Case 1

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Question 1

In this paper, financial distress and business failures are used interchangeably. Financial distress has had several descriptions, including decline, retrenchment, and bankruptcy (Mellahi & Wilkinson, 2004). Flow Management Holding BV appears to be in financial distress from the evidence presented. Mellahi & Wilkinson (2004) identified various symptoms of organizational failure, including negative profitability, shrinking financial resources, dwindling market, a loss of legitimacy, and decreased market share value. Muñoz-Izquierdo et al. (2019) described business failure manifestation includes when a company files for insolvency proceedings or seeks to renegotiate outstanding amounts with creditors. These actions indicate that the firm is financially distressed, insolvent, and may not have the liquidity to meet its day-to-day expenses.

Several clues in the Flow Management Holdings BV case study suggest the company was distressed financially. These clues include the following:

1. In November 2013, the Board of Directors (BOD) invited four banks, A, B, C, and D, for a meeting. The banks at the time represented some of their largest creditors.
2. The 2012 financial statements contained several significant errors, including spreadsheet formula errors, cost prince errors, and an overpayment of bonuses to upper management.
3. The consolidated losses for Flow Management Works BV in 2013 were € 23.1 million, adjusted from predicted profits of € 8 Million (see Table 1 below).

**Table 1-2013 Flow Management Works Consolidated Losses**



The errors in the management information system indicate that management incompetence, an inefficient management information system, lack of effective staff training, or a combination of all three contributed to the causes of financial distress. Xu and Wang (2009) concluded that poor management is the main cause of financial failure. The efficiency of business operations is a reasonable reflection of the competencies of a firm's management (Xu & Wang, 2009). The BOD must also be held responsible for not having systems to predict financial distress (Xu & Wang, 2009).

Weak management, inefficiencies in the management information systems, and ineffective BOD oversight are all controllable elements of business operations, and therefore, the financial distress could have been prevented (Xu & Wang, 2009). The process of business distress may take several years to manifest itself (Monoz-Izquiredo et al., 2019). "[business failure] is not a sudden phenomenon" (Korol, 2013, p. 22). The causes of business distress are multi-year processes that develop over time (Makropoulos, Weir, & Zhang, 2020). Business managers can prevent business distress using tools from external professional consultants and auditors. External auditors can use digital audit tools to detect the early signs of business failure (Monoz-Izquiredo et al., 2019). Therefore, the audit report users could use the analytics generated from those reports over a timeframe to prepare themselves for the possible consequences of the markers shown in the audit (Monoz-Izquiredo et al., 2019).

**Table 2- Prior Studies on Business Failures and Audit Data (Adapted from Munoz-Izquierdo et al., 2019)**



Table 2 above (adapted from Munoz-Izquierdo (2019) shows seven studies by researchers for private and public companies in the USA, New Zealand, Spain, and the United Kingdom. The studies point to the use or non-use of data generated by audit reports and the ability to predict financial distress using audit reports. Munoz-Izquierdo et al. (2019) results displayed consistency for the different methods applied and suggested that the audit report is 80% accurate in explaining business financial distress. Additionally, the researchers' evidence indicates that financial disclosures in audited financial statements that mention causes related to a combination of internal and external factors were able to explain the business failure partially. The evidence is consistent with the proponents of integrating exogenous and endogenous factors and partially explains the causes of business failure and prevention methods.

The audit report provides a statement on material uncertainties relating to events or conditions casting doubt about the firm's continuing as a going concern. The going concern is a common qualification when a firm's financial viability is in doubt. Auditing standards require professional accounts to evaluate the going concern uncertainty (Pedrosa & López-Corrales, 2018). Therefore, there are requirements for auditors to include in their report if they found any evidence of the risk of business failure. Auditors must also qualify their audit reports if there is a high risk that a business may not continue when the audit is completed.

The paragraphs above gave an opinion on the causes of financial distress at Flow Management Work BV. There is also a discussion on how financial distress could have been prevented. It is posited that the audit report produced by companies' auditors is suitable as an early indication of possible upcoming company failure. Users of financial statements, including investors, the BOD, the Courts, employees, and business analysts, rely on the audit report to evaluate firms in financial distress. The stakeholders in firms in danger of failing should be aware of going concern risks when making business and investment decisions. It is reasonable that auditors, financial advisors, and business writers are obliged to report on the statistics and markers that indicate business failure risks.

