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?**

Beyond those causes specifically identified by management in the case study[1], the causes for and/or reasons of the financial distress experienced at Flow Management Holding BV (**FM**), Flow Management Work BV (**FMW**) and the other subsidiaries (collectively, the **FM Group**) are challenging to extrapolate. Mellahi & Wlkinson identified that theoretical and empirical research on the failure of a business has reflected a clear divide along deterministic and voluntarist schools of thought[2], which each be divided into two principal components, as follows.

Deterministic (external)	**Voluntarist (internal)**
Industrial Organization (**IO**) Organization Ecology (**OE**)	Organization Studies (**OS**) Organizational Psychology (**OP**)

A detailed review of these components is beyond the scope of this submission but a summary of their core ingredients, according to Mellahi & Wlkinson and the authors cited by them, with application to the case study, is set out below. It is worth mentioning at this juncture that Mellahi & Wlkinson conclude that most business failures cannot be exclusively attributed to one of the schools of thought and/or their respective components; such failure being a product of a blend of factors, both external and internal[3]. The author agrees with this proposition.

<u>IO</u>

IO is grounded in economics and that the external environment is principally responsible for organizational failure. IO, being on the deterministic[4] side, leaves over the suggestion that human error or self-interest are the causes of corporate failure[5]. Mellahi & Wlkinson suggest that the IO perspective reflects three underlying assumptions[6] namely (1), the external environment is assumed to impose pressures and constraints on firms' strategies that would lead to failure (2), most firms operating in the same industry, or within a certain segment of an industry, are assumed to pursue similar strategies and (3), organisational decision makers are assumed to be rational and committed to acting in the firm's best interests and, therefore, failure could not be caused by them alone. For example, the resilience of a business is constantly tested by technological leaps, new (and sometimes unforeseen) competition and consumer trends. More recently, a global pandemic has placed unprecedented operational and financial stress on businesses. The variables are held to be very much external, as

[1] Page 2 of the case study.
[2] M Mellahi, K., & Wlkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. International Journal of Management Reviews, 5(1), pp 21.
[3] Ibid, pp 32.
[4] "*Relating to the philosophical doctrine that all events, including human action, are ultimately determined by causes regarded as external to the will*." (Oxford University Press).
[5] M Mellahi, K., & Wlkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. International Journal of Management Reviews, 5(1), pp 23.
[6] Ibid, pp 23.

opposed to the internal machinery of a business, which includes its management and the decisions that they make.

OE

The underlying theoretical foundation of OE is the natural selection model[7], with four factors determining the chances of success or failure for organisations: population density, industry life cycle, organisation age and organisation size[8]. Baum and Singh state that the main purpose of organisational ecology is *"to understand the mutual interactions within and among the populations and communities comprising organizational ecosystems and the mechanisms and processes underlying their growth, regulation and decline."*[9] The OE theory (which comprises several more discrete theories) concerns itself with the life cycle of a business and the challenges that it faces along the way, such as start-up costs and complications (referred to as the liability of newness by Stinchcombe (1965)[10]) and the never-ending goals of maintaining a critical mass (being too small is deemed to create problems of its own[11]) and staying relevant in the chosen market(s). Perhaps unsurprisingly, the OE theory is geared towards adaption of a business by way of continual evolution. Otherwise, organisations *"follow the path of 'inexorable and irreversible movement toward the equilibrium of death."* [12]

OS and OP

The OS and OP theories place people at the core of business survival (as opposed to external factors). The emphasis is placed upon the decision makers rather than the framework within which they operate. Mellahi & WIkinson suggest that in essence *"…the OS/OP perspective argues that failure is linked to internal inadequacies in dealing with external threats"*. [13] For example, although the external pressure (or threat) might be of equal application to two competing business (which borrows an assumption from the IO theory, above), one business might respond better than the other due to the reaction of the people concerned. A number of theories as to why a divergence in approach between individuals (or groups of individuals) have been identified, including the 'groupthink theory'[14] and the 'upper echelon theory'[15], which in broad terms concern the decision making of small groups being sub-optimal and the impact of the composition of management and its succession over time.

Case study application

The case study does not provide much background to the formation and evolution of the FM Group. However, we do know that the FM Group leases trucks and private cars and is also active in short leasing, real estate and truck repair. FM, together with its subsidiaries, employs

[7] Ibid, pp 24, referring to Hannan, M.T. and Freeman, J (1978), "The Population Ecology of Organizations", in Meyer, M.W. et al. (eds), Environments and Organizations: Theoretical and Empirical Perspectives. San Francisco: Jossey-Bass
[8] Ibid pp 24.
[9] Baum, J.A.C. and Singh, J. (1994) Organizational niches and the dynamics of organizational mortality. Administrative Science Quarterly, 36, pp 187-218.
[10] Stinchcombe, A.L. (1965). Social structures and organizations. In March, J.G. (ed.), Handbook of Organizations. Chicago: Rand McNally, pp 142-193.
[11] Freeman, J.H., Carroll, G.R. and Hannan, M.T. (1983). The liability of newness: age dependence and organizational death rates. American Sociological Review, 48, pp 692-710.
[12] Boulding, K.A. (1950). A Reconstruction of Economics. New York: Wiley.
[13] M Mellahi, K., & Wilkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. International Journal of Management Reviews, 5(1), pp 28.
[14] Janis, I.L. (1972) Victims of Groupthink. Boston: Houghton-Mifflin.
[15] Klepper, S. (1997). Industry life cycle Industrial and Corporate Change, 6, pp 145-179.

over 3,000 people and has more than 200,000 cars in its fleet (across six jurisdictions). This size of business is unlikely to have appeared overnight and might well be the product of longstanding and entrenched corporate attitudes and behaviour and, possibly, a level of complacency (discussed further below). With reference to case study, the management of FW have identified a series of reasons for the losses and negative corrections required. These reasons can in the author's view be summarised as follows (1), a lack of oversight of the business operations (2), a lack of understanding of the market (3), defective accounting and a lack of interrogation of the financials of FM and its subsidiaries and are addressed in turn below.

Lack of oversight of the business operations

We are told that an independent turnaround consultancy agency (the **Turnaround Agency**) concludes that the FM Group is viable, but that €3.3m can be saved annually by 130 redundancies. This is a significant sum and might suggest that the resourcing of the business has been excessive and perhaps a lack of investment in automated processes. The case study states that the subsidiaries within the FM Group have made a loss of €6.3m, which indicates that the wider FM Group was not performing well. Consequently, the reasons given for the initial failure might not be the whole story.

