Global Insolvency Practice Court 2023 – Case Study Module A
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Question 1

What were in your opinion the causes of financial distress at Flow Management? Could the financial distress have been prevented? If yes, explain how. If no, why not.

Organisational failure, and what causes it is the subject of a considerable body of research and commentary. Mallahi and Wilkinson in their 2004 article[1] summarise the divergent views of academics in this space, and relevantly, identify a divide between deterministic reasoning and voluntarist, the former referring to external factors as the cause of failure and the latter referring to internal factors, particularly the role of management and the influence it has on the success or otherwise of an organisation.

Those schools of thought provide a helpful framework within which to answer the question posed concerning the financial distress experienced by the Flow Management group (**Group**) (including Flow Management Holding BV (**Holding**) and Flow Management Work BV (**Work**). But as Mallahi and Wilkinson conclude "*any attempt to explain organizational failure will not be complete unless the interplay between contextual forces and organizational dynamics is taken into account"*. With the Group, there appears to be both contextual forces and organisational dynamics that lead to the financial distress being experienced.

At the outset of the case study, Holding is meeting with its banks. The basis for this meeting, we are told is two-fold. First, the expected pre-tax profit is in fact a loss and second, issues have been identified with the annual accounts for the previous financial year.

The issues identified and the explanation given for them by the company's management point squarely to one of the causes of financial distress being a failure by the Group to adequately and accurately manage its internal financial reporting. The failure to properly set prices was due to a formula error in a spreadsheet and basic accounting principles in respect of accruals have not been applied. The errors in the reporting have led to adjustments to both the current and the previous year's financial results, and have deprived management of the opportunity to properly understand the true state of the business. What also becomes apparent, is that there is a failure to properly report about the performance of the foreign subsidiaries as the financial distress within those business is only identified some time later. This highlights the importance of accurate and reliable financial reporting and management accounts. These, apparently, simple errors have had significant consequences for the company and its stakeholders.

Of equal concern is that Holding has awarded significant management bonuses to its CEO and CFO. As Barmash notes in his 1973 book "*corporations are managed by men; and men…manage organizations to suit themselves*", which would appear to be the case for the CEO and the CFO having been awarded significant bonus in circumstances where the financial results of the business suggest they were neither appropriate nor justified. As Adriaanse and Kuijl comment '[*s]olving problems should also involve removing the causes thereof*'[2], which is consistent with by the subsequent removal of the CFO of Holding.

The case study also reveals other internal matters that might be a cause of the financial distress being experienced. For example, the Group appears to have interests in real-

[1] Mellahi K & Wilkinson A. Organizational failure: a critique of recent research and a proposed integrative framework March 2004 IJMR 5(1),21-41
[2] 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 Contract and East European Law, 31(2),135-154 at 139

estate, which do not appear to be necessarily core to the business of the Group. It is not clear whether capital and investment may have been deployed into this part of the Group in priority to the core business operation of leasing trucks and private vehicles. This may be reflected by the solvency rate of Holding being lower than is required by the financial covenants. It is also not clear the extent to which the operations of the local subsidiaries have been properly integrated with the sharing of systems and processes to manage expenses and generate profits.

However, to adopt the observations of Mallahi and Wilkinson "*typically management actions alone do not yield organizational failure*". They go on to explain that the industry and the wider context in which the business operates need to be considered. We are told there is market demand for the services provided by the business and the forecasts are positive. However, over recent years, many leasing businesses have experienced structural difficulties, with new market entrants and disruptors. The price increases being forced upon certain categories of clients could have significant ramifications for forecast revenue if customers choose to go a competitor. By mid-2014, the Group appears to be taking a more strategic approach to the business, reassessing and evaluating the product range reflecting, it may be concluded, the industry and wider context in which the Group operates.