Question 2

Informal workouts or out-of-court restructuring are negotiations and processes unrelated to judiciary intervention (Garrido, 2012). According to Adriaanse & Kuijl (2006), an out-of-court or informal reorganization aims to restore the company's health within the framework of a legal entity. Informal reorganizations occur outside the formal statutory framework. The two methods of informal reorganization include business restructuring and financial restructuring (Adriaanse & Kuijl. 2006; Vidović, 2017). The distressed company can alternatively pursue a formal solution (Garrido, 2012; Vidović, 2017). Alternatively, the company may pursue a judicial reorganization plan (Adriaanse & Kuijl, 2006; Dick, 2021; Garrido, 2012; Vidović, 2017). In the US, there is a Chapter 11 bankruptcy. In other countries, similar legislation allows the distressed company to restructure.

Globally, the design of bankruptcy procedures varies widely (Hotchkiss, John, Mooradian, & Thorburn, 2008; Vidović, 2017). Some developed countries, like the United States and France, have modernized their laws that can sometimes be viewed as favorable to the distressed company's management and makes ways for the continuation of the firm as a going concern (Hotchkiss, John, Mooradian, & Thorburn, 2008). However, other developed countries, including the UK and Sweden, rely on the market to allocate the failing firm's assets. In smaller, less developed, and emerging economies, there is an ongoing effort to adopt adequate bankruptcy procedures that are effective and fair to the parties involved (Hotchkiss, John, Mooradian, & Thorburn, 2008; INSOL International, 2017; The Law Firm Network, 2014).

When companies are financially distressed and overleveraged, generally, there are several restructuring options for their bank and creditors' debt (Dick, 2021; Garrido, 2012; Vidović, 2017). The distressed entity can meet with its lenders to amend or restructure the loan agreements to allow the debtor company to take steps and attempt to remedy its condition without going into formal bankruptcy proceedings (Adriaanse & Kuijl, 2006; Dick, 2021; Vidović, 2017). Some authors argue that informal out-of-court restructuring is more efficient because it is more financially feasible and avoids the complexities and uncertainties of a formal bankruptcy filing (Adriaanse & Kuijl. 2006; Dick, 2021; Garrido, 2012; Vidović, 2017). Informal arrangements are not always straightforward and require significant creditors' agreement, collaboration, and consensus (Dick, 2021; Garrido, 2012; Vidović, 2017). Indeed, lenders holding high-priority claims must carefully assess their standing against the standings of other creditors and voluntarily agree to risk their debt ranking in favor of a recovery plan (Chen, 2020; Garrido, 2012).

Out-of-court debt restructuring involves changing or reorganizing the composition of the structure of assets and liabilities of financially distressed entities (Adriaanse & Kuijl, 2006; Garrido, 2012; Vidović, 2017). The objective is to restructure the assets and liabilities without judicial intervention (Garrido, 2012; Vidović, 2017). To this end, all parties must be interested in promoting efficiency, restoring growth, and minimizing the costs of the debtor's financial difficulties. According to Garrido (2012), "Restructuring activities can include measures that restructure the debtor's business (operational restructuring), and measures that restructure the debtor's finances (financial restructuring)" (p. 1). Informal debt restructuring is important in insolvency systems (International Monetary Fund, 1999; The Law Firm Network, 2014). When a company is financially distressed, all parties can effectively protect their interests if an agreed informal solution can be negotiated (Adriaanse & Kuijl, 2006; Garrido, 2012; Vidović, 2017).

There are general advantages and disadvantages when comparing informal out-of-court restructuring to formal bankruptcy proceedings (CFGI, 2023). The advantages of informal restricting were summarized by Adriaanse & Kuijl (2006) using the terms "flexibility, silence, and control" (p 145). One of the first requirements for a distressed company to negotiate an informal arrangement with its creditors is to examine the relationship between the distressed company and its creditors (CFGI, 2023; Garrido, 2012; Vidović, 2017). For a distressed company to lead a successful out-of-court restructuring, it must reach a financial agreement with all of its significant creditors; all of its lenders, major suppliers, and any third-party entities involved must agree on the source of the company's troubles and its potential solutions (CFGI, 2023; Garrido, 2012; Vidović, 2017). Indeed, negotiations between the major creditors are more important than negotiations with the debtor. Many diverse creditors have substantial funds outstanding, so the negotiation procedure can be complex and uncertain (Garrido, 2012; Dick, 2021). A successful restructuring is probable if the distressed company has a better relationship with all involved parties. The case study shows that the Flow Management Work BV enjoys a civil relationship with the four banks, A, B, C, and D, the major creditors. The major banks appear to be civil enough to understand it would be in the best interest of all to have an out-of-court settlement.

Vidovic 2017 details other advantages of an out-of-court restructuring, including greater flexibility to all parties, allowing a tailor-made solution to the unique problems facing the distressed company and the stakeholders. This flexibility is particularly helpful when different jurisdictions and cross-border contracts are involved. Vidovic (2017) argues that voluntary workouts are less confrontative, have less stringent rules, and have a higher degree of confidentiality. If the company's financial difficulties are kept out of the public eyes, there will be no incentive to restrict normal business activities between the customer, its customers, vendors, lenders, and the general public (Adriaanse & Kuijl, 2006, CFGI, 2023; Garrido, 2012; Vidović, 2017).

