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Global Insolvency Practice Course 2021-2022

Case Study 1: Flow Management

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

Causes of Organisational Failure

In their critique of the current body of literature concerning organisational failure, *Mellahi*[1] broadly categorises the different schools of thought, as may be summarised as follows:

(i) *First,* the determinist approach, which argues that organisational failure is caused by external industry factors (over which management has little or no control) and that the role of management is not important (or in any event wholly secondary) when it comes to an analysis of why organisations fail. The determinist approach can itself be split into two perspectives:

   a. The industrial organisation perspective, which is that jolts in the external environment generate waves of failure. This perspective reflects three underlying assumptions: (i) that the external environment imposes constraints on firms strategies; (ii) most firms operating within the same industry (or ecology: see below) tend to pursue similar strategies; (iii) management is rational and committed to acting in the firm's bests interests.

   b. The organisational ecology perspective, in respect of which the underlying theoretic foundation is natural selection. This perspective is concerned with the interplay between organisations and other organisations within the their 'populations'. Key factors that may determine prospects of success include the density of the population, the life cycle of the industry, the age of the organisation and the organisation's size.

(ii) *Secondly*, the voluntarist approach (based on organisation studies and organisation psychology), which is predicated on the assumption that managers are the principal decision makers for the firm and that their perceptions of the external environment will have a strong effect on the firm's performance. Management is the most important element, rather than external factors. There are a number of disparate (and connected) theories explaining the voluntarist approach, including *Groupthink theory* (concerned primarily with the psychology of small groups making decisions together)*, Upper Echelon theory (*concerned with top management and in particular, homogeneity and length of tenure)*, Curse of Success* (concerned with the threat that success breeds overconfidence and, in turn, cautious conservatism in the face of external change) and *Thread Rigidity Effect theory* (concerned with the tendency, in the face of threat, to maintain the status quo).

In relation to the issue of top management being a major factor in organisational failure, see *Stakeholder Influences in Organisational Survival*, Pajunen, p1268, and the discussion

[1] *Organisational failure: a critique of recent research and a proposed integrative framework,* Mellahi & Wilkinson, March 2004

regarding Mr Rudolf Elving (including, for example, in relation to his allegedly autocratic decision-making and poor communication with stakeholders).

See also *Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions,* Adriaanse and Kuijl, where the authors state (pp147-148): "*Regarding the causes of financial difficulties, it can be concluded that the problems mainly relate to poor management – i.e. inadequate reaction of management on both internal weaknesses and strengths, even as external threats and opportunities – and excessive cost structures (fixed and variable costs), as well as the presence of inadequate management information systems within the company (as a result of which important early warning signs of imminent decline are missed by management). The results, particularly those regarding poor management correspond to foreign studies by, among others, the Association of Business Recovery Professionals (R3), in the United Kingdom, as well as the European Federation of Accountants (FEE); the latter also identifies a dire need for adequate management of the company on the basis of financial information, and this confirms the identified causes in the field of (poor) management information. The popular belief to the contrary notwithstanding, economic circumstances are often not the (major) cause of the problem, at least in The Netherlands. It frequently seems to be an excuse rather than a real root cause.*"

See also *Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis*, Sudarsanam and Lai, on p184, regarding top management change being frequent quoted as a precondition to successful turnarounds.

Causes of financial distress: Flow Management Holding BV ("FMH")

The causes of the financial distress, as communicated by company management, are stated explicitly on page 2 of the case study: (i) large management bonuses of €3m issued wrongfully to the CEO and CFO of FMH; (ii) a contingency gain (i.e. a potential increase in the value of FMH's assets) wrongfully booked (prematurely), resulting in the need for a negative correction of €1.6m; (iii) a €2.8m book profit wrongfully made in 2012, in circumstances where the profit was not realised in 2012 or 2013; and (iv) formula errors in a spread sheet resulting in clients being charged too little.

Of these, (ii), (iii) and (iv) are all accounting errors, which suggests, in turn, that there are fundamental problems with FMH's finance department: specifically, a lack of expertise and/or oversight, and inadequate management information systems (see *<u>Adriaanse</u>*). Items (ii) and (iii) are arguably more concerning than (iv), because they give rise to a misleading picture of the state of FMH's financial health, which *may*, in turn, have fed into the decision to issue large and wrongful management bonuses to the CEO and CFO (who was responsible for the decision to issue these management bonuses, if not the CEO/CFO?). It is apparent that there are management and governance issues at FMH. No doubt this drives the bank's demand that the shareholder company take steps with regard to management (the CFO in particular).

