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Case Study I
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Q1 – What were in your opinion the causes of financial distress at Flow Management (see e.g. Mellahi & Wilkinson, 2004)? Could the financial distress have been prevented? If yes, explain how. If no, why not?

1. In late 2013, Flow Management discovered that its reported pre-tax profit up to September 2013 had been over-stated. Rather than pre-tax profits of €8 million, the pre-tax profits were now considered to have been €5.4 million. The accounting practices at Flow Management appear to have been flawed for at least one or two years before the meeting between Flow Management and its main creditors on 16 November 2013 during which this information is conveyed to the Company's main creditors.

2. The causes identified by the Company of the misreporting of pre-tax profits include:
    a. the wrongful payment of large management bonuses;
    b. the incorrect booking in 2012 of a contingency gain;
    c. the non-realisation of an anticipated paper gain in 2012; and
    d. a formula error which has resulted in cost/price calculations being out of kilter with reality.

3. There is a wealth of academic literature which tries to categorise and analyse the causes of organizational failure. A wide range of academic disciplines, research methodologies and interpretation has led to fragmentation and gaps in the literature. A valiant attempt to rationalise and integrate these approaches has been made (Mellahi & Wilkinson 2004).

4. Defining organisational failure is perhaps more elusive than one might imagine and there is a divergent literature on what failure might mean, how it can be measured and what label one should attach to it. For the purposes of this Case Study, I will assume that organisational failure (a necessarily broad idea) can be taken to mean 'a deterioration in an organization's adaption to its microniche and the associated reduction of resources within the organisation' (Cameron *et al*. 1988 and 1989).

5. There is a rich academic literature dealing with the causes of organisational failure. We can divide that literature into two broad camps: (i) a deterministic view of failure; and (ii) a voluntaristic view of failure.

6. Each of these two broad camps can be further subdivided into two schools of thought. Among the determinists are industrial organisation ("**IO**") scholars who, relying heavily on economic theory, consider that external events which place pressures and constraints on organisations are the primary cause of organisational failure. These external events can be almost anything, ranging from political or environmental instability to technological innovation or regulatory changes.

7. Organisational Ecology ("**OE**") scholars focus on the organisation as existing within an eco-system and within a population of other similar organisations. OE scholars deploy statistical analysis to demonstrate that various factors such as population density (i.e. the number of competitors an organisation might have), industry life-cycle, organisation age and organisation size can all influence the success or failure of an organisation.

8. Among the voluntarists, there are Organisation Studies ("**OS**") scholars and Organisational Psychology ("**OP**") scholars who see organisational failure as emanating from within the organisation itself. It is not so much the external threat that causes an organisation to fail, rather it is the internal inadequacies of the

organisation in meeting the threat that causes the organisation to fail.

9. What is apparent from the information available about Flow Management is that the causes of the organisation's financial distress all appear to be attributable to its internal processes and personnel. There is no external event such as a recession or technological innovation which has caused Flow Management to suffer its misfortunes; at least none is mentioned in the Case Study brief. Each of the four causes identified by the company itself stems from within Flow Management.

10. Groupthink Theory originates from the work of Janis (1972 and 1982). In brief, it means that decision makers in small groups have a tendency to make sub-optimal decisions: the desire for unanimity often works against the ability or desire for decision makers to voice concerns or misgivings. There is a glaring tell-tale sign of this flaw in organisational decision making within Flow Management. The existence of a spreadsheet formula error appears to have gone unnoticed because the Company simply failed to check periodically the real costs of its product delivery against the results of the cost price calculation being used by the organisation. The apparent willingness of management to accept figures at face value is perhaps indicative of an underlying unease about challenging the Company's work practices.

11. The vulnerability of a company to Groupthink is, I suggest, closely related to the vulnerability posed by what could be termed the 'curse of success'. Miller (1990) says that 'success can breed over confidence and arrogance'. Given the size and seeming historic success of Flow Management, there is a distinct possibility that the failure to question work practices or to review accounting practices was the result of complacency about the robustness and good sense of the accounting and work systems in place. If the management was more alert to the possibility that there was room for innovation or improvement, it is entirely possible that it would have been reviewing constantly its work practices and the accuracy of its data.

12. What is noticeable about Flow Management is that it does not appear to have reacted or behaved rigidly to the emerging crisis. Management appears to have dealt with the crisis quite promptly as opposed to denying it or rationalising it (Brown and Starkey 2000). This confirms my belief that management within the Company had the capacity to prevent the Company's misfortunes, but it lacked the data (or perhaps the willingness to find the data).

