key stakeholders were management, through influence exercised, and the banks, via their critical resources. The latter did not seek to exert significant influence while the business appeared stable. When FMH became financially distressed, the banks were identified early on by the management of FMH as key stakeholders who had to be engaged in order to ensure the survival of the business, both in terms of continuing finance, refrainment from taking enforcement action, and willingness to reschedule the debt. Other key stakeholders early on were the ‘main clients’ whose willingness to accept price increases was fundamental in increasing immediate cashflow. While the business was relatively labour intensive, with over 3,000 employees, it does not appear, as in the example of Kymi in the Pajunen paper, that the employee body was that important to the process as it did not possess critical resources or influence (there is for instance no intimidation that the employees would withdraw labour or strike). Nor do any suppliers (i.e. of the cars and trucks) seem particularly key on the facts as presented.

To that extent then, the model on stakeholder identification appears to have been applied successfully, if probably unknowingly. The application of the propositions on stakeholder management have, however, been less successfully applied. Integral to securing the continued support of key stakeholders (Pajunen’s ‘proposition 1’) is frequent and open communication (‘proposition 2’) and good personal relationships between management and stakeholders (‘proposition 3’). In FMH’s case, while management did engage in information sharing with the banks, and promoted confidence building through the engagement of an independent turnaround consultant, this was undermined potentially by the lateness of the notification (the banks were said to be *“shocked”* by the company’s situation in December 2013) and over time by what appears to have been a flow of inaccurate information (specifically the overestimates of profit). Further, the commitment of the banks was undermined by management’s perceived underperformance, especially in relation to the CEO and CFO. The latter point detrimentally effected propositions 3 and 4 until the CEO was replaced and the CRO was appointed. From that time, those new appointees become key stakeholders themselves (much as the new management of Kymi became fundamental in the Pajunen study). The banks’ perception of good firm performance (proposition 6) under the new management was crucial to building confidence and also fundamental to a standstill agreement being reached in August 2014. Proposition 5 (consensus on long term goals) does not always seem to have been present, especially from banks C and D.

As to what could have been done differently, earlier notification of the financial difficulties might have been given to the banks lessening the initial shock (assuming this was possible; it is not clear when the various accounting and systems errors were identified), better implementation of the immediate retrenchment strategies would have generated more confidence in the existing management, and the appointment of a CRO earlier may have been more effective in driving exploration of restructuring options. Ultimately, FMH did keep its key stakeholders on board at least in significant part because the new management gained sufficient traction and relationship with the banks to agree first a standstill and then a restructuring agreement.

As previously discussed, Adriaanse and Kuijl’s study[[21]](#footnote-21) advocates the advantages of an informal restructuring exercise. The paper stresses the importance of a restructuring of business operations alongside a financial restructuring. Four phases are identified in the paper; *stabilising* (identify the critical problems and take quick action to stabilise the situation, particularly to increase cash flow), *analysing* (for the business to look at its prospects in the long term), including a well-founded reorganisation plan), *repositioning* (a value recovery process whereby the reorganization, as outlined in the plan, will need to be initialised), and *reinforcing* (such as transferring the business to a new, healthy ‘newco’).

The processes set out above are not a particularly prescriptive in nature, perhaps to reflect the flexibility of informal restructuring, but do outline four broad phases that appear to have been followed in this case. There was a period of stabilisation early on in December 2013 when management presented plans to increase cash inflow, by raising prices to correct the cost price calculation error, and reducing cash outflow by undertaking various cost cutting measures. This was followed by an extended period of analysis whereby initially a viability assessment was undertaken, a review of FMH’s activities was intended and measures were taken to restore long term profitability (such as reducing headcount and use of contractors cutting overheads). As part of this period of analysis, an external accountant, turnaround consultant and CRO were variously engaged/recruited. This was followed by a reorganisation plan which was successfully put into action, and reinforced by the creation of the ostensibly healthy Newco.

The application of the phases was not without difficulty however, especially in relation to the first two phases. The stabilising actions, although identified early on, were delayed in their implementation. This is a problem with execution rather than process. Earlier implementation may have generated more confidence from the banks which might have led to an earlier standstill agreement – this would have allowed a breathing space for the business much sooner than August 2014 when the standstill was finally concluded. Also, no serious attempt seems to have been made to sell off loss making parts of the business or to discontinue loss making parts of the product range or to sell off profitable (none core) elements of the businesses (if any). There was also a delay in the shareholder injecting new risk bearing capital. In terms of analysis, management information systems and financial forecasting seems to have remained poor; with the financial forecasts continuing to be proved wrong (such as loss of €9 million in 2015, which had been forecast to be a break even result).