While the accounting failures noted above masked the true financial state of the business, the reason for the decline in financial performance must be linked ultimately to increasing pressure on profits, which can arise from a combination of increased expenses, revenue constraints and other external factors, for example rising bank debt and insufficient equity investment in the Group. Had the Group been adequately appraised of the decline in profitability of the business, by having accurate financial reporting, it could have made decisions regarding the business at an earlier point in time, for example, a strategic review of product-lines, markets in which it operated and customer pricing. This may not have necessarily entirely avoided the financial distress but it certainly would have been better prepared for it.

It is likely that at least to some degree the financial distress could have been avoided or at least, its impact reduced had the business had the benefit of accurate financial reporting. However, it is relevant to note the psychological factors referred to in Mellahi and Wilkinson's article which might have, in any event, contributed to the organisational challenges being experienced, for example denial, or idealization. Had the business not made the accounting errors referred to in the case study, and without the pressure that those errors created, would management have been prepared to accept the need to undertake a strategic review of the business. The accounting errors created urgency, and without that pressure, change may have been much slower. For these reasons, it seems unlikely that the financial distress being experienced by the Group could have been avoided entirely

Question 2

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

Out-of-Court restructurings, or as they are otherwise known, informal restructurings or workouts, have been accurately described as *"a reorganisation route which takes place*

outside the statutory framework with the objective of restoring the health of a company in financial difficulties within the same legal entity”[3].

One of the often cited benefits of an informal restructuring over a formal insolvency process is the preservation of value within the business. The business and its assets are not devalued by the stigma that can be associated with formal insolvency processes. While in many jurisdictions there are formal insolvency processes designed promote corporate rescue by formal restructure or recapitalisation, for example the voluntary administration regime pursuant to part 5.3A of the *Corporations Act 2001* (Cth) in Australia, the value of assets being sold through an insolvency process may still be negatively impacted, at least to some degree. The largely confidential nature of out-of-court processes avoids this potential harm and the potentially unwarranted and unhelpful speculation about a situation, the debtor or the creditors from the public.

Another advantage of an out of Court restructuring is the flexibility of the process and the speed with which (assuming consensus can be agreed) a financial and/or business restructuring can take place. The restructuring is not confined by the requirements of a specific insolvency regime and it need not only deal with a financial restructuring of the company. A restructuring of the business operations is usually also necessary. The plan need not include specific provisions, and creditors and debtors are largely free to agree such alternative arrangements as may be acceptable to them reflection their legal rights and entitlements. There is generally no need to obtain Court approval or the approval of creditors or stakeholders whose rights are not been varied or prejudiced in any way.

An out-of-Court restructuring process may not trigger termination rights in contracts with third parties that can be triggered by a formal insolvency. However the impact of this advantage has been largely diluted by the introduction in some jurisdictions (including Australia) of a prohibition on the exercise of certain rights to terminate contracts because of the entry into a formal insolvency process, so called ipso facto rights.

Management of the company or group remains in control which is again often considered to be an advantage as it avoids the costs associated with having an independent person (such as a monitor or insolvency practitioner) at the helm of the operation, and it can continue to be operated by those, who it may be assumed know the business best. The process may be considerably more cost effective and the engagement with creditors may be in some instances less adversarial. There are also less procedural requirements involved in an out of court restructuring, as compared to a formal insolvency process. For example, a voluntary administrator in Australia is required to convene at least two formal meetings of creditors at specific points in the process (see section 436E and 439A of the *Corporations Act 2001* (Cth)).

However, in some circumstances management and directors retaining control may also be a disadvantage, particularly where management may be responsible or complicit in the financial distress. In an informal restructuring, there is no independent oversight or investigation into the causes of the financial distress and into transactions that may not be proper transactions, for example the sale of assets at an undervalue or uncommercial transactions. The Australian insolvency regime grants wide powers to liquidators to investigate the affairs of the company, including by the public examination of directors and others involved in the affairs of the company, and unwind certain so called ‘voidable transactions’.