The FMH business structure "*is there and operates properly*" and there appears to be market demand for the services that FMH provides, including for so-called "*hiring and leasing days*". The fact that the FMH business model may be viable is corroborated by the conclusions of the independent turnaround consultancy, which is called in to review the business in and

around December 2013. It is also corroborated by the fact that, upon being informed around that time that prices would increase, the business's main clients all agreed and of the approximately 5,000 other contacts and clients that were informed, only a few replied negatively.

In light of the above, the causes of financial distress at FMH align far more with the voluntarist literature than the determinist literature:

1. All indications are that there are issues with management: wrongful bonuses issued and bad management information systems giving rise to unreliable information.

2. There is no explicit indication that the cause of financial distress is driven by external factors: to the contrary, the evidence is that there is demand for the services that FMH provides and that most (or many) clients are willing to pay more.

The financial distress could arguably have been prevented had adequate management information systems been in place. That would have ensured that early warning signs could have been identified and acted upon. There is no further detail provided regarding the management bonuses, other than that they were wrongful. So, clearly they should not have been issued either. From a creditor perspective, arguably there ought to have been more frequent dialogue with FMH and an insistence upon the provision of timely information (for example, the banks are called in to a meeting in November 2013, but the problems with the accounts go back in time to the book profit wrongfully booked in 2012). This would have allowed for an additional layer of oversight and for the banks to better protect their interests.

2. **What are in general the 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 key advantages of out-of-court restructurings are summarised in *Adriaanse* (on pp145-147) as being: (i) flexibility (which is a function of the fact that workouts are contractual in nature, and therefore less rigid than formal processes, which are often governed by statute); (ii) silence (workouts are private and consensual and confidential and do not take place before the Courts or otherwise in the public eye; this avoids adverse publicity and/or stigma and what *Adriaanse* refers to as the "*self-fulfilling prophecy-effect of a public procedure")*; and (iii) control (management can retain control of the company during the reorganisation).

A more fulsome 'list' of the advantages and disadvantages of workouts is presented in the World Bank's Study, *Out-of-Court Restructuring,* Jose M Garrido (2012), on pp8-13[2]. They include (non-exhaustively) the following:

Advantages

- Flexibility (as above)
- Ease of negotiation (for example, there are no procedural rules governing what may or may not be agreed)

[2] https://documents1.worldbank.org/curated/en/417551468159322109/pdf/662320PUB0EPI00turing09780821389836.pdf

- Timing issues (workouts are typically shorter processes than formal insolvency procedures)
- Confidentiality (as above)
- Less stigma (as above: this prevents value erosion)
- Continuation of the debtor's business (less goodwill loss)
- No changes in management (as above)
- No changes in the rights of parties (there is no interference in the rights of parties, for example the right to enforce security)
- No court involvement
- Lower costs (formal procedures are costlier in terms of time, money and reputation)
- Lack of regulatory impact (depending on the circumstances, a formal procedure may have adverse regulatory consequences for a business, including for example in relation to any licenses it operates under).

Disadvantages

- It may be difficult to fully assess the true financial situation of the debtor. In those circumstances, a more formal process (with the appointment of formal practitioners) may be more appropriate than a workout
- No possibility of avoidance actions (in relation to antecedent transactions) unless a formal insolvency procedure is instigated
- Workouts require unanimity amongst creditors, which may be difficult to achieve. Formal procedures allow for the majority to bind the minority
- Workouts require the consent of the debtor; in formal insolvency procedures this is not the case
- Workouts require multi-party negotiation and co-operation, whereas formal procedures provide a forum for all creditor interests to be served
- Foreign courts are more likely to recognise formal proceedings, especially formal liquidation proceedings, which may be necessary in the case of a debtor which has significant cross-border activities or assets.

Out of court restructurings in the Cayman Islands

There is little very information/literature available regarding the prevalence or otherwise of out of court restructurings in the Cayman Islands, which is an offshore jurisdiction.

In their Chambers Insolvency Guide 2020[3], Campbells (a major offshore law firm) note that:

"Due to the nature of the Cayman Islands as an offshore jurisdiction, restructuring market participants, company management and lenders are invariably based onshore. As such their views and preferences on consensual work-outs and restructurings tend to reflect the prevailing market views and preferences in the onshore jurisdiction(s) where they are based. These vary from case to case, but the most common jurisdictions (in no particular order) are London, New York and Hong Kong.