The study by Sudarsanam and Lai[[22]](#footnote-22) primarily addresses the general applicability and effectiveness of corporate turnaround strategies. These strategies include operational, asset, managerial and financial restructuring. The study tests the effectiveness of these strategies, and seeks to identify the underlying factors, through an empirical analysis of 166 potentially bankrupt UK firms grouped into ‘recovery’ and ‘non-recovery’ businesses. This is a temporal study over a three-year period, including a ‘year of distress’, ‘year of distress plus one’ and ‘year of distress plus two’. The key factors considered by the authors to be relevant to corporate recovery are the impact of timing, intensity and implementation. In other words, the study attempts to identify the effectiveness of particular strategies and how this is affected by when, how and to what extents they are adopted by the distressed business. Notably, the study concludes that *“this result does not point to restructuring strategies being the cause of non-recovery”[[23]](#footnote-23)*. Rather it is the timing, intensity and implementation which is key.

The strategies identified by the study are necessarily generic in nature and non-sector specific, as the authors concede, and have been variously adopted to a greater or lesser extent by FMH in the case study as set out below:

1. There is an initial period of operational restructuring proposed in December 2013 but delayed in its implementation until June 2014. By 31 October 2014 the banks are described as disappointed by the lack of progress;
2. While an asset restructuring is proposed early on (or more accurately, a review to see whether one should be conducted), this does not seem to have been fully implemented. Ultimately there appears to have been no strategic examination of the core business of the firm, nor any steps taken to sell off the non-Benelux businesses, as tentatively envisaged in mid-2014;
3. Managerial restructuring does take place but after March 2014; and
4. Financial restructuring is achieved only after 5 July 2015 restructuring agreement is signed (noting however that some additional injections of equity capital had been introduced before this date).

The application of the research in this case is hampered by a lack of financial data about FMH, which is fundamental to both determining its Z score but also to measuring the intensity of restructuring (measured by change in accounting and cash flow variables relative to a measure of their pre-distress size). Moreover, the case study does not provide information for a full three-year period. The general indications contained in the ‘Summary and conclusions’ section, when applied to FMH, produce a mixed result. It is noted for instance that the analysis showed that higher proportions of non-recovery firms restructure their operations, cut/omit dividends and restructure their debts in each of the two post-distress years. They also appear to restructure more intensively than recovery firms. This is said to be partly due to ineffectiveness early on leading to intensification of the strategies. As time passes, the choices of recovery and non-recovery firms diverge, with the former choosing investment and acquisition to lead them out of trouble, over internal operational and financial restructuring.

With FMH, early priority was given to operational restructuring[[24]](#footnote-24). This is a positive indicator for its recovery but was let done by lack of implementation – what Sudarsanam and Lai refer to as the requirement for *“[management] not only doing the right things but also doing them right[[25]](#footnote-25)”*. FMH also omits dividends and engages in managerial restructuring. However, the study emphasises that recovery firms typically choose investment and acquisition, and that growth strategy is less important for non-recovery firms who are preoccupied with internal matters. There is no sense of expansion, acquisition, refinement of products or growth strategy in the case study, although stability (tentative at best) for FMH by way of financial restructuring is not achieved until late 2015/early 2016, and there is not a full year three to assess. This may explain the continued preoccupation with internal factors. As noted in the case study, the situation is still *“critical”* in May 2016 but key stakeholders apparently remain engaged, further capital and refinancing may be available, and prospects are said to be positive.

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?**

Firstly, it is necessary to consider the relative positions of the banks. FMH has facilities with four banks (A, B, C and D) representing liabilities of:

1. €360 million representing working capital at the main subsidiary, Flow Management Work BV (due November 2016);
2. €35 million in other loans (due December 2013); and
3. €20 million in other loans (due to be refinanced 2017).

The division of these liabilities between the banks and the extent of each’s security is unclear from the case study. Certainly, the study suggests that A and B are the lead banks, and – extrapolating backwards from the final restructuring agreement in July 2015 – C and D are in a subordinate position and more likely to suffer a significant shortfall.

The position of the banks is initially collegiate at the meeting on 1 December 2013 and thereafter until the end of the year. The banks agree not to take any formal action, pending the report from the consultancy agency. There is consensus that action must be taken jointly and in a controlled manner. The strategy agreed is threefold: to apply pressure by charging default interest, management change and capital injection to strengthen the equity position.

We are told that the situation subsequently deteriorates with higher than expected losses, and solvency at virtually zero. There is only sufficient cash to meet obligations until the end of April 2014 and this is with a non-payment of the €35 million loan implicitly permitted by the banks. At this stage the banks’ analysis is that liquidation (‘faillissement’) will produce a reduced return. They have also identified problems with their securities (pledges), which carry the risk that proceeds may be substantially lower, or even zero, in the event of liquidation. The company maintains some trust by announcing a new CFO and promising the injection of risk bearing capital. The company, and Lease Group Holding UK Ltd (**LGH**) as shareholder, require the banks to commit and agree a standstill before formally committing themselves. At around this point, banks C and D break rank and cease their co-operation. At the end of March 2014, no standstill has yet been signed and FMH’s liquidation draws nearer.

