**GLOBAL INSOLVENCY PRACTICE COURSE 2023**

**CASE STUDY 1**

QUESTION 1

WHAT WERE, IN MY OPINION, THE CAUSES OF FINANCIAL DISTRESS AT FLOW MANAGEMENT?

The causes of Flow Management's financial distress as identified by FM's management ("**A**") were:

1. the wrongful issue of large management bonuses;
2. the wrongful recording in its accounts of a contingency gain;
3. the lack of materialisation of large book profits as provided for in the accounts; and
4. the result of basic principles used in the cost price calculation deviating from reality.

In my opinion ("**B**"), the causes of A were as follows:

1. poor management information systems;
2. poor accounting systems;
3. insufficient liquidity in the company;
4. failure of the company to optimise its sales prices;
5. too many staff;
6. poor working capital and cashflow management.

COULD THE FINANCIAL DISTRESS HAVE BEEN PREVENTED?

Possibly. Had the company's management been aware of A and B above, the financial distress might have been prevented. However, that presupposes that the company's management would have reacted to such red flags in manners that were productive, e.g., the appointment of turnaround consultants.

QUESTION 2

WHAT ARE IN GENERAL THE ADVANTAGES AND DISADVANTAGES OF AN OUT OF COURT RESTRUCTURING AS COMPARED TO A FORMAL BANKRUPTCY PROCEDURE? MORE SPECIFICALLY, WHAT ARE THE ADVANTAGES VERSUS DISADVANTAGES IN THE BVI?

Advantages:

1. flexibility: less rigid than formal procedures; tailor-made solutions can be developed (which can be amended by consent); can be agreed that any new funding takes priority.
2. Silence: informal procedures are not made public; avoid the "race to collect" amongst creditors; can prevent the filing of a winding up petition; cheaper.
3. Control: company's management continue to run the company independently; all relevant stakeholders are given the opportunity to determine the speed ad the outcome of the reorganisation.
4. Going concern value may be higher than the forced sale value.

Disadvantages:

1. No automatic moratorium on proceedings;
2. The success of an informal procedure depends (in part) on the accuracy of the information disclosed by the company itself and the willingness of the company to comply with agreements made with its financiers and shareholders.
3. Company management may need to be replaced (which is not necessarily attractive to company management).
4. Forced sale value may be higher than the going concern value.
5. The BVI Insolvency Act, 2003 adopts certain provisions of the UNCITRAL Model Law on Cross Border Insolvency (primarily set out in Part XIX of the IA), although these provisions are not yet in force. The prevailing industry view is that these provisions may never come into force in the BVI. Public policy in the BVI generally favours protecting secured creditors and there is a general consensus that the UNCITRAL Model Law on Cross Border Insolvency would cut across the rights of secured creditors.

QUESTION 3

WERE THE TURNAROUND/REORGANISATION APPROACHES AS PRESENTED IN THE READNG MATERIAL APPLIED IN THIS CASE? IF YES, EXPLAIN IN WHAT WAY. IF NO, DETAIL WHAT IN YOUR OPINION SHOULD HAVE BEEN DONE DIFFERENTLY.

The answer is both yes and no.

Yes:

1. Adriaanse & Kujil: Phase 1: Stabilising – an effort was made by the company to identify the critical problems which required immediate action in order to stabilise the situation.
2. Adriaanse & Kujil: Phase 2: Analysing - an accounting firm was called in to investigate company procedures.
3. Adriaanse & Kujil: Phase 3: Repositioning – management reported to the interested parties (but the information contained in the reports turned out to be inaccurate).
4. Adriaanse & Kujil: Phase 4: Reinforcing – new management, CEO and CRO are appointed and the restructuring agreement is signed.
5. Pajunen: the relevant stakeholders were identified early in the process.
6. Schmitt & Reich: the successful restructuring of the company was a result of both retrenchment and recovery – supports the duality of the two concepts.

No:

1. Adriaanse & Kujil: Phase 1 Stabilising - failure to initially fully identify the critical problems which required immediate action in order to stabilise the situation.
2. Adriaanse & Kujil: Phase 2: Analysing – took far too long to draw up a well-founded reorganisation plan. The information provided to the interested parties was inaccurate and constantly changing. The measures proposed to restore long-term profitability were initially insufficient and unrealistic.
3. Adriaanse & Kujil: Phase 3: Repositioning – management reported to the interested parties (but the information contained in the reports turned out to be inaccurate).
4. Pajunen: the success of the restructuring process was jeopardised (for a period of time) by the failure of Banks C and D to continuously support the restructuring process.
5. Pajunen: the communication between the company and the banks appears not to have been full and frank (at least in the early stages of discussions).
6. Pajunen: there was no real consensus on long-term goals among the governing stakeholders for a period of time.