Furthermore, the Turnaround Agency expects savings of €3.9m by improved loss recovery, higher excess premiums on car repairs. Irrespective of whether the FM Group was perceived by its management to be making a healthy profit, the author would query why savings at this level can be made so quickly. However, it might be that the reductions proposed by the Turnaround Agency will materially impact upon the FM Group's operations and are geared towards retrenchment as opposed to recovery (discussed further below).

Lack of understanding of the market

The Turnaround Agency quickly agrees price increases with the main clients of the FM Group. Only a few other (smaller) clients respond negatively. This has a resultant forecasted increase of €7.8m in revenue. In a similar vein to the critique of the oversight of the business operations, the author would query why increases in pricing which result in a significant revenue uplift were so easy to achieve. For example, was the FM Group 'behind the curve' when it came to pricing or did the FM Group not appreciate its position in the market (as a market leader, for example)? The fact that FM Group's main clients did not (1), terminate their arrangement and/or (2), explain that they had made arrangements with rival suppliers suggests that FM Group's position in the market remained a viable one. This is supported by the Turnaround Agency's conclusion that the FM Group is viable, with a view to the market share and achieving the estimated turnovers supports the concerns outlined above.

Defective accounting

The case study outlines significant accounting issues. Faults have been found in the annual accounts of 2012 and the 2013 loss is the product of a 'formula error' in the spreadsheet[16]. Of

[16] An investigation should be undertaken in relation to whether the accountancy firm has breached its tortious, contractual and/or statutory duties due to the defective reporting in order to potential recovery any loss suffered.

course, it is open to the management of the FM Group to rely upon the professionals charged with accurately analysing the financial circumstances of the relevant company. However, with a greater grip on the operations and financials of the FM Group, the management might have identified accounting issues much earlier.

Lack of interrogation of the financials

It is possible that the management of the FM Group, having received 'good news' in the form of profitable accounts (potentially over a number of years, with the CEO and CFO of FM receiving substantial management bonuses), became complacent and failed to interrogate the financials of the FM Group. Whilst it is accepted that there are limits to which management can realistically conduct a granular review of the financials of a company, it is important that they understand and interrogate the financials at board meetings and ask meaningful questions. The discovered losses set out in the case study are significant (such as the subsidiaries making a loss of €6.3) and the author would query whether more regular detailed financial reporting should have been put in place earlier. In this regard we do not know how frequently the various boards of FM Group met (or considered the financials).

Summary

It is not possible to precisely identify the causes of financial distress within the FM Group and, importantly, when they could have first been identified. However, the reasons for the financial distress in the case study appear to lean towards internal factors (i.e., those explored in the OS and OP theories) as opposed to external factors (which IO and OE are concerned with), particularly given the conclusions of the Turnaround Agency and the apparent ease with which the main clients were dealt with. Whilst a certain amount of blame appears to lie with the accountancy firm, had management had a more detailed 'real time' understanding of the FM Group, it is conceivable that the financial distress would have at the very least been identified earlier with a view to taking steps to remedy the position (by the earlier implementation of the recommendations of the Turnaround Agency, for example). Statements within the case study relating to a future management information system being improved so that the *"figures will be more reliable"*[17] are very concerning. Without accurate financial reporting the business will continue to remain increasingly vulnerable to financial uncertainty and, potentially, financial collapse and insolvency – not to mention the potential liability that arises from being aware of potentially defective accounting.

The author has experience of dealing with companies which were apparently performing well but, in truth, were not. The directors in these instances did not meaningfully interrogate the financials being reported to them or ask challenging questions at board meetings because of the apparently healthy financial performance of the company. Only after being notified of a series of loss-making transactions did the directors then take an increased interest in the transaction mechanics and the real costs of the same, by which time it was too late. The company was hopelessly insolvent and had been the subject of a significant fraud. It could not

[17] Page 3 of the case study.

be recovered and ended up in a formal liquidation process in the Cayman Islands, the conclusion of which was not satisfactory to any of the stakeholders.

The directors maintained that they had acted reasonably and in the best interests of the company at all times. They sought to place the blame at the doors of others, in particular, the investment manager and the auditor. However, the author questions whether facets of the threat rigidity effect theory[18] were in existence, particularly in relation to denial, where the management sought to disclaim knowledge and responsibility.[19] Turning back to the case study, it would appear to be artificial to try and identify a single cause of financial distress of the FM Group, which is likely to be the product of a blend of both internal and external factors. However, in circumstances where FM made a profit of €9.4 in 2011, but losses of €6.1m and €36.4m in 2012 and 2013, respectively, something must have gone drastically wrong. We are told that the business structure is there[20] and operates properly, there is market demand that the forecast for 'hiring and leasing days' are consistent with reality. However, even if there had been a seismic shift in the market of leasing, truck repair and real estate (by the introduction of a superior and lower cost competitor, or occurrence of a pandemic, for example), the starting point appears to be to look inwards, at the management and their advisers.

The author is of the view that, on balance, it appears that the voluntarist school of thought (OS and OP) is of greater application to the financial distress experienced by the FM Group as set out in the case study; had internal steps been taken to better interrogate the financial and operational performance of the FM Group, steps could have been taken much earlier to reverse the financial deterioration or, at the very least, mitigate it.

2. **What are the general advantages and disadvantages of an out-of-court restructuring (workout) as compared to a formal bankruptcy procedure? More specific, what are the advantages versus disadvantages *in your country*?**

The general advantages of an out-of-court restructuring (or informal reorganization) are, in summary, flexibility, silence, control and cost[21]. These advantages are discussed briefly below.

<u>Flexibility</u>

Once a statutory insolvency regime is called upon, the fundamental steps that can and must be taken are (necessarily) prescribed. Despite the best intentions of the draughtsperson, it will not be possible for the statutory regime to cater for all eventualities and all scenarios of financial distress. In contrast, an informal reorganization permits the company and its stakeholders to agree upon 'tailor-made' arrangements[22] intended to be as mutually advantageous as possible. For example, debt restructuring might be simpler to achieve in an informal arrangement as opposed to within the context of a statutory insolvency regime which

[18] Staw, B., Sandelands, L. and Dutton, J.E. (1981) Threat-rigidity cycles in organizational behaviour: a multi-level analysis. Administrative Science Quarterly, 26, pp 501-524.
[19] Mellahi, K., & Wlkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews,* 5(1), pp 31.
[20] Page 2 of the case study.
[21] Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions?, Review of Central and East European Law, 31(2), pp 145-146
[22] Ibid pp 145.

prescribes for rigid treatment of certain types of creditors by way of a 'distribution waterfall'[23] (that is not to say that a creditor cannot reach an agreement with the insolvency officer holder, but any such agreement might require an application to the relevant court for approval at additional expense to the insolvency estate).