Why would C and D do this? As the principles in INSOL II illustrate there is a considerable advantage in all relevant creditors co-operating with each other to give sufficient ‘breathing room’ to the company and to refrain from taking unilateral action. It does not seem credible that banks C and D would have been serious in mid-February 2014 about abandoning informal talks and instead progressing to a formal liquidation. Bearing in mind the liquidation analysis at the time, the difficulty with their security pledges and their subordinate position, this is unlikely. A good reason not to toggle to liquidation would also be that the problems with the security could (potentially at least) be rectifiable for the banks as part of the consideration for a standstill agreement. More likely the withdrawal of co-operation was reflective of C and D’s weaker position and an attempt to leverage themselves into an improved position, knowing that management and LGH insisted upon a group agreement and that A and B stood to lose the most out of the lender group should the process default to liquidation. This was an aggressive tactic, and one which almost appears to have succeeded – by March 2014 A and B are investigating buying out banks C and D with a 15-20% discount. A byproduct of their strategy would also be to put further pressure on FMH. C and D appear to have eventually relented as no change in position was made by A and B, some co-operation did still persist (they accepted bank A’s lead on the appointment of the new CRO) and there were some slightly more positive financial signs from the company’s results, as well as growing confidence in restructured management by early August 2014.

The second action by banks C and D was in June 2014 when they threatened to cancel FMH’s credit line. This is more likely to be exactly what it is described as in the case study – an attempt to maintain pressure on the company and to get them to speed up. In terms of chronology, this comes shortly after LGH’s financial restructuring proposal (which at least A and B are willing to discuss) and in circumstances where the shareholder continues to delay over injecting new capital to strengthen the balanced sheet.

What would the advice to A and B have been? Clearly, it is likely that the breakaway of C and D would jeopardize the banks’ negotiating position with FMH and its shareholder. Having determined that an informal restructure would yield a better return than a liquidation (where there was already existing sufficient reason to terminate the facilities), disunity would prevent a standstill agreement, and deter the company from taking the required restructuring measures (not least the injection of capital by LGH). The advice to A and B should have been that it was likely C and D were ‘on maneuvers’ to leverage their position, and that a twofold strategy should be adopted to counter this. Firstly to ‘wait’ C and D out but at the same time to keep an open dialogue with them and to effect management change at the company (this was achieved by A’s suggestion of the new CRO, which was instrumental in improving the banks’ relationship with, and confidence in, management. Secondly to review options for a buy out of C and D as a fallback position in the even that they looked seriously likely to commence enforcement/winding up action unilaterally or the company was imminently likely to fail. Having experience of a similar type of action by a creditor seeming to breaking away from the main body of creditors, I would caution that kneejerk overreaction should be avoided by A and B. In the case study, C and D fell back into the fold because it was in their best interests to do so following the injection of some capital and the effect of the more effective CRO, as against the history of previous negative financials and management inertia.

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)?**

Each of the principles will be considered in turn below.

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.*

Was this principle, applied in the case study? No, certainly not initially. While the banks did cooperate with each other at the start of the process in later 2013, the aim of this cooperation was to put pressure on FMH rather than to provide a ‘pause’ for information to be gathered and restructuring proposals formulated and assessed. The strategy of the banks at that time was to apply immediate pressure (by accruing default interest) and by putting pressure on LGH, as shareholder, to inject substantial equity capital. Implicit in the principle is, however, the need to bring together the key creditors who *must* be included in the process. This was achieved by the banks grouping together as FMH’s financial creditors; thus allowing the banks to work together later on in the process when a formal standstill agreement was finally agreed. Prior to this agreement the banks also did broadly cooperate (apart from a period of noncooperation by C and D) to allow a prolonged pause when their rights were not fully pressed (although they could have been) and to allow the flow of information to them from the company. This included their (implicit) permission for the company to fail to make its 31 December 2013 payment. Arguably, therefore the overall aim of the principle was eventually implemented *ad hoc*, albeit not as a form of ‘arrangement’ contemplated by the Guidance to the first principle, and nor following the starting intention that the standstill period be at the commencement of the period of distress – essentially an early moment of breathing space and taking stock. This left the company in a state of uncertainty longer than might have been necessary and also impeded the shareholder from being confident in injecting new capital.

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.*

This principle appears to have been achieved once the 120-day standstill was agreed and signed in August 2014. There is no suggestion in the case study that any of the banks took steps to enforce their claims or dispose of their debt to a third party during this period (or presumably, its extension). Likewise, credit lines, were maintained, and although there is no detail provided of the terms of the standstill, or of the undertakings, covenants and warranties given by the parties as part of it, there are no contra indications that any element of the principle was breached, i.e. that any of the banks tried to improve their individual positions.

Nothing is said in the case study about loss sharing or equalization provisions, or consideration of conflicts of interest, and some thought might have been given to whether a linked intercreditor agreement might assist in this case.

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 of the Standstill Commencement date.*

This principle appears to have been adhered to. The case study notes that there were problems with the banks’ securities, however, and their enforcement may not have been foolproof as a result. Curing these (technical) difficulties in the securities could have been included in the terms of the standstill but this would not infringe the third principle, as the standstill period would not yet have commenced.

