**Question 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?*

Financial distress is a circumstance when a company fails to generate sufficient revenue and in turn struggles to meet its financial obligations. The management of Flow Management was first aware of the financial distress or noticed the sign of financial distress in November 2013 when it called a meeting with the banks.

Between November 2013 and December 2013, the management noticed the following:

* The 2012 annual account with reported results of EUR3 million must be downgraded by EUR8 million;
* The reported pre-tax profit until September 2013 turned out to be a loss of EUR5.4 million;
* The group loss in 2013 amounted to EUR23.1 million;
* The scheduled repayment of EUR35 million on 31 December would be missed; and
* The solvency rate was at 3.9% at the beginning of December 2013 but turned out to be virtually zero at a later date in the same month.

Given the above, Flow Management might have shown sign of financial distress as early as during the year of 2012. However, the management only noticed the financial distress in late 2013. Therefore, it also appeared that the management did not notice the sign of financial distress early enough.

In Mellahi & Wilkinson, 2004, the literature on failure was described to have two clearly separate view:

* The deterministic view including the study of industrial organisation and organisation ecology
* The voluntarist view including the study of organisation studies and organisational psychology

The deterministic perspective holds the idea that *“failure is caused by external factors over which management has little or no control”* while the voluntarist perspective is that *“who makes a decision is more important than the external context within which the decision is made”*.

Deterministic perspective

The argument of the industrial organisation perspective is that *“during uncertain times firms have difficulty accurately predicting circumstances that might effect their future activities”*, and “*uncertainty may lead to fluctuations in demand”*.

It was suggested that any management is rational and committed to the firm’s success who will not act against firm’s interest while any failure would have been caused by the external environment (e.g. population density, industry life cycle, organisation age and organisation size as suggested in Mellahi & Wilkinson, 2004) whereas the management would have nothing to do about it or lacked the ability to do anything to change the circumstances. Even though the management could, any decision made would have been affected by the adverse circumstances and therefore, the management would not be responsible for the failure.

Further in Adriaanse & Kuijl, 2006, it was stated that *“Dutch legislation lacks the legal possibility to oblige entrepreneurs and their stakeholders to be focused on taking timely measures to prevent bankruptcy procedures”*.

Given the above, it may be argued that the absence of statutory obligations imposed on the management of Flow Management hampered the ability of the management to proactively look for the sign of financial distress or to take immediate measures to respond to financial distress.

Voluntaristic view

However, Mellahi & Wilkinson, 2004 suggested that the voluntaristic perspective rejects the assumption that managers are powerless and/or rational actors but any failure is linked to internal inadequacies in dealing with external threats.

Under the upper echelon theory, longer-tenured top managers tend to attribute failure to external, uncontrollable and temporary causes but ignore internal causes of failure. The incumbent management of Flow Management might have been caught under the same trap and ignored the internal deficiencies as causes of the financial distress. It could be seen that the management was confident with the business structure and the forecasts which turned out to have significant deficiency. Should the management have considered the internal threats, earlier measures would have been taken, including to conduct thorough analysis to prepare accurate forecast, so that the financial stress could be neutralised at an early stage.

The management of Flow Management might also be over confidence to its internal system and marketing research. This phenomenon has reflected the curse of success theory where the management of historical successful companies are susceptible to failure. It was noted that one of the reasons for negative corrections of the results was the formula error in the costing method. The management might have overlooked the need to review and test the management information system which led to the reporting deficiency. Should the formula error be identified earlier, the loss in 2012 would have been detected earlier which in turn would alert the management of the potential downturn and the sign of financial distress. Furthermore, such over confidence could also be seen from the overly forecasted profit at the early stage.

The threat rigidity effect theory may also apply on the behaviour of the management of Flow Management. In Mellahi & Wilkinson, 2004, it was suggested that *“people are less likely to perceive a relationship between their behaviour and its outcome when they fail”*. This behaviour was referred as denial behaviour where the management would seek to disclaim responsibility. In addition to the accounting error, it was also known that the negative corrections were also caused by the wrong issuance of bonus and misjudgement on the anticipated book profit. However, it did not appear that the management of Flow Management had taken any measures to correct the mistakes.

The delay in noticing the sign of financial distress and carrying out the reorganisation plan had also contributed to the prolonged financial distress. It was suggested by Stuart Gilson[[1]](#footnote-1) that *“many companies recognise the need to restructure too late, when fewer options remain and saving the company may be more difficult”*. The delay by the management of Flow Management to take actions had limited the ability and options to carry out the reorganisation plan promptly to achieve a short turnaround period. Early warning followed by swift, intense and competent actions from the management would have reduced the chance, if not scale, of the financial distress.

Others

In Adriaanse & Kuijl, 2006, a few causes of financial difficulties were suggested, including poor management, excessive cost structures and inadequate management information systems. These causes mirrored the causes of the financial distress at Flow Management as discussed above. The deficiency of the management information systems had led to the failure for the management of Flow Management to detect the sign of financial distress at an earlier stage. Further, the delayed reaction of the management of Flow Management to recognise and deal with the internal weaknesses had amplified the issues.