13. It follows that the financial distress suffered by Flow Management, being caused by internal forces, could have been prevented by better management of the Company. The implementation of periodic review of work practices and accounting practices, perhaps by an external reviewer or according to criteria drafted by an external body could have identified the spreadsheet formula error at an early stage. Early identification of the problem is likely to have prevented it from becoming a serious accounting error in 2013 with all its attendant problems.

14. The implementation of a periodic review could also have identified the error in booking entries and the large overpayment of bonuses to the CEO and CFO. I suggest that the simple gathering of information and reviewing such data on a periodic basis could have prevented the existence-threatening state of affairs that came about in November 2013.

Shane Quinn

Q2 – 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?

15. Garrido (2012) has described out-of-court workouts thus: “An out-of-court restructuring or workout is a contract between the debtor and its creditors, which binds the debtor vis-à-vis the creditors and also binds the creditors *inter se*.”

16. Naturally, in any common law jurisdiction where the process of legal resolution is by necessity adversarial in its nature, there is an attractiveness to restructuring a company or group of companies without recourse to the Courts where in theory, if not always in practice, the process is a zero-sum game. In short, out-of-court workouts can provide for the best outcome for the stakeholders as a whole, even if that means that one or more stakeholders might receive less than if it went about protecting its interests by means of traditional litigation.

17. Additionally, the absence of any role for the court (perhaps in any jurisdiction) makes the process of an informal out-of-court restructuring significantly more flexible (Adriaanse & Kuijl 2006). The provisions of many insolvency laws can be strict, setting thresholds[1] and time limits. Another element of flexibility is the non-application of strict rules of priority.

18. An out-of-court process can, by agreement, treat all creditors alike, or differently according to the exigencies of the situation and the free will of the parties involved. Certain countries’ insolvency regimes require debt to be paid in local currency, whereas an out-of-court workout can provide for debt repayment in any currency. These are just some of the flexibilities and adaptive qualities of out-of-court workouts which can be described as veritable advantages.

19. The speed at which a workout can progress is also an advantage. The process, as alluded to above, is less confrontational. Procedural rules are light (if they exist at all). The smooth operation of the workout means that creditors and debtors can move at their own pace, rather than at the pace of the Court, which in some jurisdictions can be quite slow or, in the context of Covid-19, in paralysis.[2] The speed is coupled with timing. A protracted liquidation process can erode the value of an organisation’s trading stock or product, or its brand name. While the company remains in liquidation, and before its product or brand are bought out, value is seeping away. An informal work out can speed the process up but also allow the restructuring to progress and be formally announced at the most propitious stages.

20. Confidentiality is a further advantage (Adriaanse & Kuijl 2006 call this “silence”). There remains a stigma to insolvency, particularly in jurisdictions with a strong pro-creditor bias (most common law jurisdictions being such places). The reputational damage to an organisation or its board can be hard to mitigate or to overcome. Out-of-court arrangements can prevent at least widespread reputational damage, while simultaneously extracting value for creditors.

21. In short, the advantages of informal workouts are clear. They are cheaper, quicker, more flexible and protect the interests of debtor and creditor alike, treating each as a bargaining party rather than as claimant or defendant in a confrontational piece of

[1] Pursuant to Rule 149(1) of the Insolvency Rules 2005 in the British Virgin Islands, a creditor must be owed at least US$2,000 before it can issue a statutory demand for repayment and thereby invoke the Insolvency regime.
[2] ‘Bust firms unable to liquidate due to lockdown’ *Irish Independent* 24 April 2020

litigation.

22. Having stated the advantages, however, it would be wrong to assume that informal out-of-court proceedings carry no real disadvantages. One glaring disadvantage of such out-of-court processes is the rigid requirement for unanimity. If all creditors and the debtor do not move in the same direction the workout fails. If there is a large number of creditors, negotiations can be fraught with delays and deadlock, infighting and conflicting priorities. These combine to negate some of the perceived advantages of workouts in the first place.

23. Obtaining the consent of the debtor company might appear easy. A board might prefer to keep things out of court and confidential, but any decision by a debtor company to enter into an informal workout could be open to criticism from shareholders who do not accept that it is in the best interests of the company to deal with a situation in that way. Formal insolvency procedures do not require the consent of a debtor and to that extent can be less problematic than informal out-of-court arrangements.

24. The lack of accountability for antecedent misconduct or mismanagement also impacts the utility of informal workouts. Moral hazard is a real issue in commerce. Where a company has been managed badly, or its directors have acted in breach of their fiduciary or other duties, it can be just as important from a public policy perspective that such conduct is punished as it is that creditors get repaid. The ability of a company and its directors to side-step aspects of insolvency law such as the disqualification or restriction of directors could be seen to run contrary to public policy imperatives such as the good management of corporate affairs and the integrity of the marketplace.