Fourth Principle: *The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such coordination will be facilitated by the selection of one or more representative coordination committees and by the appointment of professional advisors to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.*

This principle appears to have been largely adhered to. While there was no strict co-ordination committee or coordinator authorised to represent the banks, the banks essentially operated together from the outset to conclusion, apart from two brief aberrations in 2014 where C and D withdrew cooperation and threatened to withdraw credit. This cooperation had a number of key ‘successes’; they agreed to coordinate their action, refrained from enforcement action, acted to appoint a CRO, agreed a standstill, achieved shareholder injection of cash, and ultimately were able to agree a restructuring agreement.

Further, bearing in mind the relatively small size of the group of banks, there was no need for a more formal structure of the type required where there is a wider range of creditors (such as trade creditors), other stakeholder groupings to deal with, or a diverse number of participants with potentially different objectives (i.e. where an ad hoc committee of bondholders is formed). Nonetheless, the existence of a single committee might have encouraged management and the shareholder to progress matters more quickly and provided a ready forum/structure for consultation

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

This principle appears to have been effectively adhered to by the company both before and during the standstill period. It was FMH which initiated the first meeting in November 2013 and the company does not appear to have significantly held back information at any point, nor are there substantial complaints from the banks about the lack of information provision. The independent turnaround consultant also reported back, seemingly both an interim and final report basis. There was also an independent accountant appointed. However, there was an issue with the *accuracy* of the information being provided, especially the financial forecasts. Although there is no sense that this was deliberate by management, and seems to have been the result of internal and accountancy failures at the company, the effect was deleterious on the process. This is likely to have led to the banks’ dissatisfaction with the CFO amongst others. Certainly, the banks’ confidence in what they were being told by management, despite continuing losses (such as the €27.5 million loss expected for 2014, contrary to earlier announcements), improved after the appointment of the CRO. It is also noted that by 31 October 2014 *“the provision of information has improved*”*.* This last point suggests there was perhaps some impediments to the flow of information previously.

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.*

This principle has presumably been adhered to as we are told in the case study that “*The contents of the financial restructuring agreement reflect the relative positions of the financiers involved*.” No further information is provided, although it seems implicit that the relative positions of the banks would have been determined correctly, and that the arrangements reflects applicable law. The only other party affected by the restructuring agreement is the shareholder. There is no mention of an insolvency model being utilized, or whether this took into account jurisdictional differences for the six subsidiaries, but again some modelling appears to have been carried out at various stages in terms of the banks’ ‘informal restructuring v liquidation’ value analysis.

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.*

There is no mention of a confidentiality agreement in the study, nor are any creditors other than the banks and the shareholder (if the equity injections were via loans) mentioned. Accordingly, the information does appear to have been shared with all relevant creditors, and there does not seem to be a danger of debt trading and shifting creditors passing on confidential information. The banks have kept the information confidential. It would, however, have been diligent for the company’s advisors to suggest a confidentiality agreement, and it would be in the interests of all key stakeholders to prevent the seepage of sensitive financial information which might deter customers, or advantage competitors, especially as a sale as a going concern was being floated at various junctures. Although there are press releases made by the CRO, he is part of the management of the company, and thereby can be assumed to be acting on the authorization of FMH. The information shared by the CRO (mostly about losses and setbacks it seems) are presumably aimed at keeping informed other important but less influential and resource dependent stakeholders such as employees, possibly trade unions, suppliers et al. As the group is a relatively large employer, with some 3,000 employees, there would undoubtedly be public, political and media interest in its travails.

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

This principle may have been adhered to in part. We are told that additional working capital injected by the shareholder is repaid early in January 2015 (this totals €25 million). Further, we are also told that additional working capital made available on the transfer of shares is to be to be refinanced in November 2016. However, LGH provided an additional €10 million as an unsecured loan in April 2014[[26]](#footnote-26) and it is not apparent if that was repaid. It may be that the larger payment was repaid as it was directly linked to the standstill and the September/October restructuring proposals whereas the earlier payment appears to have been interim funding without any strings attached. This approach would bring the case study more firmly within the eighth principle.

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?**

This question poses the quandary of what to do when creditors fail to agree on the adoption of the INSOL II principles and what other “soft law” alternatives may be available.

To answer this question, it is first necessary to agree on what is meant by ‘soft law’, which tends to be a vague and rather inchoate term, albeit it is used in various formal instruments, including the European Insolvency Regulation Recast (**EIR**), and set as soft law standards in instruments such as the Dutch Vereniging insolventierecht advocaten (**INSOLAD**). A useful working definition is set out in a paper by Wessels & Boon[[27]](#footnote-27), where hard law is said to be typically thought of as conventions, treaties and domestic laws, which share certain traits, namely binding obligations, precise obligations, and delegation of authority for interpretation, whereas as soft law instruments are on a *“continuum with hard law at one end and political arrangements at the other*” and marked by weakened obligations, precision and delegation[[28]](#footnote-28).