Silence

Informal reorganizations can take place in relative silence when compared to a public insolvency process before a court[24]. In the author's experience, maintaining confidentiality (as between the company and the stakeholders) surrounding the financial predicament of a company at the initial stages of financial distress can assist with reducing the prospect of stakeholders (in particular, the primary financiers) adopting overly defensive positions and also reduce the risk of a 'race to collect' by creditors identified by Adriaanse, J.A.A., & Kuijl, J.G. (2006), who suggest that *"The negative effects upon management and the missed opportunities as a result of publicity of procedures can also be characterized as opportunity costs."*[25]

Control

Invoking an insolvency regime surrenders control to others. In the author's experience, this is achieved by the appointment of an office holder who is directly accountable to the relevant court and the displacement of power from the board of directors (save as otherwise ordered by the relevant court or sanctioned by stakeholders). Unless the officer holder is involved at an earlier stage, this process will invariably result in time delay whilst the officer holder (and their team) attempt to understand the intricacies of the business for the first time. This could be prejudicial to the interests of stakeholders in circumstances where swift action is needed to placate secured creditors or secure urgent bridge financing, for example.

Cost

There are obvious cost consequences in connection with a formal insolvency process, not only in relation to the fees and expenses of the insolvency officer holder (and their team) but also the costs of the court process (which will necessitate the taking of often expensive legal advice).

Binding those worldwide

The author is of the view that another potential advantage of informal organization arises as consequence of it being easier to legally bind parties worldwide. For example, a general moratorium of actions against the debtor is put in place on the commencement of a formal insolvency process in Jersey (discussed further below). However, this moratorium does not have extra-territorial effect and might prove to be difficult to enforce (and monitor) in the often numerous jurisdictions where the company operates. Obtaining the direct participation and

[23] A distribution or payment 'waterfall' is prescribed by article 32 of the Bankruptcy (*Désastre*) (*Jersey*) Law 1990 (the **Bankruptcy Law**) in the context of *désastre* proceedings and is imported by Article 166(1) of the Companies (Jersey) Law 1991 in the context of a creditors' winding up or just and equitable winding up.
[24] Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions?, Review of Central and East European Law, 31(2), pp 146
[25] Ibid pp 146.

consent of relevant parties to an informal organization which includes a standstill agreement, for example, could circumvent these difficulties.

Disadvantages

With flexibility comes uncertainty. Consequently, one of the principal advantages of informal restructuring can be a significant disadvantage, particularly where stakeholders adopt unreasonable positions (because they can outside of the context of a prescribed statutory insolvency regime). The success of an informal restructuring appears to rest of the pragmatism, reasonableness and commerciality of all of those participating. If this is not forthcoming, wasted time and cost can quickly be incurred progressing a futile reorganization plan and the company will inevitably fall into a formal insolvency process in a potentially worse financial position.

In this regard, some of the main bottlenecks in the research undertaken by Adriaanse, J.A.A., & Kuijl, J.G. (2006), were the investors/takeover candidates who pull out of a potential informal reorganization proposal at a late stage, the insufficient supply of information from the company to its stakeholders in relation to the informal reorganization and potential breaches of trust between the company and its creditors[26]. Furthermore, often the management of the company will wish to utilise an insolvency procedure to provide for a 'cut-off date' in relation to their potential exposure to the stakeholders. Whilst the author notes that standstill agreements are often utilised to provide the company with breathing space to explore an informal reorganization, such an agreement would need to expressly address the waiver or release of claims against management (or their agents) for the applicable period, which might not be forthcoming. Ultimately, the concerns of the management (as opposed to that of the creditors) can drive a company into a formal insolvency process.

Jersey (briefly)

The starting point is that Jersey does not (yet) have a modern statutory rescue process akin to an English or a Guernsey administration, for example[27]. The closest option is a winding up on a 'just and equitable' (**J&E**) basis, which has been given very flexible application by the Royal Court of Jersey (the **Royal Court**). In a J&E, an insolvency practitioner is appointed to administer the winding up. Taking the lead from jurisprudence in England and Wales, the J&E regime is flexible and results in a bespoke order tailored to particular needs, which can include the ability to continue to trade for a limited time or facilitate a pre-pack sale of the business, for example. However, a J&E is still effectively a terminal process for the company or companies (and therefore not technically a rescue process).

The only Jersey procedure with a suspensory measure specifically to permit or facilitate reconstruction or rehabilitation is a *remise de biens* (which is governed by the Loi (1839) sur les remises de biens[28] and of ancient customary law origin) and, in essence, places the affairs and assets of the debtor in the hands of the Royal Court[29] for a period of usually between 6 to

[26] Ibid pp 151.
[27] A useful article authored by Advocate Edward Drummond on the subject is available at https://www.jerseylaw.je/publications/jglr/Pages/JLR1509_Drummond.aspx#_ftn5.
[28] https://www.jerseylaw.je/laws/translated/Pages/04.840.aspx.
[29] More specifically, two Jurats appointed by the Royal Court.

12 months. To apply for a *remise*, the debtor must own immovable property in Jersey and, subject to the secured creditors being paid in full, with a payment (no matter how small) to unsecured creditors, the debtor can, in theory, be discharged from all other debts and start afresh. It is important to note that the Royal Court retains full discretion in relation to whether to order a *remise* and the Court has commented that it is of less importance in light of the *désastre* process (a customary winding up procedure in Jersey) having evolved to encompass immovable property in Jersey[30]. The Royal Court has gone as far to say that it should "endeavour *to order a désastre even if it is more costly as a procedure, unless it can be shown to be in the interests of justice that the older remise procedure should be used, or as the Deputy Bailiff put it in* <u>Jersey Home Loans Limited</u> *there were some good or sound reason to do so".*[31]

In Jersey, the customary law maxim "*La convention fait la loi des parties"* underpins contractual relationships between parties. The maxim is roughly translated in English as the 'convention (or contract) is the law between the parties'. Consequently, subject to the prescribed exceptions to this rule (a contract which is contrary to public policy, for example), the company and its stakeholders have significant flexibility when agreeing to the terms of an informal reorganization governed by the laws of Jersey.