25. In the British Virgin Islands (BVI) there are approximately 450,000 incorporated companies. To put that in context, the population of the BVI is approximately 30,000. The vast number of companies incorporated in that jurisdiction are not local BVI organisations carrying on business within the Territory, rather they are often a convenient tax-neutral layer in a more complex multi-national organisation, or they are simply holding companies with assets and business interests abroad.

26. In those circumstances, the creditors of BVI companies tend to be foreign lending institutions, companies or individuals. Where the creditors are simply other BVI Companies, the business interests nevertheless tend to be centred abroad. This means that in practice, the insolvency procedure in the BVI is used often at the end of a dispute process elsewhere and a judgment is sought to be enforced, or where a debt remains outstanding and settlement negotiations or demands have been unsuccessful elsewhere. Often the BVI Court will be called upon to exercise its jurisdiction to grant free-standing interim relief in aid of foreign proceedings (often a *Mareva* (or freezing) injunction).

27. In this sense, an informal workout regime in the BVI is not something that is currently in high demand. There is, however, what is known as a Scheme of Arrangement. An application for a Scheme may be made to the Court by the company or a creditor, member, administrator or liquidator of the company. The arrangement or compromise must be proposed between a company and its creditors or members, or a class of either.

28. Upon the application the Court may order a meeting of the members or creditors (or class of either). If a majority in number representing 75% in value of the creditors, members (or class of either) agree to the Scheme then once sanctioned by the Court

it is binding on them and the company. If the company is in liquidation, it is also binding on the liquidator and on every person liable to contribute to the assets of the company upon its liquidation.

29. While not strictly an informal out-of-court workout, Schemes are a hybrid form of arrangement akin to what Garrido described as “a mixture of the features of contractual workouts and limited court intervention” – even if a creditor can be outvoted.

30. There have been recent developments in the BVI where the Court has provided for a “soft touch” liquidation, which is to say where the Court has appointed joint provisional liquidators but allowed the company’s management to retain control of the Company. The most notable recent case has been Re Constellation Overseas Ltd (BVIHC(COM)2018/0206 delivered 5 February 2019).

31. The proceedings in Re Constellation Overseas Ltd utilised provisions of the BVI Business Companies Act 2004 as well as the BVI Insolvency Act, 2003. In total, eleven BVI companies were restructured, by way of a provisional liquidation in the BVI, a simultaneous judicial reorganisation in the Brazilian courts, a BVI Scheme of Arrangement, as well as ancillary relief for recognition and protection under Chapter 15 of the US Bankruptcy Code. The BVI Court adapted itself to accommodate the Brazilian restructuring (which was itself a hybrid form of restructuring).

32. The case clearly demonstrates that the jurisdiction of the BVI is open and available for the most complex restructurings and has the necessary legislative framework and professional expertise to deliver focussed practical legal solutions that achieve both creditor objectives while allowing viable businesses to keep operational and trading.

33. While the BVI does not have an informal workout system in place, it will of course enforce a contract entered into between creditors and debtors. The BVI has also shown itself to be open to adaptation and innovation when required. It may only be a matter of time before an out-of-court set of rules or principles is recognized by the BVI Courts or introduced by the local government. The hole in the BVI Insolvency regime, however, is the ability of some form of authority (judicial or otherwise) to enforce a standstill period. In the absence of legislative intervention in this area, I suspect that out-of-court workouts will remain greatly underdeveloped in this jurisdiction.

Q3 – 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.

34. Sudarsanam and Lai (2001) have identified a number of important turnaround management strategies which are important to discuss in the context of Flow Management.

35. First of all, the turnaround tool labelled by Sudarsanam as ‘Managerial Restructuring’ is pertinent. Top management change is widely recognized as a precondition to a successful turnaround. Sudarsanam and Lai cite several authors in support of that contention. In short, a need or desire for new management methods is best served by new managers. Apart from anything else, a change in management is a positive

signal to an organization's stakeholders that action is being taken to improve the performance of the organization.

36. Despite the seeming logic implicit in the above contention that a change in management can give stakeholders confidence in the new direction of an organization, evidence that a change in management can positively affect the market's confidence in that organization is mixed.

37. The deployment of 'Managerial Restructuring' at Flow Management was slow to pass. In the initial months there appears to have been little appetite for significant changes at the top of the management of the company. Only in January 2014 does Flow Management announce that it will appoint a new CFO. This is despite pressure from as early as December 2013 to appoint a new CFO. A new CEO is not appointed until April 2014, some 6 months after the difficulties became apparent.