Conclusions

It is discussed above that the causes of financial distress were, to a certain degree, attributed by the external factors. However, the failure of the management of Flow Management to take into account and neutralise the internal threats had substantially contributed to the financial distress. That being said, the inaction of the management had been the major causes of the financial distress at Flow Management. As said in Adriaanse & Kuijl, 2006, *“the popular belief to the contrary notwithstanding economic circumstances are often not the (major) cause of the problem. It frequently seems to be an excuse rather than a real root cause”*.

As also mentioned above, the financial distress would have been prevented, or at least been mitigated at an earlier stage, should the management notice the early sign, face the internal threats and implement proper measures, instead of blaming the wrong causes. Even when the financial distress is confirmed, the informal reorganisation would have been more successful should the management take quick and adequate measures to restore profitability.

**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?*

Formal reorganisation includes all possibilities of reorganisation laid down by the (insolvency) law or which take place by using legal methods and possibilities. An informal reorganisation is 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 framework of the existing legal entity (Adriaanse & Kuijl 2006).

The key difference between an out-of-court restructuring and a formal bankruptcy procedure is whether the process is conducted within the statutory framework or the existing legal entity’s (i.e. the debtor’s) framework. In addition, the main feature in a workout is to “restore the health” of the debtor. In other words, the purpose of the workout is to save the business and ensure its survival. The successful outcome of which is that the business continues to exist, jobs are saved, lenders continue to receive repayments, suppliers secure continuing business and customers continue to receive the services/products. Therefore, a successful workout reduces disruption to the economy.

There are different characteristics and features between informal workout and formal bankruptcy procedure which offer them various advantages (or disadvantages) over each other.

As one can expect, formal bankruptcy procedure conducted under the statutory framework means that the process is governed and regulated by statues and stakeholders are protected by the legislations with pre-determined rules to follow with the ability to recoup to the judicial system to resolve any issue (subject to the provisions of the legislations). In this regard, stakeholders have a higher level of confidence in the process with the understanding that all other stakeholders will have to play with the same rules where the outcome of the process is easier to be anticipated.

In contrast, while the workout does not have a set rules or statues to be followed, it offers a higher degree of flexibility and removes the limitations which sometimes may be imposed in the formal procedure. For example, the bankruptcy administrator may not exercise certain powers or perform certain act without sanction from the court in which exercising such power may increase the time and costs compared to informal workout. Adriaanse & Kuijl 2006 refers flexibility in informal workout as “tailor-made” solutions and deviations which includes negotiations and agreements with the stakeholders. It requires the debtor company to think “outside the box” for solutions so as to seek support from different stakeholders. The ability to workout under the legal entity’s framework provides flexibility throughout the process.

Usually, there is statutory advertising requirement under a formal bankruptcy procedure. When a formal procedure commences, the bankruptcy administrator has the duties to inform all stakeholders, including creditors, statutory regulators, banks, debtors, suppliers, clients, employees, etc. The stakeholders may choose to continue the relationships with the debtor company only with increased scepticism. For example, suppliers and clients may choose to continue with the contracts under cash on delivery terms only.

On the other hand, the flexibility offered in workout procedure lets the debtor to decide the participants in the procedure which usually includes only those stakeholders who can exert a certain degree of influences over the debtor and the rescue. This sort of secrecy is referred as “silence” in Adriaanse & Kuijl 2006. With a limited group of stakeholders, the workout procedure and plan can be more focus, concentrated and oriented. The debtor can concentrate the resources focusing on the participating stakeholders with the oriented goal which satisfies the participating stakeholders’ wishes. Accordingly, the chance of a successful workout increases. The concentrated stakeholder group also leads to a reduced costs associated with the workout procedure which as a result, provides higher return to the creditors.

In any formal bankruptcy procedure, an independent, usually licenced, practitioner will take control of and manage the affairs of the debtor pursuant to the statutory framework. The practitioner is experienced in managing the affairs under such circumstances and hence, provides confidence to the stakeholders that their rights will be protected throughout the bankruptcy procedure administered by the practitioner. However, the practitioner will be remunerated (subject to the scrutiny of the court and/or relevant stakeholders). As a result, the return to the creditors may reduce.

In contrast, the debtor will have higher degree of control under its own framework (e.g. the debtor in possession regime in some jurisdictions). Therefore, the procedure can be administered in a controlled manner, including the timeframe, costs and outcomes, which, again, offers a greater chance of a higher return to creditors.

The one big difference between the workout and formal bankruptcy procedure is the moratorium. In a formal bankruptcy, the affairs of the debtor is in the hands of the practitioner who will investigate the affairs and realise assets to ensure a pari passu distribution. Any legal proceedings or enforcement actions will usually be stayed to avoid creditors attempting to reduce their exposure to the debtor or improve their position over other creditors unfairly. Given the informal and flexible nature offered in the workout procedure, moratorium is usually not available. While the debtor also enjoys silence throughout the process, it cannot prevent participating creditors from escalating their actions to convert the procedure to a formal bankruptcy procedure. Further, if non-participating creditors found out that they are left out from the informal process, due to the absence of moratorium, they might recourse to formal procedure to pursue their rights. Therefore, it is important to carefully consider who the participating stakeholders should be and manage their expectations while enjoying the informality, flexibility, silence and control nature of the informal workout.