In the Commonwealth of The Bahamas, bankruptcy laws are less developed, and distressed company has fewer options for relief. Lennox Patten (2017) and Crow Horwath Bahamas (2023) list The Bahamas' major legislation governing company insolvency and restructuring as The Bahamas Companies (Winding up Amendment) Act, 2011, The Bahamas International Business Companies (Winding Up Amendment) Act, 2011, The Bahamas Insolvency Practitioners Rules, 2012, The Bahamas Companies Liquidation Rules, 2012 and The Bahamas Foreign Proceedings (International Cooperation) Liquidation Rules, 2016. Lennox Patten (2017) noted that The Bahamas is more creditor friendly, with the laws skewed in favor of the creditor, with few options for the distressed Companies. There are currently no proposals to reform the legislative framework. Lennox Patten (2017) pointed out that recent court decisions concerning personal bankruptcy proceedings have shed light on the weakness of Bahamian law in this regard, showing the need for reform to provide more options for a distressed company.

Crow Horwath (2023) argues that the Bahamian laws will "keep pace with international developments and complement the country's standing as a leading offshore financial services jurisdiction" (p-1). On the other hand, Crow Horwath (2023) expressed the view that The Bahamas' laws were recently modernized, and the current insolvency legislation is designed to measure up to legislation in other financial centers. In this author's opinion, the laws in The Bahamas favor creditors. However, the formal laws do not hinder informal proceedings between creditor companies and distressed companies as long as the proceedings do not reach the public's attention. It is believed that many such informal arrangements have already taken place but have not been brought to the attention of the press or business writers. Adriaanse & Kuijl (2006) and INSOL International (2017) wrote that several countries are in the process of reviewing their insolvency legislation by their desire to prevent formal bankruptcies. Undoubtedly, The Bahamas is one of the countries seeking improvement in the legislation to allow companies to survive financial distress.

According to INSOL International (2017), countries continue to develop local insolvency laws to facilitate the rehabilitation and rescue of financially distressed companies instead of seeking liquidation to close the business and disburse the assets. The Bahamas is no different in seeking alternative ways to rescue distressed companies. It is true, however, that no matter how debtor-friendly and the efforts for the business to survive are, the evidence shows that there are advantages for all stakeholders in the speedy implementation of informal or contract-based rescues (Chen, 2020; INSOL International, 2017). This is compared with "the unpredictable costs and uncertainties of a formal insolvency" (INSOL International, 2017, p. 5). This is particularly true where cross-border businesses or complex capital structures traverse different jurisdictions (The International Monetary Fund, 1999; Vidović, 2017).

Question 3

The principles of informal restructuring are set out in the publication *Statement of Principles for a Global Approach to Multi-Creditor Workouts 11 (2017)*, as published by INSOL International. The eight principles documented by INSOL are the authoritative document or best practices for multi-creditor workouts (INSOL International, (2017). Other authors, including, Adriaanse & Kuijl (2006), Pajunen (2006), Sudarsanam (2001), and Schmitt (2013), published papers that suggested similar or contrasting views and methods of executing an informal reconstruction that, for the most part, supported the authoritative document published by INSOL International (2017).

To summarize INSOL principles, these are as follows: 1) all creditors should be willing to cooperate. 2) Creditors should not take any steps to enforce their claims. 3) The debtor should not act adversely against any relevant creditor. 4) The interest of relevant creditors is best served with a coordinated response. 5) The debtor should provide the necessary and relevant information to the creditors and advisors for proper evaluation. 6) The standstill period should adhere to all relevant laws and the relative positions of the debtors at the standstill commencement date. 7) All information provided to the creditors should be held in confidence. 8) If funding is provided, the repayment of the funding is given priority.

Adriaanse & Kuijl (2006) focused on distressed businesses' business and financial reconstruction. The authors concluded that action at the early stages of financial distress and including other stakeholders is critical to successful informal restructuring (Adriaanse & Kuijl, 2006). In the conclusions, the authors pointed to the Statement of Principles by INSOL International and advocated their acceptance as a framework for successful restructuring.