38. Given the source of Flow Management's difficulties (internal accounting processes) it appears odd that the most obvious thing to do from as early as November 2013 – that is, to replace the CFO – was not done until some two months later.

39. Further, it takes pressure from Bank A for Flow Management to appoint a Chief Restructuring Officer sometime in 2014. The appointment of a CRO is in keeping with the advice to appoint turnaround experts in times of crisis (Adriaanse & Kuijl, 2006).

40. The reluctance of the organization to refresh its talent is in keeping with the findings of Organizational Psychology scholars about longer-tenured top managers within an organization. Such longer-tenured top managers tend to attribute failure to external, uncontrollable and temporary causes (Mellahi & Wilkinson, 2004). This over emphasis, causing top management to ignore internal problems, seems to be at play in Flow Management. There is failure to acknowledge that the problem is coming from within the organization and it is that failure of acknowledgement which I say could have contributed to a slowness to adopt 'Managerial Restructuring' as a turnaround tool.

41. A second turnaround tool identified by Sudarsanam and Lai is 'Operational Restructuring'. In essence this involves a two-stage approach: (i) the efficiency/operating stage which comprises cost reduction, revenue generation and operating asset reduction strategies; and (ii) an entrepreneurial/strategic stage which comprises increasing marketing expenditure to stimulate demand, new product market focus, diversification etc. These approaches have yielded turnaround success in the past.

42. This second 'Operational Restructuring' tool came late to Flow Management. It appears that it was not until March 2014 (or sometime thereafter) that Flow Management decided to focus its strategy on increasing turnover combined with large cutbacks. It was at this point that the business' product range fell to be examined the geographical reach of the organization was consolidated. At the same time the turnover increase strategy seems to have included little more than charging existing clients more rather than seeking new clients or increasing the volume of trade.

43. It is interesting to note that while Flow Management decided to reduce the geographical area in which it operated (to excluded non-Benelux countries), the Kymi Corporation identified expansion into new markets as a means of fending off decline (Pajunen 2006). While the Kymi Corporation was engaged in the production of mass-produced paper products, Flow Management was engaged in a car and truck leasing

company. The data is not available so that I can assess whether expansion into new markets was possible for Flow Management, but it is interesting to note that consolidation was the preferred option. This is in the context of supposed confidence that there was an anticipated market demand consistent with reality (January 2014).

44. Perhaps market diversification could have aided Flow Management if it could have been accompanied by increased volumes of trade, new clients and new revenue sources. but a conclusion on that point is not possible on current information.

45. A third turnaround tool is asset restructuring. A restructuring of an organization’s portfolio can involve a suite of decisions: divestment of lines of business; acquiring other companies; forming strategic alliances with other companies; discontinuing products. Essentially, such an approach can involve investment as much as divestment. Early in the story of Flow Management there is a proposal to sell 350 cars in order to improve the solvency rate of the organization. The banks, however, preferred a cash settlement and it is not clear if the sale of 350 cars ever went ahead. It is my considered view that if the Company sought to reduce its geographical reach to exclude non-Benelux countries, an asset divestment might have been a better companion to that decision rather than further cash. A fleet now larger than what had previously served the Benelux countries might very well have been costly in terms of depreciation etc. unless additional customers were being found who would use them.

46. Despite continuing difficulties, the divestment of assets appears not to arise again until sometime in February 2014 when the banks consider the sale of Flow Management Holding BV but this goes nowhere.

47. Some asset investment appears to have happened or to have been anticipated to happen insofar as there is an expectation that the ‘management information system will have been improved’. Whether this involved capital investment or simply a change in work practices is unclear. Given the clear inadequacies in financial reporting and data collection, it is odd that an overhaul in the organization’s IT systems was not contemplated from an early stage.

48. Financial Restructuring appears to have been the primary tool deployed in the attempt to turnaround Flow Management. Financial restructuring ‘is the reworking of a firm’s capital structure to relieve the strain of interest and debt repayments and is separated into two strategies: equity base and debt-based strategies.’ One of the initial actions taken in December 2013 is to ask Lease Group Holding United Kingdom Limited (the “**shareholder**”) to pay off the equity capital so that the solvency rate could be returned to a minimum of 5%. This appears to happen (at the banks’ request) as a cash settlement rather than as the result of asset divestment.

49. The shareholder was then put under pressure to raise a further €12.5 – €15 million to help bring down the overall debt, with default interest applied. This is completely counterintuitive. The creditors had recently (apparently) forced cash from the shareholder to improve the solvency rate of the organization, now default interest was being applied to the organization’ debt to apply “pressure” (was it not already there?) to the shareholder. No consideration is given at this stage (late 2013 / early 2014) to a reduction in the principal owed or the interest rate, let alone to an extension to the maturity or balloon date or to the idea of a debt-equity swap (though this is perhaps not attractive to lending institutions unless absolutely necessary).