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[3] https://www.campbellslegal.com/wp-content/uploads/2020/12/Chambers-Insolvency-Guide-2020-Cayman-Islands.pdf

Cayman insolvency and creditors' rights do not interact to a significant extent with the viability, desirability or choice of informal and consensual out-of-court restructuring and work-out strategies. In particular, Cayman legislation is silent on consensual restructuring negotiations and therefore does not require that they take place before the commencement of a formal statutory process."

The authors further note: (i) that to the extent a creditor consents to an out-of-court workout, that consent would likely preclude it from challenging the restructuring subsequently (depending on the circumstances); and (ii) creditors cannot be crammed down in a consensual workout as a matter of Cayman Islands law (instead, a (formal) scheme of arrangement, involving a court process, would be required).

In the light of the above, the advantages and disadvantages of workouts as compared to formal bankruptcy procedures are broadly reflective of those set out in *Adriaanse*. In addition, a consensual workout will not have the benefit of a statutory moratorium on claims, which is available in the Cayman Islands upon the appointment of provisional liquidators (see Q9 below).

3. **Were the turnaround/reorganization approaches as presented in the reading material (see e.g. Adriaanse & Juijl, 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 differently.**

Turnaround processes deployed: FMH

The following principal steps were taken:

1. Invitation from the board of FMH to the four banks in November 2013 to address financial difficulties and reasons for them.
2. Presentation by management of a plan (discussions with main clients regarding price increases; notification with other clients of price increases; spending cuts, in particular in relation to staffing). That plan is subsequently executed.
3. Agreement amongst all four banks to discuss the company's situation in December 2013 (i.e. co-operation, at least initially).
4. Appointment of a turnaround consultancy.
5. Insistence upon increase financial reporting (actual costs and turnover).
6. Request that the shareholder, Lease Group Holding UK ("***LGH***"") pays off the equity.
7. Demand from the banks that measures are taken with regard to management (CFO in particular).
8. Pressure applied to LGH to raise additional sums; pressure also applied in the form of default interest.
9. Decision by the banks not to terminate their credit agreements, given that Faillissement will negatively affect returns and there may be issues with the validity of their security.
10. Appointment of new CFO and subsequently, the appointment of a new CEO.
11. Attempt by the banks to negotiate a standstill agreement, albeit this passes off with difficulty. Eventually signed (120 days) in August 2014.
12. Unsecured loans (€10m in April 2014 and €27.5m in May 2014) provided/proposed to be provided by LGH to FMH. This is eventually done (in June 2014/September-October 2014).

13. Consideration by banks A and B of purchase of debt held by banks C and D at a 15-20% discount.
14. Plans for increased turnover, large cutbacks (i.e. retrenchment), entire business mix evaluated and reassessed (recovery), possible asset sales (shares in non-Benelux companies).
15. Proposed appointment of Chief Restructuring Officer (CRO).
16. Proposals for financial restructuring (see p5)
17. Consideration of debt/equity swap and signing of restructuring agreement, paving way for sale of new company ("***FMH 2***") in a going concern situation.

In this respect the turnaround approaches presented in the reading material were, in many respects, applied. Notably:

Adriaanse & Juijl, 2006

This article addresses the two key components of an informal restructuring: business restructuring and financial restructuring.

Business restructuring usually consists of four phases: (i) stabilising; (ii) analysing; (iii) repositioning; (iv) reinforcing. Each of those phases is visible in the case study:

1. *Stabilising*. Steps are taken in the short term to increase cash flow and allow for breathing space, including price increases and spending cuts and extra savings through improved loss recovery and savings on car repairs[4].

2. *Analysing*. There is strategic analysis *ex post* to trace the causes of the current state of affairs. Enquiries are made as to the financial position (with a specialist turnaround consultancy appointed) and a determination is made that LMH is viable. Various measures are proposed to improve long term turnover, make certain cutbacks and re-evaluate business mix. Overhead costs are cut, staff are made redundant, working capital is refinanced, management information systems are resolved to be improved. There is a consideration of what should be cut (e.g. shares in non-Benelux companies).

3. *Repositioning*. The case study makes clear that the value recovery process is initialised.

4. *Reinforcing.* Management of LMH is replaced.