Although a detailed review of the insolvency process in Jersey is beyond the scope of this submission, the author is of the view that the absence of a modern 'rescue' regime in Jersey strongly militates in favour of informal reorganization being explored where possible[32]. A further reason to explore informal reorganisation is that Jersey, being an offshore finance centre, is the home to large numbers of holding companies which are not involved in the day-to-day operation of the business (and may not own immovable property in Jersey, thereby not being able to apply for a *remise*). Placing the Jersey holding company into an insolvency process can result in a chain reaction throughout a group of companies and potentially signal the collapse of the structure entirely. Jersey has not adopted the UNCITRAL Model Law on Cross-Border Insolvency (the **Model Law**) which gives rise to greater uncertainty in connection with cross-border recognition and co-operation between jurisdictions and insolvency office holders. However, Jersey's antidote to this derives from article 49 of the Bankruptcy (Désastre) (Jersey) Law 1990 (**BDJL**) which empowers the Royal Court to assist the courts of a *"relevant country or territory in all matters relating to the insolvency of a person, and when doing so may have regard to…any model law on cross border insolvency prepared by the United Nations Commission on International Trade Law."* Article 49 of the BDJL has and continues to be used effectively to reorganise or rehabilitate Jersey companies where a Jersey winding up process is not beneficial to stakeholders. In particular, this article can be

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[30] Sir Philip Bailhache QC, in: Genesis of the Law of Bankruptcy in Jersey, in Omar, P (Ed). Insolvency Law in the Channel Islands. INSOL, 2011, pp 7.

[31] <u>Re Pitman</u> [2014] JRC 008, paras 17-19.

[32] Schemes of arrangement are available under Jersey law and can be a viable option for a company looking to restructure its affairs through a court supervised process (which is often extremely expensive). There is also provision under article 167 of the Companies (Jersey) Law 1991 for an arrangement entered into between a company immediately preceding the commencement of, or in the course of, a creditors' winding up and its creditors being binding subject to certain voting thresholds being met. However, this requires a winding up to be commenced or in effect.

used to 'passport' a Jersey company into a foreign rehabilitation process, most commonly English administration.

Summary

The advantages and disadvantages of informal reorganization helpfully set out by Adriaanse, J.A.A., & Kuijl, J.G. (2006) and outlined above are all very relevant considerations in Jersey. However, the current inadequacies in the Jersey insolvency regime place an even greater emphasis on informal reorganization. In the author's view there is not currently an adequate alternative beyond a potential attempt to 'passport' a Jersey company into a foreign rescue process under article 49 of the BDJL. On the basis that a satisfactory (time limited) standstill arrangement can be entered into, the potential disadvantages of time and cost being wasted are likely to be justified unless it is readily apparent that the Jersey company is not salvageable. The author is part of the legal and regulatory committee of ARIES[33] in Jersey which is working diligently towards implementing a rescue regime in Jersey (likely akin to English administration) as soon as possible.

3. **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.**

It might first be helpful to outline the turnaround/reorganization approaches presented in the aforementioned reading material.

Adriaanse, J.A.A., & Kuijl, J.G. (2006)

This article is based on research conducted between 2003-2005 in relation to informal reorganization. Four main features of a restructuring process are identified: (i), stabilizing (ii), analysing (iii), repositioning and (iv), reinforcing[34]. These are briefly addressed below.

Stabilizing: this is the process of identifying the critical issues which require immediate attention, much like a patient who is has been in a serious accident and just arrived at the hospital. From a corporate perspective, the emphasis is on increasing the cash flow[35].

Analysing: the financial predicament of the company will need to be interrogated and an analysis of the company's longer-term prospects will need to be carried out (by way of a reorganization plan), which will invariably involve the company's principal stakeholders (the financiers, for example)[36].

Repositioning: this is the actioning of the reorganization plan by the executive management.

Reinforcing: in addition to actioning the reorganization plan, trust and confidence will need to be (re)built with the stakeholders. Changing the organization and management, including the

[33] The Association of Restructuring and Insolvency Experts – Channel Islands - https://www.insol.org/Member-Associations/The-Association-of-Restructuring-and-Insolvency-Ex (**ARIES**).
[34] Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions?, Review of Central and East European Law, 31(2), pp 140
[35] Ibid pp 140.
[36] Ibid pp 141.

replacement of key personnel, might be required to reinforce the positive trend of the reorganization plan[37].

Pajunen, K. (2006)

This article focuses on the level of stakeholder influence in organizational survival and goes into detail about, *inter alia*, the difference between a stakeholder's direct resource dependency based power (how stakeholder power is organized around crucial and needed resources) and network position based power (between centrality and its inter-stakeholder resource dependencies[38]) and their relationship and influence with an organization's survival. A (very) comprehensive assessment of the decline and turnaround process of the Kymi Corporation is carried out as a case study.

In summary, the article suggests that identifying (and respecting) stakeholder influence is a critical component of a turnaround strategy and that the influence of stakeholders may change during a turnaround process. In particular, working closely with those stakeholders which exert direct resource dependency based power and high network position based power is important.[39]

Sudarsanam, S, Lai, J. (2001)

This article focuses on an empirical analysis of corporate financial distress and turnaround strategies by examining the frequency, timing and intensity of prescribed strategies deployed by financially distressed business in the United Kingdom, such managerial restructuring, operational restructuring, asset restructuring, asset investment, financial restructuring and the intensity (financial and time commitment) to the same. The results of this article are, in the author's view, somewhat surprising. For example, the suggestion that "*Non-recovery firms also appear to restructure more intensively than recovery ones, significantly so in the case of operational restructuring and dividend cut/commission."*[40] which suggests that more intensive short-term restructuring can create difficulties later on (perhaps by overly aggressive retrenchment steps being taken, discussed below).

Schmitt, A., Raisch, S. (2013)

This article focuses on the inter-relationship between retrenchment and recovery and whether, a sequential or tandem approach by a company in financial distress is advantageous to its prospects of recovering (on the basis of *"mutually enabling qualities"*[41]). The article is not conclusive, but presents an interesting dynamic between immediate cost-cutting (known as 'firefighting') and a proactive, focused change towards something new[42].