Pajunen (2006) wrote about the influences of the various stakeholders during a company's financial crisis. The author noted the need to identify the various stakeholders and identified the primary stakeholder as necessary for the entity's survival as a going concern. Pajunen (2006) identified the secondary stakeholder as influential parties who are not critical to the entity's survival during a financial crisis. Managing the various stakeholders is important, particularly the primary stakeholder, without whose support the business will not survive (Pajunen, 2006). Pajunen gave an example of a turnaround process of Kymi Corporation and detailed the company's decline and turnaround, emphasizing the management of the various stakeholders. The author pointed out the resource dependence-based influences between the owners and creditors, the managers, and other stakeholders. It was posited that continued support of primary stakeholders is necessary for the organization's survival in a crisis. Therefore, little attention should be given to secondary stakeholders such as employees. Additionally, frequent and open communications between the primary stakeholders and the distressed company's management should increase the probability of survival.

Schmitt and Raisch (2013), in a study of 107 Central European turnaround attempts, detail the relationships between retrenchment and recovery. This relation was hitherto regarded as contradictory by some authors. Retrenchment is a management action focusing on enhancing efficiency by managing costs and reducing assets. Conversely, recovery focuses on using strategic changes to improve the firm's market position (Schmitt & Raisch, 2013). The authors noted the inter-relations between retrenchment and recovery and pointed out how both were necessary for the turnaround process, which was deemed a duality perspective. The authors provided theoretical arguments and empirical evidence that linked retrenchment and recovery as positively associated with the turnaround process. The results of their study suggest that retrenchment and recovery play a more complex and dynamic role in corporate turnarounds than was previously assumed. Retrenchment and recovery complement each other and are necessary for successful turnarounds. Using univariate analysis and multiple regression methodologies, Schmitt and Raisch (2013) found differences in the strategic choices of recovery and non-recovery firms. Recovery firms preferred an investment and acquisition strategy to aid in their recovery. Alternatively, non-recovery firms were more focused on internal operational and financial restructuring. Therefore, recovery firms were more forward-looking and relied on business expansion and external market strategies. Schmitt and Raisch (2013) did not regard long-term recovery strategies as a one-time effort, but recovery successes were inextricably tied to the effectiveness of the company's early actions when the financial distress began (Srhoj, Kovač, Shapiro, & Filer, 2023).

In the case study, many of the suggested methodologies in informal turnaround were exercised by Flow Management. For example, in the agreement on July 4, 2015, the stakeholder agreed to pursue an informal restructuring because it was believed that all parties would benefit, as opposed to formal court-supervised bankruptcy proceedings (Chen, 2020). The major creditors participated, and some adjustments to the finance were agreed upon (haircut). The shareholders provided an injection of new funding, and some of the debt was canceled (Adriaanse & Kuijl, 2006). A new entity was formed, and a firm of advisors was engaged. There was a management change at the top, and the group sought expansion and investment to assist in the recovery process (Pajunen, 2006). However, Flow Management could have taken earlier action, and the standstill agreement was delayed several times (Srhoj, Kovač, Shapiro, & Filer, 2023). This delay in initial action may have prolonged the recovery effort, according to the study by Schmitt & Raisch (2013). While most of the actions eventually taken in the case study were supported by the literature, a more systematic method could have been used, following closer to the INSOL International (2017) principles. The recovery process might have been shorter if the INSOL International principles had been used when the financial distress was first recognized (Vidović, 2017).

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Question 4

The initial meeting with the four banks happened in November 2013. By February 14, 2014, the case study indicated that banks C and D suddenly ceased to cooperate. The ceased cooperation indicates a level of frustration. The first two principles of informal restructuring, as advocated by INSOL International 2017, are quoted as follows:

**First Principle:** Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to cooperate 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.

**Second Principle:** During the standstill period, all relevant creditors should agree to refrain from taking any steps to enforce their claims. This reduces the exposure to the debtor, but creditors should expect to maintain their current position relative to other creditors. There will be no prejudice against other creditors during the standstill. Conflicts of interest in the creditor group should be identified early and dealt with appropriately.

These principles applied to the case study can provide some rational and opportunistic reasons for the possible frustration of the banks C and Ds management. Firstly, there was considerable delay in finalizing the standstill agreement that involved the cooperation of all relevant parties. The lack of a formalized standstill agreement may have been one of the causes of the frustrated behavior of the C and D bank's management. According to Barret Walker (n.d.), a standstill agreement is an understanding (manifested by deed) between a distressed company and one or more of its creditors where the creditors effectively relax their legal rights for a period. During this period, the debtor should provide all pertinent information to the creditors. Additionally, management attempts to return the company to profitability by taking established turnaround steps (Chen, 2020; Van Huÿssteen, 2015). In an effective standstill agreement, the company's management convinces the creditors that the company is salvageable and will return to profitability, which will, in a reasonable period, be better off for all parties, as opposed to formal reconstruction (Adriaanse & Kuijl (2006); Barret Walker, (n.d.).