[3] 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 Contract and East European Law, 31(2),135-154 at 139

Another disadvantage arises from the very nature of an informal restructuring – it is a consensual process requiring the support of all who are impacted. The refusal of one or two key stakeholders to a restructuring proposal could cause the restructure to fail. There is no ability outside a formal insolvency process to cram-down classes of dissenting creditors, where they refuse to consent. This is a feature of many formal insolvency processes where certain criteria apply, for example, the recently introduced UK restructuring plan creditors in certain instances can be crammed down provided they are no worse off than in the 'relevant alternative' and shareholder equity can be transferred or diluted.

There are presently no equivalent provisions allowing creditor cram down in the Australian insolvency regime but one of the important feature of a formal restructuring process in Australia (and many other jurisdictions, for example Canada) is the availability of a moratorium from enforcement action and stays of proceedings, including against directors who have provided personal guarantees for the indebtedness of the company. The moratorium and the stays operate together to provide the company 'breathing space', to preserve the status quo and to allow the proper assessment of the state of the company and its future viability. This is a powerful tool. However, an out of court restructuring does not have the benefit of such a moratorium unless creditors agree to one. It is for this reason that standstills and moratoriums are such an important feature of INSOL's Statement of Principles for a Global Approach to Multi-Creditor Workouts II". A dissenting creditor can very easily derail an out-of-court process, as Banks C and D almost did in the Flow Management example.

Whether an out-of-court restructuring or a formal bankruptcy procedure should be preferred in a specific circumstance, will depend on the specific circumstances of the company and the approach of its creditors and key stakeholders.

Question 3

Were the turnaround/reorganization approaches as presented in the reading material applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.

The most straight forward approach to turnaround/reorganization is to describe the two constituting parts, being a business or operational restructuring and a financial restructuring. It is the case that in the Flow Management case study both of these aspects have been implemented. However, describing the necessary steps for a turnaround in that limited way does not completely reflect the essence of what is occurring.

A better way to describe the different phases of a business/operational turnaround is offered in the article by J Adriaanse and Hans Kuijl[4] who describe the relevant frequently overlapping steps as being stabilizing, analysing, repositioning and reinforcing.

Stabilizing is concerned with taking steps to address the most urgent or pressing issues that arise and stabilise the business and its finances, primarily its cash-flow position. This frequently involves reducing expenses, realising assets, such as stock that can be quickly sold or collecting debtors. Other commentators[5] describe this approach as retrenchment to improve operational efficiencies and reduce costs. This phase is essential to build a strong

[4] 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 Contract and East European Law, 31(2),135-154 at 140

[5] Such as Achim Schmitt and Sebastian Raisch in Corporate turnarounds: The Duality of Retrenchment and Recovery Journal of Management Studies 50: 7 November 2013

foundation from which further, often more strategic or significant changes to the business can occur.

In the case study, we are told that shortly after the financial distress is identified, a decision was made to sell 350 cars to improve the solvency rate but which would have also generated cash flow for the business. We are also told about planned spending cuts, in particular by reducing employment costs and planned price increases. These steps all fall within the stabilisation phase of the restructure. Without taking these steps Holding could have been unable to pay its debts as they fell due and been forced towards a formal liquidation of its assets. The Group appears to take a number of steps to ensure stabilization for the next phase of the restructure. The other step the Group could have taken but didn't, as far as we are aware, would have been to extend the terms on which it was required to pay its creditors, and/or reduce to time for its debtors to pay it. This would have also boosted the businesses cash-flow during this first phase.

The second phase to explore is the analysis phase which involves analysing both the current and future prospects of the business – to understand whether the business has a chance of successfully being restructured and restored to profitability. At the outset, this phase likely involves an analysis of assets, liabilities, cash-flow and contracts/relationships and consideration of the reasons for the financial distress, but will then move into the details of what a plan for reorganisation will involve and necessary steps to improve long term profitability. This may include further reductions in overheads, strategic divestments and rationalising the offering. This phase requires the involvement of and engagement with key stakeholders – financiers, shareholders and key customers and suppliers and it will frequently involve the engagement of restructuring professionals experienced at supporting businesses through restructures.