This is a somewhat crowded field as there are a large and proliferating number of soft law ‘instruments’. As noted by the authors in Wessels and Boon there were at least fifty such texts in the insolvency field in 2015[[29]](#footnote-29) provided by standard setting organizations and other groups of practitioners and judges. A large number of these relate to harmonizing or setting a framework for cross border insolvency cases, including judicial cooperation and communication between jurisdictions such as the ‘Judicial Insolvency Network, Guidelines for Communications and Cooperation Between Courts in Cross Border Insolvency Matters (2017)’ (JIN Guidelines), to which Bermuda is a recent signatory. A less crowded field is the space occupied by INSOL II relating inter creditor workouts and the relationships, approaches and coordination between creditors within that informal setting. In this area there are some similar areas of guidance and principle including the ‘World Bank Principles for Effective Insolvency and Creditor Rights Systems’ (where paragraphs 188-197 cover much of the same territory as the INSOL II Principles but in a more summary and less prescriptive way). If, however, a creditor or group of creditors has already objected to he adoption of the INSOL II Principles, it is difficult to see how similar such principles, formulated on only a slightly different basis would be more acceptable. In this way, there is unlikely to be an acceptable ‘soft law alternative’.

The focus on adoption by key stakeholders may also miss the point. Even without formal agreement on the principles, much of what is contained there represents common sense and common practice, which has been distilled into a single, easily digestible set of principles. They are not particularly troublesome to follow, but even if adopted by agreement, there is no penalty for their breach or means of enforcement, and by their nature they are non-binding. As Wessels and Boon note:

*“The governance framework of soft law instruments is limited: we have found no examples for restructuring and insolvency law that clearly state the consequences of violating the terms of the instrument. Furthermore, it may take considerable time before the impact of soft law instruments becomes apparent. Therefore, some scholars submit that soft law instruments are inferior to hard law”.[[30]](#footnote-30)*

Therefore, in the event there is a ‘wrecker’ creditor, who does not want to go along with a an informal restructuring process, the situation may be more suited to a formal insolvency process. Using the Bermuda example set out earlier, the company could be put into provisional liquidation. This would provide the benefit of the statutory moratorium on claims, while allowing management to continue in place to pursue a restructuring. The objections of a minority dissenting creditor might then be overridden in a scheme of arrangement for example.

While it may be possible for soft law instruments to ‘find some teeth’ via endorsement by a court of the relevant jurisdiction or incorporation or promotion into a practice direction, this is unlikely to occur in relation to principles/soft law relating to informal creditor work outs, which are by their very definition occurring ‘out of court’. This is more likely to occur where a court is approving a protocol relating to formal insolvency proceedings, such as the approval of a cross border protocol based upon the ‘ALI-III Global Guidelines’ by the Grand Court of Cayman in a 2018 case where two sets of insolvency proceedings in different jurisdictions were on foot[[31]](#footnote-31).

The alternative approach would be for a creditor group, perhaps acting by committee, to agree a bespoke protocol based around the parts of the INSOL II or World Bank Principles which are acceptable to the whole body of creditors.

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

The restructuring agreement is, at heart, a debt for equity swap (conversion of debt into shares) centered around a ‘phoenix’ newco which allows the core of the FMH business to continue on as a new company. It is structured as a fully consensual out of court agreement to deal with all creditors. This has a number of constituent elements as follows:

1. A new Dutch incorporated company is to be created to continue the business of ‘old FMH’. The operating companies of FMH are to be transferred into this ‘newco structure’ leaving FMH behind as essentially a shell;
2. The shell of FMH is then to be formally liquidated. In order for this to happen, the banks and the shareholder will release all claims against FMH. The way is then clear for what may be some form of expedited winding up, the detail is not included in the study;
3. FMH and its shareholder will also release all claims against the Newco and its subsidiaries (i.e. there may have been inter group loans and such like that have to be resolved) in order to allow the new business to proceed unencumbered;
4. The banks and key management are to receive the shares in the Newco. LGH is no longer part of the business;
5. The shares to management (including the CRO) are to lock in the main talent in the business and to ensure that the business is driven forward;
6. In terms of the consortium of banks this is a debt for equity swap which centres on the working capital facility provided to Flow Management Work BV, the main subsidiary of FMH. This debt is to be reduced by €97.5 million, leaving a debt of €240 million owed by the subsidiary. Although it is not entirely clear from the detail of the study, this is likely to be on revised terms and/or refinanced with rescheduled payments (there is mention of refinancing in 2016 which is later delayed);
7. The banks retain their security (pledges) on the assets of Flow Management Work BV;
8. Banks C and D write off their other additional working capital loans to Flow Management Work BV;
9. The €55 million loan in Flow Management Work BV is cancelled in full.

As we are told that the *“contents of the financial restructuring agreement reflect the relative positions of the financiers involved”*, it is implied that Banks A and B take the lion’s share of equity in the Newco.

Newco is left with the operating subsidiaries of FMH but with a much-reduced debt position. Working capital is said to have been made available again on the transfers of the shares. Solvency of the Newco is a much improved 5%.