In terms of financial restructuring, various of the measures set out in *Adriannse* at p145 (Table 4) are taken, including reducing current debts, reducing repayment obligations, deferring repayments, deferring interest payments and a debt for equity swap.

Pajunen, 2006

The article stresses the importance of stakeholder identification and engagement. Key stakeholders are identified and engaged in the case study: (i) the creditors (banks) are all called in relatively early, and are obviously central to the workout process; (ii) the owner (LGH) is engaged early and pressured to make management changes at LVH and to inject

[4] See further *A global view of business insolvency Systems,* Westbrook, Booth, Paulus and Rakaj, at [5.4.4 and 5.4.5]

further capital; (iii) key clients are dealt with gently (with price increases 'discussed') and 'less important' or 'non-key' clients are kept informed of those same price increases; (iv) new management is put in place, including a new CRO. It might be said that all of Propositions (1-6) set out in the *Pajunen* article are, to a greater or lesser extent, visible in the case study.

Sudarsanam, S. Lai, J., 2001

The article addresses the effectiveness of corporate turnaround strategies (including managerial restructuring, operational restructuring, asset and financial restructuring) and the impact of timing and intensity of the implementation of those strategies on corporate recovery.

In the case study, as noted above: there is managerial restructuring (replacement of CFO and CEO and appointment of new CRO); operational restructuring (increasing revenue, reducing costs: this is similar to the 'retrenchment' phase addressed in *Raisch* and the 'stabilising' phase in *Adriaanse*), and financial restructuring in the form set out in the restructuring agreement.

A., Raisch, S., 2013

Raisch concerns the interplay between retrenchment (increasing efficiency through cost and asset reductions) and recovery (improving market position through strategic change). There is evidence of both retrenchment (reducing costs by staff redundancies and making additional savings; improving revenue through price rises) and recovery (increasing turnover by itself, a re-evaluation of the business mix) in the case study.

4. **Banks C and D seem to frustrate the process at a certain point. What could have been the (rational and/or opportunistic) reason(s) for them to behave like that? What would you have done in that situation in your role as advisor of the other two banks?**

This is a holdout situation, with Banks C and D threatening the viability of the workout (in particular insofar as Banks A and B consider it may result in a risk that LVH, the shareholder, will not inject further capital).

It appears that Banks C and D have *"a general lack of confidence in the Flow Management Company"* and this may be a perfectly rational reason for their reluctance to agree to a standstill agreement. They may also wish to exit their investment quickly (noting that there is discussion, at some stage, of Banks A and B purchasing their debt (at a discount), or to push for repayment of their debt in full (for example, given their own liquidity or other commercial concerns), possibly on the basis that it is fully refinanced by Banks A and B. These are rational/opportunistic alternatives to participation in the negotiations, which may otherwise result in lower recoveries for Banks C and D.

In that situation, advising Banks A and B:

1. The first point would be to advise that Banks A and B have no formal or legal power, per se, of compelling Banks C and D to 'come to the table'. Creditors are entitled to look out for their own commercial interests without reference to the commercial interests of other (unrelated) parties. It is a requirement of a successful workout that there be unanimous support for it.

2. The second point would be to advise Banks A and B in relation to the implications of the workout failing, i.e. the possibility of a formal insolvency process.

3. The third point would be to see if there is any possibility for Banks A and B to engage in further talks with Banks C and D in order to better understand their concerns (and in particular, the reasons for the holdout). For example, if Banks C and D wish simply to exit the investment, it may be possible for them to sell their credits to Banks A and B (i.e. debt trading). This would remove Banks C and D from the picture and leave Banks A and B to conduct a more efficient restructuring by facilitating productive interbank discussions with fewer stakeholders. If, by way of further example, Banks C and D wish to compel further changes in FMH's management, then there may be scope for a joint approach to FMH and or LVH on that basis.

4. There may be scope for Bank A or B to assume a 'lead bank' type role, or alternatively establish a steering committee (albeit perhaps a steering committee is not necessary in these circumstances, where there are only four banks).