QUESTION 4

BANKS C AND D SEEM TO FRUSTRATE THE PROCESS AT A CERTAIN POINT. WHAT COULD HAVE BEEN THE RATIONAL AND/OR OPPORTUNISTIC REASONS FOR THEM TO BEHAVE LIKE THAT? WHAT WOULD YOU HAVE DONE IN THAT SITUATION IN YOUR ROLE AS ADVISOR OF THE OTHER TWO BANKS?

1. Banks C and D may have taken the view that 3 months after being initially informed by the company of the financial difficulties, the information that had been provided to them was so self-evidently inaccurate and unreliable that there was no basis for believing that the company could be trusted to participate in an effective restructuring – as a consequence, Banks C and D may have considered that winding up the company may have been preferable.
2. Banks C and D may have taken the view that their security was legally sound and enforceable (more so than Banks A and B) and therefore they did not have to engage.
3. Banks C and D may have been seeking to negotiate settlement with the company directly (excluding Banks A and B) and/or seeking to sell their debt to a third party.
4. The position adopted by Banks C and D may have been calculated posturing in an attempt to apply pressure on the company to do more in terms of improving solvency.
5. I would have encouraged Banks A and B to either (i) seek to persuade Banks C and D of the advantages of co-operating with each other; and/or (ii) seek earlier agreement to a standstill period; and/or (iii) demand a faster and more accurate response as a whole from the company; and/or (iv) investigated sooner the possibility of buying out Banks C and D at a discount.

QUESTION 5

WHICH OF THE EIGHT PRINCIPLES OF THE "STATEMENT OF PRINCIPLES FOR A GLOBAL APPROACH TO MULTI-CREDITOR WORKOUTS II" CAN BE FOUND IN THE WORKOUT PROCESS OF FLOW MANAGEMENT (EXPLICIT OR IMPLICIT)?

First Principle: all the relevant creditors were prepared to co-operate with each other (although later than one would have expected and in varying degrees) to enter into a Standstill Period to enable information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed.

Second Principle: although not expressly set out, it is presumed that during the Standstill Period, all relevant creditors agreed to refrain from taking any steps to enforce their claims against or to reduce their exposure to the debtor and were entitled to expect that during the Standstill Period their position relative to other creditors and each other would not be prejudiced.

Third Principle: although not expressly set out, it is presumed that during the Standstill Period, the company agreed not to take any action which might adversely affect the prospective return to the relevant creditors as compared with the position at the Standstill Period commencement date.

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

Sixth Principle: although not expressly set out, it is presumed that proposals for resolving the financial difficulties of the company and, so far as practicable, arrangements between relevant creditors relating to the standstill reflected applicable law and the relative positions of relevant creditors at the Standstill Period commencement date.

Seventh Principle: although not expressly set out, it is presumed that the information obtained for the purposes of the process concerning the assets, liabilities and business of the company and any proposals for resolving its difficulties were made available to all relevant creditors and, unless already publicly available, were treated as confidential.

QUESTION 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 (IN THE BVI)? IF YES, EXPLAIN IN WHAT WAY? IF NOT, DO YOU SEE ANY ALTERNATIVE (INFORMAL) POSSIBILITIES?

An option in the BVI is a creditors’ arrangement. Creditors’ arrangements were introduced by the BVI Insolvency Act, 2003 in an attempt to provide a relatively simple procedure for an insolvent company to bind its unsecured and non-preferential creditors with an arrangement compromising its debts (including those of creditors who may have voted against the arrangement). A creditors’ arrangement is similar to an English company voluntary arrangement. There are no court hearings (unless a creditor challenges the arrangement) and creditors do not need to be split into separate classes. Secured creditors or preferential creditors cannot be bound by a creditors’ arrangement unless they consent in writing. A creditors’ arrangement is available to all BVI incorporated companies (to the exclusion of foreign companies). It may be used independently or in conjunction within an existing insolvency procedure. The directors of the company may propose a creditors’ arrangement by passing a resolution formulating a proposal for a creditors’ arrangement and nominating an interim supervisor, who will be responsible for calling a creditors’ meeting. The resolution must acknowledge the debtor’s insolvency. The interim supervisor must be a BVI licensed insolvency practitioner. In circumstances where insolvency proceedings are afoot in the BVI, a liquidator or provisional liquidator may also make a proposal for a creditors’ arrangement and elect an interim supervisor to call the creditors’ meeting. At the creditors’ meeting, the interim supervisor will present the proposal for approval by the creditors together with a statement of the company’s affairs. The creditors’ arrangement will require approval of 75% in value of the creditors present or by proxy who vote at the meeting. Following approval, the creditors’ arrangement will bind all creditors including dissenting creditors (with the exception of secured and preferential creditors who must consent in writing). The appointment of a supervisor displaces the directors’ power of management over the assets that are subject to the arrangement and the directors (or the administrator or liquidator) forthwith after the approval of the arrangement must take all necessary steps to put the supervisor in possession of the assets included in the arrangement. Notably, the appointment of the supervisor does not displace the directors and therefore a creditors’ arrangement outside of liquidation proceedings is a debtor in possession proceeding. Unless there is a moratorium in place by virtue of the debtor being subject to pre-existing BVI liquidation proceedings, calling a creditors’ meeting and making a proposal for a creditors’ arrangement will not of itself result in a stay of proceedings. Unsecured creditors will be entitled to commence enforcement action against the debtor until they are bound by the creditors’ arrangement. Secured creditors will be entitled to enforce their security at any time unless they have approved the creditors’ arrangement. Any member, creditor, surety or co-debtor may apply to the BVI courts where the arrangement unfairly prejudices its interests or where there has been a material irregularity in relation to the meeting at which the arrangement was approved. The BVI courts have wide discretion as to the remedy and can revoke or suspend the decision approving the arrangement.