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[37] Ibid pp 143.
[38] Panjunen, K. (2006). Stakeholder Influences in Organizational Survival. *Journal of Management Studies*, 43(6), pp 1261-1288.
[39] Ibid. 1283.
[40] Sundarsanam, S, Lai, J., (2011), 'Corporate Financial Distress and Turnaround Strategics: An Empirical Analysis', *British Journal of Management*, Vol. 12, pp 197.
[41] Schmitt, A., Raisch, S. (2013). 'Corporate Turnarounds: The Duality of Retrenchment and Recovery', Journal of Management Studies, 50(7) pp 1222.
[42] Ibid, pp 1221.

FM Group

On 16 November 2013, the four banks, A, B, C and D, (together, the **Banks**) are invited by the board of FM for a meeting due to financial concerns. This amounts to active engagement with principal stakeholders which is identified as a positive step when it comes to potential recovery in the articles authored by Adriaanse, J.A.A., & Kuijl, J.G. (2006) and Pajunen, K. (2006).

An accountancy firm (not being the company's auditor) is called in to investigate the procedures within the company, which could be categorised as a step within the analysing and stabilising categories identified by Adriaanse, J.A.A., & Kuijl, J.G. (2006). The board of FM are also required to report on the actual costs and turnover each month which ties into the aforementioned categories. The hiring of the Turnaround Agency which determines that the company is viable is a step which could fall within the analysis, repositioning and, possibly, reinforcement categories identified by Adriaanse, J.A.A., & Kuijl, J.G. (2006).

The price increases struck with the main clients is a positive step of repositioning (Adriaanse, J.A.A., & Kuijl, J.G. (2006)), liaising with a stakeholder with direct resource dependency based power (Pajunen, K. (2006)) and financial restructuring (Sudarsanam, S, Lai, J. (2001)).

The decision to make 130 staff members redundant is step of retrenchment (Schmitt, A., Raisch, S. (2013)) and relates to operational restructuring (Sudarsanam, S, Lai, J. (2001)).

The extra savings that will be realised through improved loss recovery, higher excess premiums and savings on car repairs are both financial and operational restructuring steps (Sudarsanam, S, Lai, J. (2001)) and could also be categorised as recovery steps (Schmitt, A., Raisch, S. (2013)).

The replacement of the CEO of FM in April 2014 is a reinforcement step (Adriaanse, J.A.A., & Kuijl, J.G. (2006)), particularly as it was requested by the Banks and part of a managerial restructuring (Sudarsanam, S, Lai, J. (2001)). However, query whether this should have happened much earlier, potentially when the original problems were discovered and found to be irremediable in 2013.

The plan at page 4 of the case study to increase turnover by itself, in combination with large cutbacks are steps of retrenchment and recovery (Schmitt, A., Raisch, S. (2013)). Evaluating and reassessing the business product range are analysis steps (Adriaanse, J.A.A., & Kuijl, J.G. (2006)). Selling the shares of the companies outside the Benelux-countries is a retrenchment step (Schmitt, A., Raisch, S. (2013)) and potentially part of a wider organisational managerial restructuring, operational restructuring, asset restructuring and financial restructuring (Sudarsanam, S, Lai, J. (2001)).

The appointment of a chief restructuring officer (**CRO**) is a reinforcement step (Adriaanse, J.A.A., & Kuijl, J.G. (2006)), in particular as it was requested by the banks and part of a managerial restructuring (Sudarsanam, S, Lai, J. (2001)). The discussion surrounding the entering into of a standstill agreement with the Banks is a critical step identified by Adriaanse, J.A.A., & Kuijl, J.G. (2006) which can improve the prospects of a successful informal reorganisation.

Summary

A large number of the turnaround/reorganization approaches in the reading material are evident in this case study. As set out in the answer to question 1, the complacency of management might have been a material cause of the financial decline of the FM Group. Had the managerial restructuring been put in place earlier, that could have potentially avoided or at least mitigated the financial distress. However, the author accepts that that in circumstances where a company is ostensibly performing well the proposition of a managerial restructuring might be met with a number of questions.

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 lawyer of the other two banks?**

It appears that the Banks have collectively provided working capital to FMW, which at 16 November 2013 amounted to €360m (the **Working Capital**) and had made loans to FMW of €55m (the **Loans**). We are also told that banks C and D have provided additional working capital in the sum of at least[43] €35m (the **Additional Working Capital**), with €35m due to be repaid on 31 December 2013. The providers of the Working Capital (the Banks) have the benefit of pledges on most of the assets of FMW (the **Pledges**), whereas the providers of other the Loans and Additional Working Capital appear to have no or subordinated security and might receive nothing from their claims in a liquidation[44]. However, we are told that there are issues with the Pledges and that they might not constitute the level of security envisaged when they were entered into[45].

The Banks, having been advised of a pre-tax profit up to September 2013 of €8m, are subsequently told on that a loss of €5.4m is to be suffered. In December 2013, it transpires that the loss of €5.4m is isolated to FMW and that the foreign subsidiaries of the FM Group, together with FMW and FM have accumulated losses of €23.1m. On 20 December 2013, the actual results for 2011-2013 are confirmed as being a €9.4m profit for 2011, a €6.1m loss for 2012 and a €36.4m loss for 2013. Consequently, the position communicated to the Banks has moved from a pre-tax profit (up to September 2013) of €8m, to a loss of €36.4 for 2013 resulting in solvency being at 0.1%. The Banks therefore have considerable financial exposure as a consequence of the financial underperformance of the FM Group. Understandably, the Banks (as a collective group) will be concerned.

The position is worse for Banks C and D. They provided the Additional Working Capital. To the extent that the issues with the Pledges can rectified, they have the benefit of security in relation to their contribution to the Working Capital, whereas they appear to be unsecured in relation to the Loans (€55m) and the Additional working Capital (at least €35m).

Fundamentally, the Banks will be concerned with protecting their position in recovering the amounts due to them. It is proposed that a standstill agreement be signed no later than 31

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[43] Although a payment of €35m is due to be made on 31 December 2013 in respect of the Additional Working Capital (page 5), this is described as the repayment of part of the debt (page 3) and point 5 of the Restructuring Agreement requires banks C and D to write off the debt in relation to the Additional Working Capital (page 6).
[44] Page 7 of the case study.
[45] This could result in a potential claim against the lawyer(s) responsible for any defective drafting of the Pledges.

March 2014 on the basis that the Banks are acting collectively. Banks A and B appear to be on board with this, but banks C and D are not. There are a number of potential reasons for this which stem from whether banks C and D should continue to provide funding in circumstances where their prospect of recovering the amounts due to them might only continue to decrease over time.