This approach was applied in the case-study as we are told in detail the analysis undertaken of the Group and the specific businesses to move through the standstill phase with the banks and ultimately reach a restructure agreement. An independent accounting firm is appointed to analyse and report on procedures in the business and the business mix is evaluated and reassessed. Asset divestments are considered, for example the sale of Holding BV and the sale of some of the subsidiaries but until the restructure plan is effectuated, we are not told whether any actual divestments occur.

The next phase is described as repositioning which is about embedding the strategic changes and steps identified during the analysing phase and continuing to engage with stakeholders about progress against the agreed goals. The role of management in this phase cannot be underestimated. We are not told much in the case study about the progress of the group with implementing its plans to operationally restructure the Group.

The final phase is referred to as reinforcing. This is concerned with the reinforcement of the balance sheet but also the reinforcement of management. There is some support for a conclusion that senior management change is an important feature of successful turnarounds[6]. The reasoning for this is the difficulty faced by incumbent management making the significant changes required to achieve meaningful change in the business and the commitment shown to stakeholders by change in the leadership. We see this occur in the case study with the replacement of the CFO which appears to have been an important step to secure the ongoing support and confidence of particularly the Banks. This is particularly relevant where is appears to be the failings of management that caused, in part

[6] S.Sudarsanam and J.Lai Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis British Journal of Management Vol 12 183-199.

the financial distress. The reinforcement of the balance sheet to lead to a more financial stable company is linked to the second part of a restructure being the financial restructure.

Having explored the phased approach to a business restructure/turnaround, it is also necessary to consider the financial restructuring which is what the case study explores in the most detail. S.Sudarsanam and J.Lai[7] describe this as being the "*reworking of a firm's capital structure to relieve the strain of interest and debt repayments*". A financial restructuring can involve equity and debt based strategies, with usually an aim of increasing equity investment and reducing the debt burden, either by reducing the quantum of the debt or otherwise modifying the terms to reduce interest payable or extending the terms. This plays out in a number of ways in the case study with various proposals for the modification of the financial commitments of the Group, including debt for equity swaps, debt compromises and delayed payment terms. This is all to achieve a stronger balance sheet and a better capitalised business to support the restructured operations.

Question 4

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

Banks C and D attempt to frustrate the process at a couple of particular points, namely:

1. they stop cooperating with Banks A and B during the negotiation of the standstill agreement in circumstance where the management and shareholder will not commit themselves to taking action unless the banks act as one party and the negotiations for the standstill agreement become more protracted**;** and

2. in June 2014, banks C and D threaten to cancel their facilities.

There may have been a number of reasons why these financiers behaved in that manner.

One reason may be simply frustration at the situation in particular the impact that the unreliability of the financial reporting being provided by the Group, the lack of confidence in management and the time it was taking to agree the terms of the standstill.

A feature of the case study appears to be the approach of the shareholder Lease Group Holding United Kingdom Ltd (**Lease Group**). From the outset there is no significant commitment being made by Lease Group to invest further equity or risk bearing capital into the business. The initial proposal by Lease Group, we are told is to reduce assets to improve the solvency rate. However, the Bank indicate cash equity was preferred. Banks C and D, may have concluded that without the additional shareholder support and commitment the restructure was unlikely to succeed.

The case study does not indicate whether the banks are parties to a syndicated facility and have the benefit of the same security interests over the same assets or whether some of the banks have a better or improved security position vis a vis the other lenders. We are told that there are issues with the pledges granted and it may have been that Banks C and D were able to get this resolved quicker. Also, we are told that it is banks C and D that provided the

[7] ibid

additional working capital. If this was the case, it may explain the motivation of banks C and D to be more bullish in their approach.