5. There may scope for Banks A and B to apply 'soft' pressure on Banks C and D to adopt a more co-operative approach. See for example the comments of Mr Pen Kent, the Bank of England's Director for Finance and Industry, in a speech to the Chartered Institute of Banker on 12 November 1992, where he said as follows in relation to the 'London Approach': "*The London Approach does not remove the right of individual banks to make their own commercial judgments but it does recognise that, where the vast majority of banks agree on one particular strategy, those banks holding a different view also have a long-term interest in preserving the co-operative culture. In that light they may reconsider their decisions on the basis of the collective good. While a bank may not be entirely happy with every aspect of a support package, it may be willing to accept that what is on offer is preferable to the alternatives. It might reach this conclusion because it fears that failure of the banks concerned to agree on the terms of a workout may result in receivership which would be in no-one's interests. Another consideration is that where there is undoubtedly a significant degree of market pressure, often unspoken, that may deter a bank from taking a stance perceived as unreasonable by their colleagues. A bank which frustrates an orderly workout for a company may find that other banks are less likely to be constructive next time round when their roles are reversed."* Of course, here, there are only four banks (in respect of which there appears to be a 50/50 split). However, the principles still apply and it makes sense for dialogue to take place as quickly as possible in order to understand whether the road blocks to a successful workout can be removed (and the workout proceed), or whether a formal process is inevitable.

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

First Principle: relevant creditors to co-operate with each other to give sufficient though limited time to the debtor for information about its affairs to be obtained and evaluated for the purposes of resolving financial difficulties

All financial creditors (Banks A, B, C and D) are involved in the workout process for FMH – consistent with the First Principle.

Also consistent with the First Principle, the creditors allow (limited) time for information to be gathered. They are called in November 2013 but work with FMH to enable information to be obtained (including by the appointment of a turnaround consultancy). Efforts are then made to enter into a standstill agreement, which is signed in August 2014 (but notably, only after some difficulty and 8 months after being alerted to the financial difficulties, thereby *arguably* inconsistent with the First Principle: see page 9 of the Principles under *The Standstill Period - Commencement*).

Second Principle: during the standstill period, all relevant creditors should refrain from taking any steps to enforce their claims or (otherwise than by disposal of their debt to a third party) reduce their exposure, but they are entitled to expect that their position shall not be prejudiced. Conflicts of interest are to be identified early and dealt with appropriately

In the case study, none of Banks A, B, C or D take any steps to enforce their claims, consistent with the Second Principle (although one of the reasons for this may be that problems are identified with some of the pledges).

Third Principle: during the standstill period, the debtor should not take any action which might adversely affect the prospective return to creditors

No adverse steps are taken by FMH (albeit there appear to be concerns with constantly changing information given by FMH, and there are delays in the reorganisation steps to be carried out). This is consistent with the Third Principle.

Fourth Principle: the interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty (for example by the selection of representative co-ordination committees and/or professional advisors)

The case study does not specifically address the issue of a steering committee. It does not appear that one is formed. The reason for this may well be that there are only four banks in this scenario, whose interests are broadly aligned (aside from an apparent holdout at one juncture). In this respect the commentary to the Fourth Principle states that *"in some cases the number of relevant creditors involved in an attempted rescue is sufficiently small that a steering committee is unnecessary"*. There is at least reference (case study, pp3-4) to the banks realising that a joint approach is desired.

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 creditors

FMH provides management information and allows Banks A, B, C and D access to information, consistent with the Fifth Principle. Access is granted, in the early stages, to an independent turnaround consultancy (i.e. to professional advisers).

In saying this, there is a concern (see case study, p5) that FMH's new management have been giving "*constantly changing*" information. That is unhelpful and inconsistent with the Fifth Principle – which is, self-evidently (albeit implicitly), based on the assumption that the information given is accurate. On this note, see the commentary to the Fifth Principle, which states (emphasis added): "*The relevant creditors will need to receive <u>information which they can place reliance upon</u> and have evaluated by their advisers. <u>For this reason the information will have to be obtained, or at least be capable of due diligence, by independent advisers</u> acting for the relevant creditors. <u>The advisers to the relevant creditors can in some cases work from information provided by the debtor or its advisers but issues of reliance and liability can cause difficulty in this regard</u> and, where asset valuations are needed, it will usually be necessary for the relevant creditors to commission such valuations themselves.*"

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 the relevant creditors at the standstill commencement date

The case study does not explicitly address whether the proposals reflect applicable law, but it may reasonably be inferred that they do so. The case study explicitly notes that "*the contents of the financial restructuring agreement reflect the relative positions of the financiers involved.*"

Seventh Principle: information obtained for the purposes of the workout process should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential

There is no express mention of a confidentiality agreement. The commentary to the Seven Principle recommends "*in all cases*" that one is entered into: to the extent there was no confidentiality agreement entered into, that would inconsistent with the Seventh Principle.