Another possible reason for the apparent frustration can be gathered from the case study that banks C and D may have had strong legal rights against the assets of Flow Management. In the eventual settlement on July 4, 2015, it was revealed that banks C and D provided additional working capital to Flow Management Work BV and may have additional legal rights that improved their ranking in the recovery process of the debt if a legal remedy were to be pursued (Chen, 2020). The enforcement of these legal rights may have been delayed during the standstill period. The second principle of INSOL International 2017 noted above that there was an expectation that the position of banks C and D would not be prejudiced. Under this principle, there was also an expectation that all conflicts of interest be dealt with appropriately. It is possible that banks C and D perceived some threat to their relative standing in the ranking of their debt and that there were insufficient efforts to agree on the standstill agreement and to satisfy any perceived conflicts of interest effectively. Garrido (2012) argued that the advance of additional funding from banks C and D resulted in an "inter-creditor" (p. 30) agreement among major creditors that will determine which creditors will rank for repayment in advance of the other entitlements in the event of a subsequent formal insolvency procedure. Banks C and D could have also created a security interest over specific unencumbered assets or collateral with a value greater than or equal to the amounts advanced (Garrido, 2012).

There was a wide acceptance of the need for a standstill agreement, but the parties did not seem willing to agree. There appears to be a lack of trust between the parties in early 2014, contributing to the apparent frustration of banks C and Ds management. In a loan agreement with strong legal powers under the terms of the debt instruments, there may have been some consideration by the frustrated banks' management to enforce their instruments, thereby putting all of the other creditors at risk (Chen, 2020; Van Huÿssteen, 2015). Such action may have also made the company's distress public, contrary to the arguments of Adriaanse & Kuijl, 2006; and Garrido, 2012. Adriaanse and Kuijl, 2006 argue that if the restructuring were a public event, suppliers, clients, and financers would approach the distressed company differently and may be unwilling to procure new contracts or do so with strict terms. Both researchers posited that the restructuring process should be done in relative silence. Adriaanse and Kuijl, 2006 noted that "informal reorganizations take place in relative silence" (p. 146).

Additionally, if the reconstruction process were public, there is a danger of "a *race to collect"* (Adriaanse & Kuijl, 2006, p. 146),where creditors get in each other's way as they seek to enforce their legal remedies at the expense of other creditors (Chen, 2020). This process may involve seeking formal court-supervised procedures, not in the interest of any parties. Adriaanse and Kuijl 2006 refer to this as the "*self-fulfilling prophecy-effect of a public procedure"* (p. 146).

For the recovery to be successful, all parties must work in harmony and agree to the terms of the debt reconstruction. Banks A and B must assist the stakeholders in completing the standstill agreement as early as possible and ensure that the rankings of the debts are not prejudiced (Dick, 2021; Garrido, 2012; INSOL International, 2017). As an advisor to banks A and B, in order to effectively deal with any perceived frustration on behalf of the management of banks C and D, we would advocate adhering to the principles of INSOL International 2017 and the recommendation of other authors, including Adriaanse & Kuijl (2006), Pajunen, (2006), Sudarsanam &, Lai, (2001), Schmitt &, Raisch, (2013), and Vidović, (2017). Other authors who advocated silence during the standstill period and the parties' cooperation in the negotiations with a distressed company included Brédart, 2014. Dick, 2021, Hotchkiss, Mooradian, & Thorburn, 2008, Khurshid, 2013, Kisman, & Krisandi, 2019, & Muñoz-Izquierdo, 2019. The advice to banks A and B would also include not seeking to purchase the debt from C and D banks because such actions may be interpreted as counterproductive to the group (Chen, 2020; Garrido, 2012; Vidović, 2017). Such actions may jeopardize the standing of the debt of C and D (Dick, 2021; Garrido, 2012).

Question 5

The case study requests the explicit or implicit application of which principle in the workout process agreed with Flow Management. INSOL International (2017) published eight principles that "should be regarded as statements of best practice for all multi-creditor workouts" (p. 1). All eight principles refer to methodologies for effectively carrying out informal restructuring for distressed companies. In the preamble to the principles, the eighth principle is noted below (INSOL, International, 2017, p. 3):

**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.

Therefore, the eighth principle appears to be the agreement between banks A, B, C, and D, the other stakeholders, and Flow Management Work BV. While other INSOL standard principles may apply to the workout process, the eighth principle is the most appropriate solution to this question.

The eighth principle mentions the treatment of additional funding (referred to as "New Money" (p. 32). There may be a necessity for New Money to assist in a temporary shortfall or to enhance working capital. The INSOL principles recommend doing this by securing the new funding over assets of similar value. The case study reveals that new working capital funds were provided by banks C and D. The providers of the New Money are usually placed in a preferred position because the principles require that any New Money be prioritized in repayment terms (INSOL International, 2017).