50. By January 2014 the injection of further risk-bearing capital was being mooted as a possible turnaround tool. It is not clear if this comes to pass. Banks C and D lost the appetite to cooperate, causing friction among the creditors and affecting the ability of

the creditors to negotiate in tandem. A possible buyout by Banks A and B of the debt of Banks C and D seems to go nowhere, though the clarity this might have brought to the situation by simplifying negotiations is hard to overstate.

51. It is not until June 2014 that the repayment of Flow Management debt finally began to be rescheduled. Default interest has been abandoned and a waiver of other obligations were agreed. This is accompanied by further investment by the shareholder.

52. Of course, the final restructuring plan reached in 2015 is itself a form of financial restructuring where the banks swap debt for equity in a new shell company.

53. The work of Sudarsanam and Lai (2001) indicates that debt restructuring is not indicative of an organization's likelihood of turnaround. In fact, on the analysis that they conducted, only 3% of firms that recovered from a period of distress entered into debt restructuring in the first year of distress. This is consistent with the experience of Flow Management. Other turnaround strategies were delayed or paid lip service. The focus on financial restructuring was at the forefront all the way through. It is a pity that other forms of turnaround strategies were not pursued more vigorously.

54. Within the framework put forward by Schmitt and Raisch (2013) there is retrenchment, which can be characterised as defensive in nature and recovery, which can be characterised a proactive and focussed on change. The overall approach to Flow Management, both by the organisation itself and by the creditors can fairly be said to be retrenchment. I say this for the following reasons:

    a. The initial reaction of Flow Management is to increase prices and cut labour and other costs;
    b. The initial reaction of the bank is to bring the solvency rate back up to 5%, not by asset restructuring but by a cash injection from the shareholder;
    c. Additional money is injected into the organisation in March 2014 by the shareholder, but it is never clear what that money is intended to achieve except to ease cash flow troubles;
    d. The strategy by March 2014 is still focussed on large cutbacks and increased turnover, as opposed to entering new markets, diversifying the product range or innovation;
    e. By March 2014 Flow Management wishes to reduce its geographical area of activity; and
    f. By June 2014 no new ideas except further cash injections seem to be forthcoming.

55. While Schmitt and Raisch argue that a dualism between retrenchment and recovery can exist (and indeed there are certain 'sweet spots' where they interact at optimal levels), the drive for change which recovery implies is simply very weak in Flow Management. Yes, a new CFO and CEO are appointed (eventually) and yes, a CRO is appointed to the Board, but it is difficult to see what adaptations, what proactive measures to help Flow Management to recover are ever taken. There is a continual focus on cash injections, working capital and debt repayment, but seldom a focus on innovation, staff upskilling or product/market diversification.

56. Schmitt and Raisch acknowledge that lots of kiterature views retrenchment and recovery as contradictory forces. It appears that Flow Management did not believe it could both retrench and recover at the same time. The dualism argued for by Schmitt and Raisch could have helped Flow Management in my opinion. An initial rescheduling of debt repayments and labour cost cuts could have been accompanied

by a cash injection from the shareholder to improve the solvency rate. While a certain amount of retrenchment was understandable (shrinking geographically, for example), such retrenchment ought to have been accompanied by proactive policies such as:

a. Selling off unneeded cars from the fleet and re-investing the money in fewer but newer and more efficient cars;
b. Diversifying the customer portfolio;
c. Reassessing the range of products available with a view to consolidation or expansion;
d. Considering whether car repairs ought to have been outsourced or if already outsourced, considering whether car repairs ought to have been brought in-house; and
e. An overhaul of top management.

Q4 – 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?

57. Banks C and D seem to cease cooperating in and around February 2014. It is not clear if anything in particular prompted this decision to withdraw cooperation, but it comes shortly after several further disappointing announcements about the true state of affairs of Flow Management and it is also clear at this stage that the organisation is expecting an alignment among the banks before it will commit itself to a standstill agreement.