Trust and confidence

The standstill agreement is to be signed by the Banks without a concrete proposal for the restructuring of the FM Group or from the shareholder in connection with an injection or risk-bearing capital or the repayment of amounts to the Banks. This might not be unusual given that the standstill agreement is intended to provide some 'breathing space' whilst a plan is formulated. However, given the continual news that the FM Group is making increased losses banks C and D might have lost all trust and confidence in the management of the FM Group and be of the view that its continued operation might only service to prejudice their position further.

Pledges

In circumstances where solvency is at 0.1% on 1 December 2013, banks C and D will be seriously considering their options under the Pledges. On the basis the issues relating to the Pledges can be rectified[46], seeking to enforce against the same directly might be the more attractive option (i.e., before the financial situation becomes even worse). This would be particularly so to the extent that the secured assets can be pursued and sold outside of the context of a liquidation process (and are thereby insulated from the fees and expenses of the insolvency office holder). However, a 'forced sale' could result in a discounted amount ultimately being recovered and, as the solvency rate is 0.1%, the prospect of a full recovery by banks C and D, even under the Pledges, is unlikely[47].

Pressure

Banks C and D not co-operating by refusing to enter into a standstill agreement could pressure the shareholder and/or banks A and B to take urgent steps to try and put forward a proposal to rescue the FM Group which could be advantageous to banks C and D (such as a risk-bearing capital injection and/or the waiving of the amounts payable to banks A and B). By not co-operating, banks C and D continue to keep the 'sword of damocles'[48] hanging over the FM Group and its stakeholders, including banks A and B. Banks C and D are clearly trying to negotiate themselves into a better position. However, this strategy is a potentially risky one as other creditors might panic and take steps to invoke an insolvency process, for example.

The potential pressure tactic deployed by banks C and D might have had some success in that banks A and B investigated whether it would be possible to buy out banks C and D with a 15-20% discount. Subject to the analysis of the potential recoveries were they to continue

[46] Careful consideration would need to be given to whether any perceived modification and/or enhancement of the terms relating to the Pledge could be construed to be a preference and consequently liable to be set aside.
[47] The author notes that in or around June 2014 the view is that a liquidation scenario would result in a maximum of 55% recovery (page 5).
[48] A Greek story referring to the imminent and ever-present peril faced by those in positions of power.

to participate, banks C and D might be interested in such a proposal and could try and negotiate an increased payment from banks A and B. The potential pressure tactic is also evident in June 2014, we are told that banks C and D threatened to cancel credit in order to try and accelerate matters and (successfully) force the shareholder to provide more financing.

Approach as the lawyer of banks A and B

In circumstances where banks C and D are not co-operating, the first step is to urgently understand the validity, effect and recoverability under the Pledges in favour of banks A and B and whether they are different to those in favour of banks C and D (are the pledges held by banks C and D subordinate to those held by banks A and B, for example)[49]. If banks A and B can be properly classified as secured creditors and solvency of FMW is above 0%, their approach will be different to that were they unsecured creditors and only able to benefit *pari-passu* with other unsecured creditors.

In tandem with this analysis, an improved communication channel should be opened with, in addition to the management FM and FMW, the representatives for banks C and D in order to understand their strategy and particularly whether they are considering invoking an insolvency process. The author would seek assurance that the partial repayment of the Additional Working Capital (€35m) which was due on 31 December 2013 will be deferred to a date to be agreed (the implicit permission given by banks C and D would be not satisfactory). Repaying the Additional Working Capital at this time would prejudice of the other creditors in a potentially insolvent situation. However, at least under the laws of Jersey, such a payment might constitute a preference and be liable to set aside or unwound by the Royal Court.

On the basis that banks A and B are and will remain sufficiently secured through the Pledges (within or outside of an insolvency process), the pressure to react urgently is lower. However, should this not be the case (and it does not appear to be), a concerted effort will need to be made to improve the position of banks A and B by taking additional and/or improved security against the assets of FM Group, where possible[50]. A review should also be undertaken of what steps need to be taken to return the company to a healthy level of solvency so that the obligations to banks A and B can be managed (whilst assessing the viability of the FM Group so as to not throw ‘good money after bad’).

Otherwise, there is a risk that the insolvency officer holder and other secured creditors (such as banks C and D, to the extent that they hold superior pledges) will strip the value out of the structure leaving little, if anything, for unsecured creditors (which could include banks A and B).

[49] It is unclear whether banks A and B are more senior than banks C and D.
[50] Careful consideration would need to be given to whether any perceived modification and/or enhancement of the terms relating to the Pledge could be construed to be a preference and consequently liable to be set aside.

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

First Principle: the main stakeholders (the shareholder and the Banks) have been identified and appear to have generally co-operated[51] and shared information. A standstill agreement is proposed to the Banks by the management and shareholder of FM and, after some dissention from banks C and D, is ultimately accepted in the middle of August 2014 (on a time limited basis). No co-ordination committee is formed but this might not have been necessary (the author would need to understand more about the composition of the stakeholder body).

Second Principle: the author has not seen a copy of the standstill agreement, but it is expected to have included, *inter alia*, an agreement between the parties to refrain from taking steps to enforce their claims or otherwise reduce their exposure to the debtor (otherwise than by disposal of their debt to a third party) as we are not told of any the Banks seeking to enforce their security rights, for example. The general consensus appears to have been that an insolvency process was not advantageous and the Banks should work together.

Third Principle: the author expects the standstill agreement to provide for the debtor not taking any action which might adversely affect the prospect return to the relevant creditors (either collective or individual). However, as noted above, we are not given information about the composition of the stakeholder body and it is conceivable that the eventual restructuring of the FM Group prejudiced other creditors, as it is principally geared towards protecting the Banks' interests. For example, those creditors with claims against FM would receive nothing following the transfer of all if its assets to the new entity and cancellation of any claims that FM might have against it.

Fourth Principle: the management of FM and shareholder recognise that a joint approach from the Banks is desirable (however, the status and participation of other creditors remains uncertain). It is not clear whether the Banks have selected a representative co-ordination committee to co-ordinate the flow of information (but, as noted above, this might not have been necessary).

Fifth Principle: although in advance of the entering into of the standstill period, it appears that the Banks were provided with information by FMW of the assets, liabilities, business and prospects, so that a proper evaluation of its survivability may be made. It would seem likely that the CRO was also able to report to the Banks.