The workout process also calls for banks C and D to accept a haircut of € 32.4 million, a waiver by the consortiums who also provided working capital of € 97.5 million, and the cancellation of a € 55 million loan in full. The eighth principle is the only principle dealing with additional funding, the status of the providers of additional funding, the effect of new funding on other creditors, and the non-obligation of the provider of the additional funding to provide more funding should there be any formal bankruptcy proceedings, unless there is a court approval (INSOL International, 2017, p. 34).

Adriaanse and Kuijl, 2006 argued that any new funding should take priority, "separate from current positions and guarantees" (p. 145). Adriaanse and Kuijl (2006) mention the provision of new funding while emphasizing the flexibility of an informal restructuring procedure. This is aligned with the INSOL International principles, specifically, the eighth principle. Vidović (2017) noted that informal workout processes for distressed companies are creatures of contract law that allow means for resolving financial and operational problems in the debtor company, including providing additional funding or debt discharge. These arguments align with INSOL International 2017 principles for cross-border restructuring.

Question 6

Ideally, stakeholders in distress should follow the recommendations of INSOL International (2017). INSOL published eight principles that "should be regarded as statements of best practice for all multi-creditor workouts" (p. 1). All eight principles refer to methodologies for effectively implementing informal restructuring for distressed companies. However, the insolvency practitioner may encounter situations where some of the stakeholders of the distressed company may choose not to adopt the principles advocated by INSOL International, 2017. In these circumstances, it may still be beneficial for all parties to seek alternative methods of informal restructuring for the benefit of all the parties and a quick and private resolution (Adriaanse & Kuijl, 2006; Chen, 2020; Garrido, 2012; Vidović, 2017).

Garrido (2012) argued that heterogeneity in a group of creditors makes it easier for different creditors to have different incentives in dealing with the debtor. Some creditors may disregard the negotiation process and try to obtain full payment from the debtor, using various enforcement provisions for specific claims (Chen, 2020; Van Huÿssteen, 2015). If these creditors are non-financial, there is a healthy chance that financial creditors will support the debtor for the payment in full to this category of creditors. If the dissenting creditor is a bank or another financial creditor, it may be more difficult for other financial creditors to accept. In this scenario, the dissenting creditor may receive payment in full while the other creditors share the results following the sacrifice of the workout. The "holdout" (Garrido, 2012, p. 35) creditors create a collective restructuring problem as they take advantage of the efforts of the creditors who agree to participate in the workout (Garrido, 2012). By enforcing its claim for full payment, a financial lender may recover a smaller amount to the group's detriment (Chen, 2020). If many financial creditors take this approach, the informal reconstruction fails, and a formal liquidation procedure will begin (Chen, 2020; Garrido, 2012). In this case, all creditors will likely receive less than in an informal, negotiated workout (Chen, 2020; Garrido, 2012; Van Huÿssteen, 2015).

The holdout problem is an example of a "prisoner's dilemma" (Garrido, 2012, p. 35). In this situation, cooperation may result in a better conclusion than individual action, but an individualistic act provides a better result for the individual creditor. If the creditor that holds out is a bank or other financial institution, the action may lead to the failure of the reconstruction process and a run on the debtors' assets. The result may be a formal insolvency, even where the evidence suggests that the debtor has a viable business with a chance to regain profitability. Therefore, the holdout problem may cause the informal workouts to fail. However, the financial institution holding out may face considerable peer pressure from other institutions. More importantly, future workouts with that particular creditor may be in jeopardy, and other financial creditors may be reluctant to enter agreements with previous holdout creditors, deepening distrust (Garrido, 2012).

In informal workouts, the most difficult negotiations frequently occur among the financial creditors holding secured debt instruments (Dick, 2021; Garrido, 2017). While it is not necessary to replicate the ranking of claims in a liquidation procedure, as far as possible, the negotiators should follow the formal debt ranking process as closely as possible(Garrido, 2017). If a secured creditor perceives any risk to their status regarding the ranking of the debts, there is a risk that the creditor may "hold out" and decide not to respect the standstill and enforce its security (Garrido, 2017). Indeed, the hold out creditor may force the debtor into formal insolvency.

The Bahamas has no legislation to encourage out-of-court negotiations for debt restructuring. Under the current law, a debtor owed funds can seek the court's supervision to appoint a receiver or manager, seek a declaration of insolvency, and enter into formal or provisional liquidations. There is no evidence of plans to address the lack of insolvency laws in The Bahamas. Therefore, there are no soft laws to encourage negotiations. However, this does not stop parties with funds receivable from a distressed company from entering into private negotiations with creditors seeking an out-of-court solution.