Banks C and D may have been opportunistically considering trading their debt to a third party. This is not prevented by any of the soft law, best practice guidance for restructuring and debt trading is accepted as a potential exit route for financiers in these situations. Banks C and D may have considered that a better price may have been achieved for the debt without a formal standstill in place.

An alternative opportunistic reason may have been that banks C and D were trying to negotiate a better position for themselves as against the other banks. Banks A and B realise that the banks not cooperating reduced their leverage against the company and perhaps banks C and D saw this as an opportunity to improve their outcome or encourage banks A and B to acquire their debt at close to par so as to regain control over the restructure process. We are told that consideration is made to buy out banks C and D at a 15-20% discount. Bank C and D may have concluded that the more disruption they caused to the process, the more the other banks might be prepared to pay to remove them from the process.

Finally banks C and D may simply have a different investment mandate or risk appetite than banks A and B which is not unusual were financiers come from a variety of jurisdictions and themselves have different funding models.

As an advisor for the other banks, the key first step would be to understand, or gather as much available information to understand the motivation of Banks C and D as that would inform appropriate next steps.

Other steps would include exploring whether the banks could collectively agree to a decision making protocol or agree to have a steering committee tasked with the objective of achieving the restructure. Reminding the banks of the likely benefits arising from an out of court consensual restructure may assist in focusing attention on achieving the outcome.

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 and implicit)

The case study highlights the role of banks A, B, C and D (together the **Banks**) as stakeholders in the workout process for Flow Management and the Group. However, the potential for differing objectives between each of those creditors risks the achievement of a consensual workout. However, as the Governor of the Bank of England highlighted in his letter to Mr Robinson, the then President of INSOL International "*a collective approach….can help preserve value, to the benefit of the creditors as a whole and other stakeholders in the company*." The "Statement of Principles for a Global Approach to Multi-Creditor Workouts II" (**Statement**) sets out the best-practice principles by which that might be achieved.

To some extent and with varying levels of success and strict compliance with the guidance in the Statement, each of the principles in the Statement except principle 8 can be found within the workout process of Flow Management.

The First Principle concerns cooperation between creditors to allow a standstill period for information to be gathered and evaluated and for plans for the workout strategy to be

devised. This is as an alternative to immediately forcing a company into formal insolvency upon the occurrence of defaults.

In the case study, while the documentation of a formal standstill arrangement takes a considerable period of time, from the outset the Banks allowed an informal standstill in order to gather information and for that information to evaluated in accordance with the best practice approach endorsed in the Statement. The formal standstill agreement was ultimately executed in August 2014, and provided for a specific milestones regarding the pursuit of four potential rescue/workout strategies.

Without the cooperation of the Banks any attempted workout or rescue of Flow Management was highly unlikely to succeed.

The second principle in the Statement promotes the forbearance by stakeholders of the exercise of their rights either to enforce their claims or reduced their exposure. The Statement frames this principle around ensuring stability while a rescue is pursued and reassurance to management that their efforts to turn things around will not be thwarted by unexpected creditor action. A forbearance helps achieve this where statutory moratoriums that might apply in formal insolvency processes have not yet been triggered (for example pursuant to the voluntary administration regime in Australia).

In the case study, there is an extended period of informal forbearance where the Banks have legal rights to terminate the credit agreements and claim the recovery of their debts but do not do so. While the Banks are apparently frustrated at times with the progress, ultimately, there are prepared to allow Flow Management the time to devise and implement the restructuring plans. While we are not told whether a formal forbearance was a term of the Standstill Agreement, it seems to be a fair assumption that it was. It is not intended that this principle prevents the consideration of the trading of the debt which was considered in this instance.

The third principle in the Statement reflects the consideration that creditors, in this case the Banks, can expect from agreeing to maintain the status quo and not exercise their rights by way of a standstill or forbearance. A debtor should not take any action that might adversely impact the return to creditors during the period of standstill and this includes preferential treatment of some creditors, the sale of assets at an undervalue or otherwise run down the business to prejudice the likelihood of repayment to creditors being achieved.