An area that requires clarification is the comment that *“the providers of the original working capital… will receive part of their claim on liquidation”.* It is unclear what this refers to as it does not appear that FMH will continue to hold any significant assets which will be relevant on liquidation (although it may hold cash and other assets, it is not clear), and the restructuring deal also involves cancellation of any claims held by the banks against FMH.

Lastly, in order to be effective, the restructuring agreement will need to bind all creditors, lest the restructuring exercise be rendered meaningless by the independent actions of a minority and hold out creditor, and it is assumed that there are no trade creditors etc. who have been left out of this agreement to cause disruption.

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

There are two aspects to this question, as it potentially applies to the whole of the restructuring process as well as to the final result. Issues that might arise of a cross-border nature would therefore include if the process were to fail at any time (and head out of the shadow of formal insolvency procedures into a liquidation process, as perhaps intimated by the actions of Banks C and D at various points) and with respect to the finalized restructuring agreement.

Starting at the end as it were, as a fully consensual out of court restructuring agreement has been reached, there may be fewer cross border legal issues than otherwise would occur in a mutli-national liquidation. The key stakeholders will be bound by the agreement, and any breach of it will be a matter to be determined under the governing law of the agreement and subject to any pertinent exclusive jurisdiction or arbitration clause dealing with enforcement and dispute resolution. The latter may be a preferable inclusion given the international flavor of the business and the possibility that the banks may be based in various different jurisdictions. There remains the formal liquidation of FMH which will be subject to Dutch law as Holland is the company’s centre of main interest (COMI) for the purposes of the EIR (having both its registered office in the Netherlands and also being the place where the administration of the company is regularly conducted). Bearing in mind the consensual and comprehensive nature of the restructuring agreement there is no readily identifiable risk of court action elsewhere or issue of recognition of the Dutch liquidation as ‘foreign main proceedings’ arising.

It is conceivable that the share transfers which form such a crucial plank of the restructuring may require regulatory consideration and/or approval in the different jurisdictions where the subsidiaries are incorporated (namely Holland, Spain, France, Australia, South Africa and the USA) and consideration of this issue should have been brought to bear by the parties’ advisors before the restructuring agreement was finalized and signed. In relation to non-legal issues, there may be political and public interest in the restructuring as the business has a relatively significant number of employees. A collapse of the business may also affect other local businesses including truck repair and supply chain parts businesses. FMH also operates in a potentially niche sector (the lease of trucks), with seemingly only a limited pool of market competitors (this is extrapolated from there only being three interested buyers in 2016). There may need to be a planned release of information to the public about the restructuring and a degree of trade union engagement may be necessary in certain of the jurisdictions.

Taking a step back from the concluded agreement and back into the restructuring process from notification of FMH’s financial distress to creditors in November 2013, it is clear that if informal discussions fail a number of potentially complex cross border legal issues may arise. As discussed above, FMH’s COMI is Holland and the company holds assets (the shares of its subsidiaries) in Holland and two other EIR jurisdictions, as well as three non-EIR jurisdictions. Should formal liquidation proceedings commence, they can only commence in relation to FMH as the main proceeding in Holland. Article 16 of the EIR provides for the automatic recognition of an order for opening proceedings and for recognition in France and Spain (if required) of any office holder appointed by the Dutch Court. Article 18 allows an office holder to exercise his powers in other jurisdictions provided that he complies with local laws. The Dutch law, as the law of the jurisdiction where main proceedings have been opened, will then generally apply in the other EIR jurisdictions, including in relation to the sale of assets (although a different law may apply to the security). The EIR also provides for cooperation and coordination between office holders in different jurisdictions; see for instance Articles 20 and 31 dealing with cooperation and accounting.

Issues of recognition or cooperation (if parallel proceedings are required) may then potentially arise in the USA, Australia and South Africa where the remaining subsidiaries are incorporated. These three states have all adopted the UNCITRAL Model Law on Cross Border Insolvency (**Model Law**) into their national laws. As the Model Law contains a similar concept of COMI to the EIR (a rebuttable presumption that the COMI will be the place of incorporation, with it otherwise being where the company conducts its administration), any insolvency proceedings in those jurisdictions, such as US Chapter 15, will be ancillary proceedings to those in Holland. The Notes to the Model Law suggest that it will operate alongside laws such as the EIR (although the EIR makes no such reference). Although the Model law is flexible, and has a similar overall purpose to promote recognition and cooperation to the EIR (at least insofar as it relates to EU states), the potential for conflict remains. However, there is an insightful analysis in this regard in Mohan, S. ‘Cross-border Insolvency problems: Is the UNCITRAL Model Law the Answer?’[[32]](#footnote-32), where it is suggested that the problems of transnational insolvencies are more apparent than real, and that debtors and their major creditors and lenders largely determine the number of countries where the financial problems of a company will be resolved.