Eight 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

No "new money" is provided by creditors during the standstill period or under the restructuring proposal.

6. Suppose it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, are there are any other possibilities for "soft law" to use (perhaps specifically in your country/region)? If yes, explain in what way. If not, do you see any alternative (informal) possibilities?

There are no 'Cayman Islands specific' soft law guideline approaches to multi-creditor workouts, in the same way, for example, as there are in the UK (the so-called 'London Approach' referenced above) or in other jurisdictions (the World Bank's 2016 *Toolkit for Out-of-Court Workouts*, at Section 3.6 *et seq*, references various country-specific guidelines– the Bangkok Rules, the Instanbul Approach, the Jakarta Initiative, and the approaches in Lebanon, Jordan, Latvia and Mauritius). The reason for the absence of Cayman specific guidelines is likely one of need, in circumstances where it is an offshore jurisdiction and preferences are likely to reflect the prevailing market views and preferences of creditors in the onshore jurisdiction(s) where they are based (see the *Campbells* article cited at Q2 above).

In terms of possible 'out of court' alternatives, if the INSOL principles were not be to be followed:

1. Receivership, to the extent available to one of the creditors under the terms of any relevant security documentation, may be another possibility available to secured creditors. In the Cayman Islands there are no specific statutory provisions governing receivership appointments arising under security documentation. There is also no statutory requirement to register the appointment of a receiver.

2. Debt trading/purchase may be another option, whereby creditors unwilling to adhere to the INSOL principles sell their credits (either to new creditors who *are* willing to adhere to the principles, or to existing creditors, in order to reduce the number of creditors required to co-ordinate and co-operate).

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

References to 'steps' in this answer are to the seven steps listed on page 6 of the case study.

1. The main assets of FMH (i.e. the six operating companies) are transferred to a new shell subsidiary entity, FMH 2. Diagrammatically speaking, FMH 2 is interposed directly 'underneath' FMH as its wholly owned subsidiary. See step 1.

2. FMH is liquidated in an undisclosed manner. All claims by the banks and LVH, against FMH, are cancelled. FMH and LVH cancel all claims against FMH 2 and all of the operating subsidiaries. See steps 3 and 4.

3. Shares held in FMH 2 are transferred from FMH to: (i) the consortium of banks that originally provided working capital to Flow Management Work BV (one of the operating subsidiaries) ("***FMW***"), and (ii) to certain board members. In this way, the consortium of banks obtain equity in FMH 2, and thereby obtain an (indirect) equity interest in the operating companies through FMH 2. See step 2.

4. In exchange for this equity over the operating companies, various ‘haircuts’ are taken by the banks in respect of the corporate group’s outstanding borrowings:

    a. The consortium of banks that provided working capital to FMW, write off €97.5m, with a €240m claim remaining. Notably, the consortium possesses pledges on most assets of FMW and will receive part of their debt claim in a liquidation scenario. So, not all debt is cancelled: the banks will be both creditors of FMW (the €240m claim), and shareholders of FMH 2 (which in turn owns shares in FMW and the other operating subsidiaries). See step 6.

    b. Banks C and D, which had provided additional working capital facilities to FMW, write off those additional working capital facilities (again, though, they receive indirect equity in the form of shares in FMH 2). See step 5.

    c. The €55m loan to FMW is also written off. See step 7.

In essence, the restructuring agreement is a debt for equity swap, whereby debt held at the operating company level is (partially) forgiven by the banks in exchange for the issuance of equity interests in a new holding vehicle (FMH 2) that wholly owns the operating companies. Risk-avoiding capital (debt) is reduced, including by conversion into risk-bearing capital (equity).

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

The Flow Management corporate structure contains a number of companies incorporated in various jurisdictions across the globe: The Netherlands. Spain, France, Australia, South Africa, and the USA. Each of those countries have their own systems of law.

In terms of potential legal cross-border issues arising:

1. One issue that may arise is that the debtors are clearly in financial difficulty. Is a workout, in respect of which the debtors are able to maintain possession and control of their assets, permissible under these different jurisdictions? Some jurisdictions allow for rehabilitation, whereas other jurisdictions are less focussed on rescue and more focussed on liquidation proceedings. This is sometimes referred to as a ‘bias’ towards either rescue/rehabilitation or liquidation.