58. I suspect that there are two possible explanations for the behaviour of Banks C and D:

    a. The first explanation might be that Banks C and D were trying to leverage any disparity between them and Banks A and B to encourage Banks A and B to consider buying out their debt. Since Banks C and D held less debt than Banks A and B, forcing a liquidation would not have resulted in any guarantee of a return for Banks C and D. They may have considered that the safest option was to take a reduction on their debt by selling it to Banks A and B. The possibility of such an exit rears its head further down the line in the process, and I cannot help but wonder if the earlier non-cooperation was designed to prompt those thoughts in the minds of Banks A and B.

    b. The second possible explanation is that Banks C and D were being difficult in order to prompt a more bullish approach to the situation by Banks A and B. As minority creditors, Banks C and D could not take the lead in the same way as Banks A and B. Banks C and D may have entered the process on the assumption that Banks A and B would be a little more aggressive about forcing a restructuring of Flow Management. Change in Flow Management was slow. Managerial restructuring was happening in piecemeal fashion and even though communication from Flow Management had improved, none of the creditors was entirely happy with the management of the organisation. It may have been the case that Banks C and D wanted to frighten the horses at Banks A and B, indicate that they were not happy (prompting fears that Banks C and D would seek to begin formal debt recovery measures) and thereby induce a more robust attitude from Banks A and B.

59. Had I been advising Banks A and B at the relevant time, and I had perceived the two motives set out above I would have advised Banks A and B to revaluate their approach. I would have explained in detail the frustrations of Banks C and D and offered Banks A and B two options. Either:

    a. Banks A and B do in fact share the frustrations of Banks C and D and need to exert greater pressure on Flow Management to improve or change its management, remembering that the debt of all four banks is at stake; or

    b. Banks A and B do not in fact share the frustrations of Banks C and D and need to buy out the debt held by Banks C and D so that Banks A and B can exert greater control over the process.

Q5 – 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

60. The four banks, A, B, C and D fail to coordinate their strategy from the outset. They appear to start almost immediately with remedial action rather than focussing on achieving a standstill period or discussing shared/divergent goals in the short and long term. While none of the banks immediately seeks to enforce their security, I do not think that this is borne of a spirit of cooperation. However, there is obviously a minimum level of coordination among the Banks inasmuch as they all recognise their joint goal of recovering the debt and the joint challenges they face. No bank breaks rank in the early months at least. It is only when Banks C and D begin not to cooperate that we see a real threat to this first principle. As I have explained in my answer to Question 4, however, the motives here might have been to achieve an early exit in the form of a buyout or to prompt a stronger approach by Banks A and B.

Second Principle

61. At various points in time the banks decide not to begin legal action to recover the sums owed to them. However, their decision on this front in the initial months at least appear to reflect the possible legal frailties of the security the held in respect of their debt. In January 2014 the Banks indicate that they are willing to sign up to a standstill until no later than 31 March 2014, but this appears to be motivated by a desire to perfect the pledges rather than to facilitate a turnaround.

Third Principle

62. This third principle does seem to have been adhered to but as described above the motivation might have had more to do with the quality of the security held by the Banks than any desire to cooperate.

Fourth Principle

63. There is no formal coordination put in place at an early stage. Nobody is appointed a lead coordinator or "point man" for the Banks. Having said that, the fourth principle is largely adhered to by the Banks' decisions to do the following:

    a. Appoint a Chief Restructuring Officer;

b. Agree a waiver of €152 million; and

c. Agree to a debt/equity swap.

64. Without some form of communication and coordination between the Banks, these things could not have been achieved easily. In that sense, despite there being no formal coordination in place, the fourth principle is implicitly adhered to by the Banks.

Fifth Principle

65. One of the earliest processes put in place is the monthly reporting of actual costs and turnover. Further interim reports on the underlying performance of Flow Management appear to be forthcoming as the months progress and by means unknown the management information system “will have been improved”. The success of the improved reporting does not seem to arrive until much further down the line, perhaps as a result of the appointment of the Chief Restructuring Officer. In this sense there was an early adherence to the fifth principle.

Sixth Principle

66. While it is not explicitly stated on the facts that the proposals for resolving the financial difficulties of Flow Management reflect the local applicable law, there appears to be no suggestion of any derogation from the sixth principle as far as applicable law is concerned.

67. We are told, that “the contents of the financial restructuring agreement reflect the relative positions of the financiers involved.” The liquidation of Flow Management Holding BV is to proceed in an undisclosed manner, so it is not entirely clear if the interests of all creditors are being served. There may be trade creditors, for example, who will be left with a loss. This would appear to breach the spirit of the sixth principle if not the letter. But I cannot draw a conclusion on that without further information.

Seventh Principle

68. The facts that the information obtained for the purposes of the process concerning the assets, liabilities and business of Flow Management and any proposals for resolving difficulties does appear to have been made available to creditors (at least insofar as it was readily available). There appear to have been various press releases at certain points in time. It is unclear why a privately held company needed to make press statements (though this may be a requirement under Dutch law?). To that extent principle seven might have been breached.