If this proposition is correct when tested, and given the small group of lenders in this case, and the focus on the Dutch end of the business (both in terms of FMH itself but also importantly Flow Management Work BV as the major operating subsidiary of the group), it might reasonably be considered that the scope for proceedings elsewhere will be limited. If difficulties did arise protocols could be agreed between office holders appointed in different jurisdictions, and approved by the respective courts. A protocol in this context has been described as *“nothing less than a tailormade law for an individual case[[33]](#footnote-33)*”*.* Examples of protocols designed to harmonize proceedings through a framework of cooperation and communication include the Lehman Brothers (2009), Madoff (2009) and Nortel Network (2009) cases[[34]](#footnote-34).

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]**

As there is no procedural equivalent to a moratorium (in the sense of a temporary suspension of payments) or a restart (pre-pack) following liquidation under Bermuda law, this question will be considered in relation to a fairly rudimentary grasp of the framework of the basic Dutch law provisions[[35]](#footnote-35).

The four options outlined in October 2014 were (in broad summary):

1. A going concern option (dependent on injection of significant further capital by the shareholder, and an extended standstill agreement or refinancing);
2. Selling Flow Management BV if viability of the overall business is not demonstrated;
3. A debt for equity swap, with or without shareholder support; or
4. A moratorium [formal suspension of payments procedure] or restart following liquidation, with the company being sold in a ‘controlled manner’. However, the banks must be willing to provide a bridging loan.

These options were being put forward in a factual context where the losses for 2014 had increased to more than expected (€39 million) and a €10 million loss was forecast for 2015, followed by a slight profit in 2016. There had been a successful sale of some surplus assets, and further benefit was expected from the organizational restructuring that still had some way to go. Information flow from the company had also improved. We are told that the Banks formed the view that the going concern situation appeared to be the best one, with a debt for equity swap also being investigated.

The option in d. above, whether viewed as a moratorium or as a restart, is framed as a last resort. While the moratorium would allow the business of FMH to survive current but temporary financial difficulties, this was not the immediate concern in October 2014. This is because the standstill agreement was still in place, and there was no reason to believe that it would not be extended for an additional period. The banks were still engaged in active discussions with management and the shareholder and there was evidence of a viable going concern basis. Moreover, immediate cash problems had eased through the sale of surplus assets and the company was able and prepared to provide additional security. Furthermore, and fundamentally, it is understood that key criteria for a moratorium is that the financial difficulties are short term, and that the company will be able to address them in the short term. Not only would entering a formal moratorium impose a court assigned receiver on FMH, who would govern its finances and lead discussion with creditors, but the maximum period for the suspension would be 18 months (with some limited ability to extend in certain situations). This would undermine the position of management, with whom (particularly the CRO), the banks now enjoyed an improved relationship, and was unlikely to resolve the company’s financial problems without a wider reorganization and fundamental financial restructuring. On its face, it looks like a procedure more amenable to a business with temporary cash flow difficulties rather than a business with significant long-term structural and solvency debt to equity ratio problems.

The option of a restart is more difficult to assess. This is understood to be a form of pre-packaged bankruptcy filing, where there is a third-party investor or purchaser and a plan to acquire or sell parts of the business out of the bankrupt estate and then for the purchaser to then continue the business in another company vehicle standing at the ready. This process takes place under the supervision of a ‘silent administrator’ who ensures the plan is acceptable to itself and to the bankruptcy judge. As with the moratorium, there is a partial loss of control to the court/administrator and the flexibility of an informal work out process, although this could arguably be ameliorated by much if not all of the plan being worked out in advance. Both forms of procedure also invite publicity, possibly very negative publicity. Looking back at the paper by Adriaanse and Kuijl where the key strengths of an informal process are identified as “*flexibility, silence and control”[[36]](#footnote-36)*, each of these elements are being compromised to a degree. For other stakeholders there will be a lack of transparency. With regard to the last of the elements identified in the paper, without a fuller knowledge of Dutch law, it is impossible to say whether the process might also invite other interested buyers and lead instead to a break up of the healthy parts of the business. It is also clear that a restart would require significant further funding either from the shareholder or the bank, with little advantage other than leaving unsecured creditors behind, who were likely to be ‘out of the money’ in any event. In this way risk would be weighted towards the banks. One would also expect the shareholder to be less than enthusiastic when a going concern was possible and there would be a loss of opportunity of any value being restored to LGH. Overall the option looks less enticing than the going concern or debt for equity swap is at the forefront of the banks’ considerations at that time.

Conversely, the potential reasons in support of the proposition of a restart following liquidation being a good one are first and foremost the advantage of a ‘clean slate’ for the new company, leaving behind historical issues (old debts, contracts et al) that would not provide value going forward. It is also understood that the Dutch law is flexible enough to allow a degree of cherry-picking in the arrangements which are carried over, including employee contracts. The banks could refresh their security arrangements. There is scope for management and shareholder in the new business vehicle, and potentially for less exposure to risk for the shareholder. The benefits to the Banks, however, appear more limited. It is difficult to assess the degree of this risk without greater familiarity with how a restart works in practice under Dutch law.

The nearest equivalent in Bermuda law would be a sale of the business or parts of it by a provisional liquidator. This would require fair value to be obtained by the liquidator for the business, usually likely a form of tender/auction process for the assets, and court approval. This would not usually attract a lender, especially one with security, but rather a ‘white knight’ investor or third party competitor. There are also not the clean slate and cherry-picking provisions of Dutch law that would be available.