2. There may be risks and liabilities associated with continuing to trade in circumstances where some of the debtors are/may be of doubtful solvency. The directors of the operating subsidiaries may need advice in respect of the duties and obligations owed under local law. Insurance may need to be sought.

3. There is no moratorium in place, and therefore it is still possible for a disgruntled creditor to petition for the winding up of the subsidiaries (likely in the place in which the subsidiaries are incorporated). The workout will not compromise any other debts, for example, debts owed to non-bank creditors.

In terms of potential non-legal cross border issues arising, the workout will require co-ordination and communication and collaboration between various stakeholders across various jurisdictions, time zones and possibly also languages.

9. In October 2014 four scenarios have been drawn up. Why *was* or *wasn't* calling for a moratorium (see scenario 4) a good option given the situation at that time? [you are allowed to give your opinion based on your own countries' Bankruptcy Act; be as detailed as possible].

The (120 day/four month) standstill agreement was entered into in the middle of August 2014 and was therefore due to expire mid-December 2014. The banks were at this stage unhappy with constantly changing information being provided to them, but they were content with FMH's new management (including the CRO) and had noticed a slight improvement as a result of the reorganisation (hence their pursuit of a standstill agreement). In other words, the banks were still vested in the restructuring process and were assessing their options, with a view to preserving value.

In those circumstances, calling for a formal moratorium would arguably not have been a good option at this time, on that basis that it may well (certainly, it would in the Cayman Islands) have required the instigation of a formal insolvency process before the court, with the attend loss of a number of the advantages of an out of court restructuring (for example, the loss of confidentiality, loss of goodwill, increased expenditure: see further Q2 above). There is no reference, in the case study, to the existence of other creditors threatening claims.

Within the Cayman Islands context, section 104(3) of the Companies Act (2021 Revision) allows for the appointment of provisional liquidators upon the application of a company (but not its creditors) in circumstances where: (i) the company is, or is likely to become, unable to pay its debts; and (ii) the company intends to present a compromise or arrangement to its creditors. This is sometimes referred to as a 'light-touch' or 'soft-touch' appointment. Upon hearing an application under s104(3), the Court will have regard when exercising its discretion as to whether make such an appointment, to the express wishes of creditors and whether there is a real prospect of refinancing and/or sale as a going concern being effected for the benefit of creditors[5].

Some of the disadvantages of the provisional restructuring regime in the Cayman Islands are well explained in a recent article appearing in *South Square Digest,*[6] where the author notes: "*In order to access the provisional liquidation regime, a winding up petition must first be presented in respect of the company. This can often present a serious public relations challenge where the company conducts business in jurisdictions that are unfamiliar with the provisional liquidation process and its use in restructurings. It can be challenging to reassure directors, shareholders and creditors that the filing of a winding up petition is a necessary gateway to an eventual corporate restructuring, and not the beginning of a process that will lead to the eventual dissolution of the company. The winding up petition also risks triggering contractual defaults, impacting on the value of assets that might be sold as part of the*

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[5] See for example *Sun Cheong Creative Development Holdings Ltd,* Unreported, Smellie CJ, 20 October 2020

[6] *Provisional Liquidation and Restructuring: The Cayman Islands and Hong Kong*, Michael Popkin, December 2020: https://www.campbellslegal.com/wp-content/uploads/2020/12/Provisional-Liquidation-and-Restructuring-the-Cayman-Islands-and-Hong-Kong.pdf

restructuring and causing reputational damage with customers that the company may wish to retain. These issues are some of the strong drivers for the implementation of a corporate restructuring regime that stands outside of the liquidation process."

Perhaps for these reasons, there have been consultations in recent years regarding the implementation of a new restructuring officer regime in the Cayman Islands, which would allow for the appointment (by the Court) of restructuring officers (who must be qualified insolvency practitioners) outside of the winding up context, with companies retaining the benefit of a statutory moratorium during the restructuring process. In fact, in a very recent development, on 21 October 2021, the Companies (Amendment) Bill 2021 was gazetted[7], paving the way for the implementation of this new regime in the near future. Numerous offshore firms have published material relating to this positive new development[8].

[7] http://gazettes.gov.ky/portal/pls/portal/docs/1/13116568.PDF
[8] See for example: https://maples.com/en/knowledge-centre/2021/10/good-news-for-debtors-seeking-access-to-the-cayman-restructuring-regime