Broadly, this principle appears to be applied during the workout of Flow Management. For example the debt advanced by the shareholder in April 2014 was provided on an unsecured basis with interest payments being capitalised onto the loan, so that repayment of that debt was not preferred over the repayment of the Banks and the repayment of interest on that new debt did not reduce the available cash-flow in the business.

The fourth principle relates to the coordination of the response to a debtor in financial distress and encourages the use of creditors' committees and joint representation by advisors to assist the attempted restructuring.

In this case, we are not told that a creditors' committee is established to work with Flow Management. That may be because the number of Banks, and the key creditors is more limited in this case study. For example, we are not told that the company or the Group has extensive bondholder or noteholder liabilities which can comprise disparate groups of creditors and be harder to manage.

However, on the whole there is a reasonable level of coordination between the Banks, at least by the time the standstill agreement is finally agreed. However, it is clear that issues have arisen between the creditors are various junctures in the process, and certain Banks took different approaches. This part of the process could have been better managed if they had shared legal or other advisors or had devised another way to coordinate their response.

The fifth principle is certainly key to any successful restructuring, being the reasonable and timely access to relevant information concerning the business and affairs of the debtor to allow an informed decision to be made about the financial position and any proposals put to them. The seventh principle separately makes clear that this information should be given to all relevant creditors and treated confidentially.

In the case study, there are many examples of information being provided to creditors, from the outset of financial difficulties up to the ultimate entry into the restructuring agreement in a manner consistent with these principles. However, one of the major limitations is the problems identified with the accuracy and reliability of the information. This can lead to difficulties for creditors trusting the information provided which can undermine an attempted turnaround. However, it appears to be the case that all the Banks have been given access to the same information to base their decisions on and it is implied that it has been kept confidential.

The sixth principle provides that arrangements between creditors should reflect applicable law and ensure equal treatment based on their relevant positions at the time of the commencement of the standstill.

This seems to be the case in the Flow Management case study. We are told that the Banks expect their return from a formal insolvency process to be worse for them given issues with their security. The returns from a restructure are frequently compared to the estimated outcome that creditors, or classes of creditors could expect to receive on the liquidation of the company.

The eighth principle relates to the granting of a priority to the repayment of additional funding advanced by creditors to support a rescue process. Additional debt, often in the form of working capital to allow a company to continue to trade is frequently required during a restructure period. The principle encourages the provision of that additional debt on the basis that it will be repaid in priority to other liabilities. In the case study, we are not told about the advance of additional debt other than by the shareholder who agrees to do so on subordinated terms to ensure the continued support of the Banks.

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 (perhaps specifically in your country/region)? If yes, explain in what way. If not, do you see any alternative (informal possibilities)?

In Australia there are a number of sources of ‘soft law’ including regulatory guides published by the Australia Securities and Investments Commission (ASIC), the Banking Code of Practice and best practice guidelines published by bodies such as the Australian Restructuring, Insolvency and Turnaround Association (ARITA). Those publications cover a range of topics. However, none of them provide specific guidance, equivalent to the guidance offered by the Statement where there are various creditors involved in a distressed situation. While the Statement and also the London Approach/Rules (being an alternative

non-binding guidelines initially formulated by the Bank of England in the 1970s) are regularly adopted, there is nothing that is specific in Australia.

If the creditors refuse to adopt the Statement, there are a couple of other alternatives that stakeholders, or at least those who are committed to a collaborative approach to the workout could promote or encourage to maximise the chances of a restructuring being successfully achieved. These options may include:

1. informal creditor committees so creditors with aligned objectives can nominate a representative to deal with other creditors on their collective behalf. This is often seen with disparate groups of bondholders forming an ad hoc committee to provide views on restructuring proposal;
2. encouraging the parties/creditors groups to mediate or use an independent person to try to mediate disputes between creditors/groups of creditors to achieve a compromised solution;
3. the retention of an independent person to conduct a due diligence review on behalf of all creditors to ascertain the strengths and weaknesses of their respective positions.