Sixth Principle: the author expects that the standstill agreement provided for the applicable law and relative positions of the relevant creditors being addressed as the standstill commencement date. However, uncertainty remains in relation to other creditors (as the focus is on the Banks, which have the benefit of security, to the extent that it is valid and

[51] Banks C and D were difficult at times, likely in an effort to improve their negotiating position.

enforceable). It might be that the unsecured creditors' interests have been prejudiced but it is not clear from the case study.

Seventh Principle: the Banks appear to be centrally involved in the discussions relating to the assets, liabilities and business of the FM Group. To the extent that this information was not agreed to be treated as confidential before the standstill agreement, the author expects that the standstill agreement will have regularised the position vis-à-vis confidentiality.

Eighth Principle: scenario 4 (drawn up in October 2014) concerns the provision of a bridging loan by the Banks. Although not ultimately pursued, the possibility of bridge financing is considered as one of the options proposed in October 2014 and it is anticipated that the Banks would have insisted in the repayment of this bridging loan being accorded priority status (which, subject to the solvency issues, might have necessitated wider creditor involvement). However, as mentioned, it might be that the unsecured creditors have been effectively left behind.

6. **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?**

Jersey has not adopted the Model Law and the Statement of Principles (**SIPs**) are not of direct application in Jersey. However, on 10 March 2021, the Jersey Statements of Insolvency Practice (**JSIPs**) were issued[52]. The JSIPS cover (1) ethics (2) the conduct of restructuring procedures and assignments and assignments and (3) fees and disbursements in formal restructuring work. They are loosely based on the SIPs, are a work in progress and will be expanded over time. It is important to note that the JSIPS are not legally binding and expressed to be best practice only[53]. However, it remains to be seen how the Royal Court would assess the weight to be attached to the JSIPs and what prejudice might arise by non-compliance. For example, the regulatory codes of practice issued by the Jersey Financial Services Commission (**JFSC**), whilst not law, are regularly cited as a benchmark against which individuals and businesses are judged. Falling short of these codes can have very severe consequences. Directors of Jersey companies have recently been given another incentive to abide by the JSIPs and SIPs. Jersey's Attorney General recently issued guidance relating to applications for director disqualifications under article 78 of the Companies (Jersey) Law 1991. This article enables the Attorney General or JFSC to apply for a court order disqualifying individuals from being directors of companies. The Royal Court will need to be satisfied that the person is *"unfair to be concerned in the management of a body corporate"*. If satisfied, the Royal Court may make an order restricting or disqualifying that person from acting as a director or manager for a period of up to 15 years. There is a necessarily high bar to such an order being made and few orders have been made to date, but the author could conceive of a

[52] The author contributed to the drafting of the JSIPS as part of legal and regulatory committee of ARIES - https://www.aries-ci.org/JIPS.
[53] See paragraph 6 of JSIP 1 - https://www.aries-ci.org/JIPS.

scenario where taking steps in contravention of JSIPs or SIPs could be a relevant consideration for the Royal Court. In the case study, there do not appear to be any reasons to not follow the JSIPs/SIPs, save that creditors beyond the Banks (trade creditors, for example) might not find the idea of the Banks' interests being protected over their own particularly palatable. Those creditors could seek to exert their own pressure by threatening to try and place one or more of the entities within the FM Group into insolvency for example.

Fundamentally, the author takes the view that the principal driver and compelling argument for taking steps in accordance with the JSIPs or SIPs (whether with express reference to them or not) will be economic recovery. The principles are geared towards ethnically and expeditiously facilitating multi-creditor workouts and delivering advantageous recovery when compared against a formal insolvency process. In the absence of very good reason, following the principles (which the author contends are of application in all jurisdictions) should not be controversial.

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

In summary, the Restructuring Agreement promotes a new company, Flow Management II BV (**FM II**), being sold as a going concern for the benefit of the Banks[54].

We are aware that the providers of the Working Capital (the Banks) have the benefit of the Pledges on most of the assets of FMW[55] and the amounts due under the Loans and Additional Working Capital have no or subordinated security and the relevant banks would (most probably) receive nothing from their claims in a liquidation of FM[56]. Whilst it is understood that the payment 'waterfall' in an insolvency process will differ between jurisdictions, the starting point is that the creditors of the debtor are paid in preference to its shareholders. Consequently, where a debtor is insolvent, the shareholders are unlikely to recover anything as the assets are distributed (in cash or *in specie*) to the creditors first. The interests of the creditors must be protected first and foremost. The Banks, having considered the four options in October 2014 and the financial reports thereafter, have determined that a formal insolvency process is not the most attractive avenue available and have therefore taken steps to secure an interest in the FM Group at both a creditor and shareholder level (discussed further below).

The Restructuring Agreement is a 'clean break' arrangement in that it:

- results in the incorporation of FM II and transfers the shares of the subsidiaries of FM to FM II[57];
- displaces the shareholder of FM, Lease Group Holding United Kingdom Ltd., (the **Shareholder**);
- the banks who financed the Working Capital (the Banks) along with board members of FM (such as the CRO, possibly to incentivise the individual to make FM II profitable) being the shareholders of FM II,

[54] Certain board members will also be issued shares but presumably on a minority basis.
[55] To the extent that they are valid and enforceable.
[56] Page 7 of the case study.
[57] This is assumed to have happened as a consequence of FM cancelling claims against FM and its subsidiaries (as set out at paragraph 4 of the Restructuring Agreement).

(together, the **Reorganization**),

- cancels all of the claims as between FM and the Shareholder on one hand and FM II and its subsidiaries on the other and facilities the write off of debt, with:
  - the amount due in relation to the Additional Working Capital being written off entirely by banks C and D (the 'haircut');
  - the waiver of €97.5m by the Banks in relation to the Working Capital (with a claim of €240m remaining against FMW, the assets of which are the subject of the Pledges); and
  - the amount due under the Loans being written off by the Banks,

(together, the **Debt Restructuring**).

The product of the Reorganization and the Debt Restructuring is intended to preserve and protect the interests of the Banks and, in particular, their ability to recover the sums due to them. This reorganization is ultimately to the prejudice of Shareholder who is left with nothing and the other creditors of FM, as no amounts appear to be being paid to FM for the transfer of assets to FM II. There is a 'clean break' between FM and FM II (as a consequence of a waiver and/or cancellation of claims) with FM being dissolved. This has made FM II a more attractive proposition to potential purchasers as a going concern; it having new management, new ownership (the Banks and certain board members) and having cut ties with the 'toxic' previous entity and owner (FM and the Shareholder) and materially reduced its financial exposure to the Banks and other creditors (as a consequence of the Debt Restructuring).