69. In any large organisation, a press release might be used as a means of communicating indirectly with less central stakeholders (employees, trade unionists, locally interested political actors etc.) but when the press release is negative there is every risk that potential buyers for the organisation will be deterred. It is not clear what effect Flow Management’s press releases had from the facts provided.

Eighth Principle

70. There may have been a partial adherence to this eighth principle. We are informed that additional working capital is repaid in early January 2015. The amount involved was €25 million. Further additional working capital was made available on the transfer of shares to be refinanced in November 2016.

71. The shareholder did provide an unsecured loan to Flow Management in October/November 2014. It is not clear if this was ever repaid (even partially).

Q6 – 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?

72. Under the BVI Business Companies Act, 2004 (the "BCA") there are two types of court supervised arrangements.

73. Plans of arrangement are a means of achieving a wide range of corporate restructurings by way of court approval involving the company and its members predominantly, while schemes of arrangement (which are based on UK company law) are an arrangement between a company and some or all of its creditors or members to compromise their rights against the company subject to court supervision. Whilst there is some degree of overlap between the two, there are also significant differences making one more suitable than the other in certain circumstances.

74. The definition of "arrangement" in the Act is very wide and encompasses reorganisations, mergers, consolidations, separations of businesses, dispositions of assets or businesses, dispositions or exchanges of shares or securities, amendments to memorandum and articles, dissolutions and any combination of these different activities.

75. An application for a Scheme may be made to the Court by the company or a creditor, member, administrator or liquidator of the company. The arrangement or compromise must be proposed between a company and its creditors or members, or a class of either. The consent threshold is a majority in number representing 75% in value of the creditors or members.

76. Upon the application the Court may order a meeting of the members or creditors. If a majority in number representing 75% in value of the creditors, members (or class of either) agree to the Scheme then once sanctioned by the Court it is binding on them and the company. If the company is already in liquidation, it is also binding on the liquidator.

77. The BVI has seen a number of successful creditor schemes in recent years including Re Constellation Overseas Ltd (BVIHC(COM)2018/0206 delivered 5 February 2019) as described above.

78. Plans of arrangement do not involve creditors, so I will exclude them from the scope of this answer.

Q7 - Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015.

79. The 4 July 2015 Restructuring Agreement essentially involved the creation of a new company (“**NewCo**”) to allow the continuation of the organisation as a going concern. The four Banks set up NewCo and are its shareholders. Into NewCo are placed all the operating companies of Flow Management BV (“**OldCo**”) which in turn is liquidated.

80. In essence what has happened is that the Banks have swapped their debt for equity in NewCo while the original bank debt of €240 million remains secured by the pledges over assets which (assuming they rank in first priority) can now be realised in the liquidation of OldCo. This allows OldCo to proceed to liquidation in which other lenders and shareholders will receive little or nothing while the Banks will be able to avail of the pledges which they have taken the time to cure.

81. The result is that NewCo will rise from the ashes like a phoenix and contain the trading subsidiaries, free of the historic debt. NewCo will then be in a position to be sold as a going concern on the market. Both shareholder and the creditors can move forward with a fresh start.

82. The Case Study briefing paper suggests that the restructuring agreement reflects the relative positions of the financiers involved. This is borne out by the haircut taken by Banks C and D and the seeming cancellation of the unsecured €10 million loan given to OldCo by the shareholder.

83. The result of the restructuring agreement is that by May 2016 when NewCo faces new difficulties, it is able to weather the storm. Despite operational losses of €9 million it is able to record (hopefully by now with more certainty) that it will make a profit. The solvency rate is above 5% and the forecast for 2016 is break even. Interest in now shown by other actors in the market who might wish to buy NewCo (though whether this is pre or post insolvency remains unclear).

Q8 – Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process?

84. Several of the relevant trading companies fall to be considered within the scope of Regulation (Recast) (EU) 2015/848 (the “**Regulation**”). (Flow Management Holding BV; Flow Management Work BV; FMW Spain SL; FMW France SPRL)

85. The regulation, in so far as it relates to jurisdiction, prescribes the rules for when the court of a particular Member State can entertain insolvency proceedings. It also sets out the rules on matters such as choice of law and the enforcement of judgments. The interpretation of the regulation is similar to that of the Brussels Regulations (and Convention) so that ‘autonomous’ meanings are given to particular terms.

86. The meaning of insolvency proceedings depends on the Member State in question. In essence, ‘*They must be collective proceedings, based on the debtor’s insolvency, which entail at least partial divestment of that debtor and prompt the appointment of a liquidator*’.[3]

[3] Case C-341/04 Eurofood [2006] ECR I-3813 [46]

87. The meaning of insolvency does not apply to winding up on grounds other than insolvency (such as voluntary winding up or winding up in the public interest). The proceedings must also involve the divestment of a debtor (whether partially or wholly), which in essence means that the powers of administration and disposal no longer belong to the debtor.