QUESTION 7

EXPLAIN IN DETAIL THE ESSENCE AND RESULT OF THE RESTRUCTURING AGREEMENT AS SIGNED ON 4 JULY 2015.

The restructuring agreement reflects the relative positions of the financiers involved and provides for a better outcome for the financiers than if a straightforward liquidation of the company had been pursued. Further, the company (in a subsequent form) will survive and ensure the retention of jobs for its employees.

The operating subsidiaries of Flow Management Holding BV are transferred to a new company, Flow Management II BV. This isolates Flow Management Holding BV.

The shares in newco, Flow Management II BV (which is now the parent company of the operating subsidiaries), are transferred to the Banks who financed the original working capital of Flow Management Work BV, as well as to the a number of board members (including the CRO) – debt/equity swap. This ensures that if and when Flow Management Work BV is sold as a going concern (see below), these stakeholders will receive the proceeds of the sale and thus obtain a return on their investment in Flow Management Work BV.

Flow Management Holding BV is to be liquidated – all claims against this company will be cancelled by the banks and its shareholder. The financiers are effectively waiving their debts – a moratorium.

Flow Management Holding BV and its shareholder will cancel all claims against the newco, Flow Management II BV and its subsidiaries – a moratorium. Otherwise, the result will be circular.

Banks C and D, who previously provided Flow Management Work BV with additional working capital will waive their entire debt claim (EUR 32.5 million) against Flow Management Work BV.

The consortium who previously provided Flow Management Work BV with working capital (EUR 337.5 million) will waive approximately 29% of their debt claim against Flow Management Work BV (leaving alive a debt claim of EUR 240 million). The consortium possess pledges on most assets of Flow Management Work BV and will receive part of their claim on liquidation.

The EUR 55 million loan in Flow Management Work BV is cancelled.

As a whole, the restructuring agreement illustrates the fact that the financiers have to be prepared to accept to take a haircut to achieve a percentage return on their assets – but a smaller haircut than if a straightforward liquidation had been effected.

QUESTION 8

WHICH (POTENTIAL) LEGAL AND/OR NON LEGAL CROSS-BORDER ISSUES – IF ANY – DO YOU RECOGNISE IN THE FLOW MANAGEMENT RESTRUCTURING PROCESS?

There may be potential cross-border issues arising out of the fact that the subsidiaries of Flow Management Holding BV are incorporated in 6 different jurisdictions. FMW Australia Ltd, FMW South Africa Ltd and FMW USA Ltd are incorporated in jurisdictions which have adopted legislation based on the Model Law, but it may be that the subsidiaries incorporated in the Netherlands, Spain and France are not. It is therefore possible that there are inconsistencies between the laws in such jurisdicitons which could lead to inharmonious legal approaches.

For example, there may be differing approaches in how to:

1. Have the foreign insolvency proceeding recognized;
2. Take control of aassets of the foreign company;
3. Pursue investigations and institute recovery proceedings, e.g., in relation to voidable transactions and breaches of directors' duties;
4. Afford the same status to foreign creditors as to local creditors;
5. Co-ordinate concurrent proceedings in two or more jurisdictions.

QUESTION 9

IN OCTOBER 2014 FOUR SCENARIOS HAD BEEN DRAWN UP? WHY WAS OR WASN'T CALLING FOR A MORATORIUM (SEE SCENARIO 4) A GOOD OPTION GIVEN THE SITUATION AT THAT TIME?

Had a moratorium been put in place in October 2014:

1. the company would not have been able to provide EUR 10 million of tax refunds as extra security on 31 October 2014;
2. the sale of surplus assets would not have been possible; and
3. the company would not have been able to repay EUR 25 million to the providers of the (additional) working capital in January 2015

which individually or collectively may have impacted on the relevant parties and their preparedness to sign the Restructuring Agreement on 4 July 2015.

JUSTIN DAVIS

11 APRIL 2023