All of these options rely on the spirit of the Statement that a collaborative approach is increasingly recognised as likely to achieve a better outcome for all concerned.

Question 7

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

The essence of the Restructuring agreement signed in July 2015 was an agreement by the consortium of Banks (A, B, C and D) to swap their debt for equity in the newly formed business being Flow Management II BV (**NewCo**). The Banks have converted from providing non-risk bearing capital to Holding and Flow Management Work BV to holding risk bearing capital in the newly formed entity.

As a result:

1. the business of the Flow Management Group may continue but through a new entity, being NewCo;
2. the Banks have become shareholders of NewCo and the original shareholders entitlements have been diluted or replaced entirely;
3. NewCo has lower leverage and a better debt to asset ratio, noting that ownership of the operating companies has been transferred to NewCo;
4. NewCo and its subsidiaries' cash-flow derived from the operating businesses does not need to be committed to the repayment of the bank debts. This will likely improve the cash-flow position;
5. the Banks' claims against Holding are released which reduces the number and value of creditors able to participate in the liquidation of that entity;
6. Banks C and D write-off all the additional working capital provided to Flow Management Work BV;
7. the Banks also agree to partially compromise their claims against one of the key operating subsidiaries reducing the leverage of that entity by over Euro150Million which will improve the solvency rate and other financial ratios;

8. shareholder claims against Holding, and shareholder loans, including those made during the restructure period are cancelled again reducing the number and value of creditors for the liquidation; and
9. the restructured business has an opportunity to seek a going-concern sale.

This form of restructure is best where stakeholders, in this case, the Banks, are satisfied that the business is viable despite the financial distress or the financial distress is temporary in nature. While as a consequence of the debt for equity sway, the Banks bear the risk of remaining invested in the business, they stand to gain in the event that the business prospers beyond the restructure and ultimately a going concern sale achieved.

Question 8

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

There are various legal and/or non-legal cross-border issues that might arise on and/or as a consequence of the Flow Management Restructuring process. These include:

1. *Restrictions on foreign investment* – we are not told where the consortium of Banks and the board members are domiciled, but there may be restrictions on the transfer of shares to those entities and regulatory clearance may be necessary. For example, in Australia there is the Foreign Investment Review Board whose role it is to examine investments into Australian assets and provide clearance on behalf of the Australian government. As a general rule, foreign persons and entities require approval before acquiring shares or other assets in Australian companies. This would certainly have relevance for the transfer of the shares in FMW Australia Ltd to the shell company.

2. *The liquidation of Flow Management Holding BV* – This may have various cross-border issues if this entity has assets and liabilities in more than one jurisdiction. Recognition of the foreign main proceedings may be required in jurisdictions where the company has an establishment. We are not told which jurisdiction the liquidation will occur in and choice of jurisdiction (assuming there is one) may be important.

3. *Consequences for employees* – We are not told about the consequences or potential consequences for employees and whether some may be made redundant as a consequence of the restructure or whether their employment may be transferred. This could give rise to various legal issues regarding the payment of employee claims, which depending on the jurisdiction, may be paid as a priority over other creditors or the transfer of their employment contracts to a new entity.

4. *Working capital* – the restructure contemplates significant debt reduction by the compromise of liabilities which would materially reduce the debt burden faced by the Group. However, the restructuring proposal does not contemplate the group obtaining further working capital to fund its operations out of the restructure. This may be critical to the success of the restructured group.