88. There must also be a debtor, whose centre of interest must be in a regulation state (i.e. a member of the EU) and there must be the appointment of a 'liquidator'.

89. The principal connecting factor for a court to get jurisdiction is that the state is the centre of the debtor's interests. It is the place where the debtor conducts the administration of his interests on a regular basis. This is supported by a presumption in Article 3(1) of the regulation that the place of the registered office is the centre of the debtor's interest. For these purposes, 'where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States, the presumption… can be rebutted only if factors which are both objective and ascertainable… enable it to be established that the actual situation exists which is different from that which locating it at that registered office is deemed to reflect'.

90. Other of the trading companies fall to be considered in relation to the UNCITRAL Model Law on Cross-Border Insolvency (the "**Model Law**"), adopted by the United Nations Commission on International Trade Law in 1997. (FMW Australia Ltd.; FMW South Africa Ltd.; FMW USA Ltd.). The Model Law does not attempt to unify the substantive insolvency laws of different countries, but rather focuses on encouraging co-operation and co-ordination between countries.

91. An important feature of the Model Law is that it provides for a streamlined procedure for the representative of a debtor in a foreign insolvency proceeding to obtain recognition of the foreign proceeding and apply for relief from domestic courts in aid of that proceeding. Among the relief available under the Model Law, in Article 21, is the "entrustment" to the foreign representative of the assets located in the country hearing the application. This gives the foreign representative the power to control the disposition of those assets.

92. "Entrustment" relief under the Model Law enables the foreign representative to co-ordinate a sale of the debtor's assets where those assets are located across multiple jurisdictions, thereby maximizing the value of those assets, or in different circumstances, minimizing the loss of value attendant upon a sale. Article 21 also empowers the domestic court to allow the foreign representative to distribute the proceeds of the asset sale in the foreign proceeding, provided the court is satisfied that the interests of any local creditors are adequately protected.

93. Article 25 of the Model Law requires domestic courts to cooperate "to the maximum extent possible" with foreign courts and representatives.

94. In the situation involving Flow Management, four of the trading companies could seek to resolve cross-border issues with reference to the EU Regulation. The other four trading companies may approach cross-border issues with reference to the UNICTRAL Model law. While this suggests a potential for conflict to exist (or additional local regulatory/registration requirements), it is evident that the different instruments have a similar purpose and that any conflict is capable of being resolved.

Q9 – 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 you own countries' Bankruptcy Act; be as detailed as possible].

95. By the end of June 2014, the Banks had become increasingly frustrated by the ever-changing projections and shifting timelines. In fact, Banks C and D threatened to cancel credit in an effort to engender a sense of urgency within the company. Some improvement in the performance of management had prompted a change in attitude, and the Banks were now prepared still to pursue a standstill agreement.

96. At the same time the issue surrounding the pledges held by the banks as security appear not yet to have been resolved. The risk here is obvious – if the pledges are unenforceable, any option resulting in liquidation could leave the Banks with (at least) a shortfall.

97. Despite this background four scenarios were drawn up, one of which was a moratorium on debt repayments with the company being sold in a controlled manner. Such a proposal had points to recommend it and points to recommend against it.

98. First of all, a moratorium in the manner envisaged would have allowed for a clean start for the company in new hands. The historical debt issues would not have provided any value to a "go forward" plan. Consequently, a moratorium would have been a pre-requisite. Secondly, the moratorium would have given the shareholders a fresh start without increasing their risk exposure any further (certainly not further than the Banks). The third advantage of a moratorium would have been to shift any liquidity risk to the Banks in the early stages of rebuilding the Company's fortunes. A fourth advantage would have been the frontloading of any retrenchment. The moratorium would thereafter have allowed Flow Management to focus on recovery and to implement recovery plans from the first day.

99. Having said all that, a moratorium posed drawbacks also. Of the four options drawn up, the moratorium was very much presented as a last option. Given the prevailing circumstances (improved relations between the Banks and the Company), the other three options might have been construed as being more palatable. A primary problem with the fourth option was that it weighted all the risk on the Banks' side. Secondly, the fourth option, while restoring value to the Company for the shareholders, would have entailed a foregoing of the opportunity of the Banks to recover their debt in whole (at least). Thirdly, the only possible way of justifying the moratorium would have been by burning any unsecured creditors in the process. If such unsecured creditors were trade creditors, this might have had a negative effect on the ongoing performance of the Company.

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Case Study I
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