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. Ibid, see Figure 2 at 32 [↑](#footnote-ref-2)
3. American Institute of Bankruptcy,”The Anatomy of the Hertz Chapter 11”, podcast, October 14, 2021 [↑](#footnote-ref-3)
4. Falling to 0.1% in December 2013 and -9.5% in June 2014 [↑](#footnote-ref-4)
5. Mellahi & Wilkinson, at 28 [↑](#footnote-ref-5)
6. Ibid, citing Argenti (1976) [↑](#footnote-ref-6)
7. Adriaanse, JAA, & Kuijl, JG (2006), ‘Resolving Financial Distress: Informal Reorganisation 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-7)
8. Ibid at 135 [↑](#footnote-ref-8)
9. Ibid at 136 [↑](#footnote-ref-9)
10. Ibid at 145 [↑](#footnote-ref-10)
11. Ibid at 146-147 [↑](#footnote-ref-11)
12. Ibid at 146 [↑](#footnote-ref-12)
13. This is similar to an English scheme of arrangement under part 26 of the Companies Act 2006 or a Hong Kong scheme of arrangement [↑](#footnote-ref-13)
14. Kawaley, RC (2015), ‘Cross Border Insolvency in the British Atlantic and Caribbean World: Challenges and Opportunities’, in: Parry, R & Omar, P (eds), *International Insolvency Law: Future Perspectives*, INSOL Europe, r43-124, at 91-93 [↑](#footnote-ref-14)
15. Fraser, J & Jackson, C (2018). ‘Winding up Companies under Bermuda Insolvency Law’, in: Kawaley, R (ed), *Offshore Commercial Law in Bermuda,* Wildy & Simmonds, London 2nd edition, 368-398, at 377 [↑](#footnote-ref-15)
16. Schmitt, A, & Raisch, S (2013), ‘Corporate Turnarounds; the Duality of Retrenchment and Recovery’, *Journal of Management Studies*, 50(7), 216-1244 [↑](#footnote-ref-16)
17. Ibid at 1238 [↑](#footnote-ref-17)
18. Ibid at 1216 [↑](#footnote-ref-18)
19. Pajunen, K (2006), ‘Stakeholder Influences in Organizational Survival’, *Journal of Management Studies*, 43(6), 1261-1288 [↑](#footnote-ref-19)
20. Ibid Figure 1 at 1265 [↑](#footnote-ref-20)
21. See fn 7 [↑](#footnote-ref-21)
22. Sudarsanam, S & Lai, J (2013) ‘Corporate Financial distress and Turnaround Strategies: An Empirical Analysis’, *British Journal of Management*, Vol.12, 183-1999 [↑](#footnote-ref-22)
23. Ibid 197 [↑](#footnote-ref-23)
24. A key factor for recovery firms; see Table 6 at 193 [↑](#footnote-ref-24)
25. Ibid 194 [↑](#footnote-ref-25)
26. The text of the case study actually implies that the removed CEO deposited this money but as that makes little sense, it is assumed that this is an error and that the deposit was made by the shareholder. [↑](#footnote-ref-26)
27. Wessels, B, & Boon, G, ‘Soft Law Instruments in Restructuring and Insolvency Law: Exploring its Rise and Impact (2019)’, SSRN [↑](#footnote-ref-27)
28. Ibid at 2 [↑](#footnote-ref-28)
29. Ibid Fn1 at 1 [↑](#footnote-ref-29)
30. Ibid at 13-14 [↑](#footnote-ref-30)
31. Wessels, B. & Boon, G, ‘When Soft Law Instruments Matter: OBLB Influences Cayman Islands’ Judgment Approving Cross-Border Insolvency Protocol’, *Business Law Journal,* University of Oxford (25 November 2020). [↑](#footnote-ref-31)
32. Mohan, S. ‘Cross-border Insolvency problems: Is the UNCITRAL Model Law the Answer? (2012)’. *International Insolvency Review.*  21, (3). 199-223, Research Collection School of Law at 22 [↑](#footnote-ref-32)
33. Westbrook, J, Booth, C., Paulus, C., & Rajak, H. ‘A Global View of Business Insolvency Systems (2010)’, *The World Bank and Brill*, Washington DC, at 245 [↑](#footnote-ref-33)
34. As listed by the International Insolvency Institute at its website at https://www.iiiglobal.org/search/node/protocols [↑](#footnote-ref-34)
35. Regard has been had to Restructuring and insolvency – Netherlands – Q&A Guide, Lexis Nexis. The Netherlands – Global Restructuring and Insolvency at <http://restructuring.bakermckenzie.com/wp-content/uploads/sites/23/2016/10/Guide-The-Netherlands.pdf> and Netherland: rescue procedures in insolvency at <https://www.eurofound.europa.eu/es/node/89354> [↑](#footnote-ref-35)
36. Fn 7 at 145 [↑](#footnote-ref-36)