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

It is assumed that FM II is to be registered in the Netherlands. If not, cross-border issues arise in connection with the incorporation of FM II and the transfer of the shares of the operating companies of FM to it (discussed further below).

As the operating companies of FM all in various jurisdictions (the Netherlands, Spain, France, Australia, South Africa and the United States of America), the transfer and registration of the shares of the operating companies to FM II will give rise to legal and non-legal considerations in the respective jurisdictions where the operating companies are registered. Consideration will need to be given to the legal efficacy and consequences of the shares of FM II being registered in the names of the Banks and the members of the board in their respective jurisdictions (if registered or resident outside of the Netherlands). The Banks will need to consider the potential impact of waiving amounts which would otherwise be notionally secured under the Pledges. We are told that the Pledges secure most of the assets of FMW, but it is not clear what laws the Pledges are governed by (nor what jurisdiction they are subject to) and where the secured assets are located. We are told that FM is to be liquidated in an undisclosed manner. On the basis that FM is registered under the laws of the Netherlands and is the centre of main interests (**COMI**), this should assist the liquidator(s) of FM in the event that cross-border issues arise on the basis that foreign courts should respect the COMI and recognise and assist the liquidator(s) of FM.

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]

A moratorium in an insolvency context is the suspension of the payment of debts and creditor claims (beyond filing a proof of debt or, in Jersey, applying for leave from the Royal Court to bring a claim), thereby providing the debtor, through its liquidator, breathing space to try and regularise its financial affairs. The author is not aware of a specific provision under the Companies (Jersey) Law 1991 relating to an application for a moratorium outside of an insolvency process. However, this does not prevent the terms of a moratorium being agreed and, as mentioned above, it is possible to apply for a *remise de bien* in certain circumstances. For the avoidance of doubt, a general moratorium of actions against the debtor is provided for by the insolvency framework in Jersey in connection with the winding up of companies (where a liquidator is appointed) and where the debtor has been declared *en désastre* (where the Viscount is appointed). It is important to note that a Jersey moratorium would not prevent the Banks from enforcing their security (on the basis that it is valid and enforceable) so they would have to voluntarily agree to such a moratorium.

Potential advantages and disadvantages of no moratorium

Not agreeing to a moratorium keeps the pressure on the management to actively address a turnaround situation. Although the Banks have entered into a 120 day standstill agreement, releasing the pressure of enforcement and potential insolvency proceedings for an indefinite period of time might be counterproductive. The Banks would not have to provide a bridging loan (one of the requirements of scenario 4), although it is expected that this would be given priority repayment status in accordance with the eighth principle of the Statement of Principles (although this might be of questionable value in an insolvent situation). On the basis that an insolvency officer holder is to be appointed as part of a court ordered moratorium, the liquidation estate will avoid this expense (which is likely to be paid in priority to all other claims). A court ordered cross-border moratorium might also be expensive and difficult to enforce in different jurisdictions (it is unlikely to have immediate extra-territorial effect, for example). Subject to the governing law of the terms of the Pledges and the insolvency laws of the Netherlands, the Banks should not lose the ability to enforce the Pledges against FMW in the event that it is placed into a winding up process.

Potential advantages and disadvantages of a moratorium

With reference to the threat rigidity effect theory[58], the continued pressure of the increasing amounts due to the Banks could result in managerial inertia and prejudice management's ability to focus on a recovery plan due to ongoing 'firefighting'. In this regard the inter-

[58] Staw, B., Sandelands, L. and Dutton, J.E. (1981) Threat-rigidity cycles in organizational behaviour: a multi-level analysis. Administrative Science Quarterly, 26, pp 501-524.

relationship between retrenchment and recovery[59] so that the company can be sold in a 'controlled' manner becomes a relevant consideration (scenario 2). It is not clear whether the moratorium is to extend to all of the subsidiaries within the FM Group. However, to the extent it does not, there remains a risk that an application could be made to place one or more of them into an insolvency process in a foreign jurisdiction (thereby giving rise to COMI considerations). This an irritation and worse still set off an adverse chain reaction in relation to the remainder of the structure. It is, in practice, very difficult to monitor and regulate the rights of creditors in multiple jurisdictions (expensive urgent simultaneous court applications can be necessary to regularise the position).

A moratorium might provide the foundation for a pre-packaged sale of the business[60] which could provide advantageous returns to the stakeholders on the basis that a relatively swift sale can be achieved and the costs of the pre-packaged sale (which would likely be given priority status) should be much less than those of an (often protracted) liquidation process. In contrast, on the basis that an insolvency practitioner is to be appointed as part of a court ordered moratorium, this will come at a (priority) cost, but an objective individual will be appointed to oversee the recovery process with a view to maximising returns for stakeholders if a sale is achieved. Subject to the terms of the Pledges and the insolvency laws of the Netherlands, the Banks should not lose the ability to enforce the Pledges in the event that liquidation takes place. However, the value of assets secured by the Pledges might well have been significantly eroded due to (1), continued financial underperformance (2), the discounting of asset value in a 'forced sale' scenario and (3) potentially the costs and expenses of the liquidation being paid in priority.

On balance, the author is of the view that there would have been a material upside in scenario 4 being pursued. However, the Restructuring Agreement places the Banks in an improved position at two levels (shareholder and creditor). This gives the Banks greater control over the operation of FM II and its subsidiaries whilst also preserving and protecting its creditor position (albeit having made some substantial debt write offs). Consequently, if FM II performs well, the Banks stand to make recoveries as a creditor and also as a shareholder. Otherwise, the Banks can continue to focus on the sale of FM II and seek maximum recovery whilst avoiding the risk of a 'forced sale' scenario. That said, and for completeness, the author notes the potential material upsides in progressing scenario 1, which would have kept the business operating and given all creditors (including unsecured) a chance of making a recovery. However, financial restructuring alone is not deemed to be sufficient to lead to a successful restructuring[61] so other substantive changes would likely have been necessary.

[59] Schmitt, A., Raisch, S. (2013). 'Corporate Turnarounds: The Duality of Retrenchment and Recovery', Journal of Management Studies, 50(7) pp 216-1244.
[60] Which can be facilitated through a J&E winding up in Jersey.
[61] Sundarsanam, S, Lai, J., (2011), 'Corporate Financial Distress and Turnaround Strategics: An Empirical Analysis', *British Journal of Management*, Vol. 12, pp 197.