5. *Risk of insolvency of foreign subsidiaries* – we are not told about the liabilities of each of the foreign subsidiaries. However, there is a risk that local creditors of these entities might attempt to take enforcement action against the subsidiary directly, notwithstanding the broader restructuring agreement which operates at the parent

level following the transfer to Flow Management II Group. Any insolvency of one or more of these entities will operate in accordance with local law and regulation in the relevant jurisdiction.

Question 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?

The reference to 'moratorium' in the question is understood to be a reference to the formal reorganisation methods available under law in The Netherlands. In an Australian context, it appears this process is most similar to the voluntary administration regime in accordance with Part 5.3A of the Corporations Act 2001 (Cth). Both processes have as their main objective the rescue of the company and/or the business as a going concern. However the Dutch moratorium process may be designed for short term liquidity issues rather than longer term financial distress.

The provision of a moratorium, pursuant to the voluntary administration regime provides the company with protection from its creditors, by preventing creditors from exercising certain rights and continuing to progress claims against the company for a period of time while decisions regarding the company's future are made, and the possibility of the business being recapitalised or restructured is explored.

It is a powerful and protective right to allow a company to maintain the status quo while further analysis of the financial position is conducted by the appointed voluntary administrator. As discussed in question 2 above, a moratorium is often a significant advantage of a formal insolvency process over an informal or out-of-court restructuring process. However, notwithstanding the moratorium, secured creditors of Australian entities with security over whole or substantially the whole of the assets of the company are permitted to exercise their rights of enforcement over the company during the so called decision period at the start of the voluntary administration process.

In the Flow Management case study, the ability for secured creditors to exercise certain rights notwithstanding the moratorium could be problematic. We know that banks C and D have occasionally refused to cooperate with the Group and other creditors. In a formal insolvency process, and despite the potential for a restructure plan to be reached, they may still decide to exercise their rights of enforcement under their pledges (assuming they are valid) which could derail the whole process.

Under the Australian voluntary administration regime, the moratorium and other protections apply while decisions are made during a statutory prescribed period of time which may only be extended by Court order, and upon the Court being satisfied that it is in the best interests of creditors[8] The company may continue to trade during this period, although must notify those it does business with of its status as a company which has voluntary administrators appointed. Frequently one of the major challenges faced by voluntary administrators in their efforts to continue to trade the business while seeking a solution is the availability of funding. Voluntary administrators are personally liable for debts incurred while appointed to the company. Accordingly, the need for new funding is often even more acute.

[8] Section 439A(6) and (7) Corporations Act 2001 (Cth)

We are told in the Flow Management case study that further bridging funding would be required to allow the group to continue to trade through the process. This may be problematic for the existing funders, and any funding made available to the voluntary administrators would likely be on preferential or priority payment terms. The voluntary administrators may also need to make an application to Court to be relieved of their personal liability for the debts incurred (this is possible pursuant to the Corporations Act 2001 (Cth) and such applications are common place). This often adds to the cost of the voluntary administration process, which can be a disadvantage of formal insolvency processes. This may be a reason why calling for a moratorium was not a good option at the time.

The voluntary administration process ends after a second meeting of creditors, at which creditors are asked to decide on the future of the company – whether it be returned to the control of the directors, placed into liquidation or whether a Deed of Company Arrangement (being a plan for the restructure or recapitalisation of the company) should be executed, assuming one has been proposed. While there are specific state outcomes, the voluntary administration regime, like an informal restructuring is very flexible in terms of how the outcomes are achieved. For example, while consent of the shareholders or leave of the Court is required, there are powers permitting the transfer of shares[9].

Having regard the circumstances of Flow Management and the extended period of financial distress experienced, it is entirely appropriate that a moratorium or similar process be considered. However, on balance it was unlikely to be a good option to pursue at the time given the ongoing need for funding and the consequences it may have had for the ongoing trading. The alternative restructuring options appear to have better prospects of achieving the rescue of the business as a going concern and the protection of various stakeholder, including creditors and the shareholder.

[9] Section 444GA Corporations Act 2001 (Cth)