Question 7

The restructuring agreement signifies that the influential stakeholders agreed that the business is worth saving, and the objective is to work with the company as a going concern (Dick, 2020). The previous discussions of liquidation or formal actions under the loan agreement had concluded.

Under the restructuring agreement, the assets and liabilities of all operating subsidiary companies of Flow Management Holdings BV were transferred to a new entity named Flow Management Holdings 11 BV. This includes Flow Management Works [FMW] BV, FMW Spain SL, FMW France SPRL, FML Australia Ltd., FMW South Africa Ltd., and FMW USA Ltd. As all of the assets and liabilities of the subsidiary companies are transferred, the subsidiary companies will cease to exist and be removed from the list of companies at the respective Register of Companies. FMW 11 BV is a Flow Management Holdings BV subsidiary in the Netherlands.

The actions were taken at this point support Adriaanse & Kuijl's (2006) stage of business stabilization. During this phase of the restructuring, the stakeholders take action to stabilize the entity or group, with an enhanced emphasis on cash flows. The objective is to maximize incoming cash and minimize outgoing cash to allow some "breathing space" (Adriaanse & Kuijl, 2006, p. 140). Additionally, this action signifies the dynamic change in influence at the company, as Pajunen (2006) noted. The transfer of shares to the consortium of banks that financed the original working capital illustrates the shift in stakeholder influence during the recovery period. It also demonstrates confidence in the CRO as an important leader for the company, and the company has a probable future as a going concern.

Flow Holdings BV, now a shell company with no assets, liabilities, customers, or staff, will be fully liquidated. The lack of significant assets implies that the receipts from the liquidation are inconsequential. The cancellation of all claims indicates that there were successful negotiations between the parties for the turnaround of the company, and the possibility of future profits (Sudarsanam & Lai, 2001). The stakeholders recognized that pursuing a going concern alternative would be a better choice (Chen, 2020; Van Huÿssteen, 2015).

Canceling all claims against the new company indicates that the new entity can survive without carrying the legacy debt of the previous entity, Flow Management Holdings BV. Such assets will be sold so the company can concentrate on its primary strategy (Adriaanse & Kuijl, 2006; Port Brown, (n.d.). According to Port Brown (n. d) different company departments and subsidiaries may not fit with the company's primary strategy face elimination during a restructuring process to boost the emerging company's chances of survival. Strategically, the prior division or subsidiaries may not align with the company's long-term goals.

The willingness of banks C and D to waive € 32.5 million and to write off the company's debt demonstrates confidence in the company, its products, management, and probable return to profitability (Adriaanse & Kuijl, 2006).

Question 8

The case study stated that Flow Management Holdings BV is intrinsically related to other international counterparts. Inevitably, the restructuring of Flow Management will require considerations for legal and cross-border issues. The more complex the international group, the more complex the legal and cross-border ramifications. According to the International Monetary Fund (1999), the differences in national insolvency laws have presented significant consequences for international entities with assets and liabilities in different countries. If a branch or department of an international conglomerate are located in one country becomes insolvent, "should creditors in that country be allowed to initiate insolvency proceedings while the enterprise as a whole is still solvent?" (p. 108). Alternatively, is it possible to hold separate proceedings in the various countries if the entire enterprise is insolvent? (International Monetary Fund, 1999).

Advice from a professional turnaround specialist with training in cross-border insolvencies may be necessary to ensure the timely and optimal results of the efforts of the management of Flow Management 11 BV. According to the Law Firm Network (2014), some of the considerations for cross-border restructuring include the following:

* The recognition of different insolvency laws in different countries with related companies.
* Financing options available and the necessary considerations for companies wishing to continue trading during restructuring or insolvency.
* Alternative informal restructuring processes available without the need for court intervention.
* International tax management to optimize the company's tax liabilities and obligations in different jurisdictions.
* The processes available and necessary considerations for companies restructuring or seeking insolvency protection from judicial bodies.
* Governmental representation and differences in financial services firms in different jurisdictions.
* Stakeholder Interaction, both official and unofficial, and the relation with non-governmental groups, including trade unions in different jurisdictions.
* The issues for secured and unsecured creditors of companies in financial difficulty.
* The differences in the rights of creditors and remedies during the enforcement of insolvency laws in multiple jurisdictions

According to the International Monetary Fund (1999), because of the growing importance of cross-border insolvencies, countries should introduce legislation to facilitate the recognition of foreign proceedings and strengthen cooperation and coordination among courts in different countries. One of the important developments in this area is the Model Law on Cross-Border Insolvency by the UN Commission on International Trade Law, [1997] (UNCITRAL). More than 40 countries negotiated this law. At that time, 40 countries represented a good sample of differing legal systems. One of the objectives of this model law is to achieve limited but effective cooperation compatible with all legal systems and, therefore, acceptable to all countries. Its goals are to ensure cooperation in cross-border insolvency cases through recognition of foreign decisions and access of foreign liquidators or administrators to local court proceedings. Model laws such as UNCITRAL would assist in the cross-border restructuring of Flow Management Holdings BV.

Question 9

In INSOL International Principles (2017), the second principle calls for all relevant creditors to refrain from taking steps to enforce individual claims. In the case study, option four was a consideration that called for a moratorium or a formal suspension of payment procedures, a controlled liquidation, and the requirement of the banks to provide a bridging loan. Given the situation at the time (October 2014), this was not a good option for various reasons.

Van Huÿssteen (2015), writing from a South African perspective, describes a moratorium as a temporary halt of rescue activity by agreement. During a moratorium for company restructuring, all legal and commercial activity ceases for an agreed future event that will allow the cessation of the moratorium (Van Huÿssteen, 2015). During a moratorium, creditors can still pursue legal actions to protect their interests (Chen, 2020; Van Huÿssteen, 2015). However, such actions increase the distress for the troubled company and can be detrimental to all stakeholders (Van Huÿssteen, 2015). According to Chen (2020), moratoriums are mechanisms for insolvency companies where there is a suspension of creditors' individual actions. The moratorium period provides distressed companies with a valuable breathing space to negotiate with creditors and other stakeholders and search for solutions to end insolvency (Chen, 2020; Van Huÿssteen, 2015).

In June 2014, there was positive news coming from the company. The case study revealed that the shareholder was willing to deposit € 10 million in the short term and contribute € 25 million in September – October 2014. This was on the condition that a standstill agreement was reached and the funds were needed. Additionally, by early August 2014, there was some appreciation of the new management of Flow Management Holdings BV, including the appointment of a CRO (Pajunen, 2006). By the end of October, the case study noted, "the banks conclude that a going concern situation seems to be the best one" (p. 6).

Option four will effectively lead to a liquidation, or the selling of the company by a "fire sale" method, selling off the assets and ending the company's life. In a fire sale, the assets are sold quickly and may not get the best price, minimizing the cash flows into the liquidating company (Kenton, 2021). In June 2014, management had considered that liquidation would only yield 55% of "the total in outstanding debt" (p. 5). Option four also called for a controlled liquidation and the requirements of further funding by the banks in the form of a bridging loan.

For those reasons, option four appears not to make financial sense. All of the principal stakeholders, in this case, the consortium of banks, would not have been in a position to recover a significant portion of their debt while expending additional funds. According to Regroup Solutions (2021), a controlled liquidation implies the suspension of the company's management, and a liquidator takes total control of the company. Therefore, the bank loses its ability to negotiate and is left to the kindness of the liquidator (Dick, 2021). The result may not be in the best interest of the company's assets, customers, creditors, and other stakeholders (Van Huÿssteen, 2015). The better solution would be to manage the company as a going concern, based on the investigation concluding that the company can retain profitability soon.

The Bahamas laws are currently without the ability of a financially distressed company to seek an informal solution, and any creditor can approach the courts to place the debtor company into mandatory liquidation. This robs the stakeholders of the ability to negotiate with the management and relevant creditors to salvage what may be a profitable company that is experiencing financial distress. Lennox Patten (2017) and Crow Horwath Bahamas (2023) list The Bahamas' major legislation governing company insolvency and restructuring as The Bahamas Companies (Winding up Amendment) Act, 2011, The Bahamas International Business Companies (Winding Up Amendment) Act, 2011, The Bahamas Insolvency Practitioners Rules, 2012, The Bahamas Companies Liquidation Rules, 2012 and The Bahamas Foreign Proceedings (International Cooperation) Liquidation Rules, 2016.

Lennox Patten (2017) noted that The Bahamas is more creditor friendly, with the laws skewed in favor of the creditor, with few options for the distressed Companies. There are currently no proposals to reform the legislative framework. Lennox Patten (2017) pointed out that recent court decisions concerning personal bankruptcy proceedings have shed light on the weakness of Bahamian law in this regard, showing the need for reform to provide more options for distressed companies. The current laws in The Bahamas do not align with INSOL International's (2017) second principle that discourages creditors from seeking to enforce individual claims. The ability to agree to a moratorium does not exist in the current Bahamian insolvency laws.

Choosing the fourth option in October 2014 was the least desirable option. An informal restructuring process that chooses the going concern basis would be a better choice (Chen, 2020; Van Huÿssteen, 2015).` The investigation into the company indicated that the company was economically feasible. The action taken in 2015, when a new company was formed, the debts were eliminated, and a new management team led to eventual profitability. At times, a negotiated informal process is the best financial solution for the stakeholders when facing a temporary financial difficult period in the company's operations.

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