While out-of-court restructuring and formal bankruptcy procedure each bear certain characteristics and features, the advantages of them over each other are not quantifiable. The closest research conducted by Gilson, John and Lang[[2]](#footnote-2) by comparing the stock returns of a sample listed companies before and after a chosen formal or informal procedure could only show that informal workouts generated significantly higher share returns. To a certain extent, it was shown that important market value is preserved in informal reorganisation (Adriaanse & Kuijl 2006).

In British Virgin Islands (“**BVI**”), there are formal restructuring or bankruptcy procedure governed under the BVI Business Companies Act (“**BCA**”) and Insolvency Act (“**IA**”) including:

* Plan of arrangement for companies under the BCA
* Schemes of arrangement for companies under the BCA
* Company creditors’ arrangement for companies under the IA
* Individual creditors’ arrangement for individuals under the IA
* Administration for companies under the IA (though has yet to be in effect)
* Liquidation and provisional liquidation for companies under the IA
* Bankruptcy for individuals under the IA

These legislations are all formal procedures with court involvement in which the processes are governed by statues and managed by independent licenced practitioners. Stakeholders may recoup to the court for direction and assistance if needed. In particular to the restructuring tools, creditors have the opportunity to decide the future of the company (or individual) by voting on the restructuring plan proposed and/or court sanction is required. Advertisements and/or notices of the procedure and appointment are also compulsory. In this regard, the formal BVI procedures take away the benefits of flexibility, silence and control features available in an informal procedure but retain court and creditor involvement so that the process is being monitored to ensure stakeholders’ confidence throughout the process.

The predominant nature of the companies incorporated in the BVI as investment/asset holding structure means that the restructuring targets are usually the (financially troubled) onshore operating subsidiaries rather than the BVI incorporated company itself. Therefore, informal workout does not usually happen within the BVI incorporated companies. Instead, a formal procedure is usually commenced in the BVI (e.g. “soft touch” provisional liquidation) for an independent practitioner to take control over the assets of the BVI companies (i.e. the investments in the onshore operating subsidiaries) so that an informal workout can be commenced within the onshore operating subsidiaries. This kind of arrangement ensures that the restructuring process is monitored by the BVI court and at the same time, enjoys the features of flexibility, silence and control of an informal workout conducted within the onshore operating subsidiaries.

**Question 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.*

The restructuring plan proposed and/or implemented by Flow Management has demonstrated the turnaround/reorganisation approaches as presented in the reading material in a wide range of aspects.

*Informal reorganisation & turnaround strategies*

In Sudarsanam, S., Lai, J., 2001, a few turnaround tools and strategies were discussed which included:

1. Managerial restructuring
2. Operational restructuring
3. Asset restructuring
4. Financial restructuring

In Adriaanse & Kuijl 2006, it was described that management changes, assets sales, new finance and guarantees given by management are some of the popular measures. It further stated that informal reorganisation consists of two processes:

1. Business restructuring
2. Financial restructuring

Business restructuring is to restore the operational profitability of a company in financial difficulties (Adriaanse & Kuijl 2006). This presents similar strategies in operational restructuring and asset restructuring in Sudarsanam, S., Lai, J., 2001 under four phases:

1. Stabilising – to increase cash flow
2. Analysing – to set forth the core activities of the company by identifying the relevant financiers, products/services, customers, etc.
3. Repositioning – to recover value
4. Reinforcing – to reinforce the field of management and the company’s balance sheet

Financial restructuring is the process of revising terms of funding and credit with the financiers and creditors and securing new funding in the form of risk-avoiding capital and/or risk-bearing capital.

Accordingly, the following restructuring plan of Flow Management has reflected the approaches in Sudarsanam, S., Lai, J., 2001 and Adriaanse & Kuijl 2006.

Managerial restructuring

Corporate restructuring is a process aiming at a restoration of confidence in the company and its management among interested parties. Further, the active attitude by management and shareholders attributed to the success of a reorganisation (Adriaanse & Kuijl 2006).

When a company is in financial distress, lenders and creditors may lose faith in the incumbent management who is in charge of the company’s performance when the company undergoes financial difficulties, even though it may not have been the incumbent management’s fault that the company is experiencing in financial distress. Therefore, a promising managerial restructuring may rebuild the confidence of the lenders and creditors, who are crucial to a successful restructuring, that the new management team can handle the crisis.

Both the banks and the shareholder of Flow Management Holding BV (“**FMH**”) were contended that measure must be taken with regard to the management. Initially, the banks requested the board of FMH’s shareholder (“**Lease Group**”) to take actions against the management team, in particular to the CFO. In January 2014, the banks put trust in FMH when Lease Group announced that it would appoint a new CFO soon. Further, the CEO of FMH was replaced by the board of Lease Group in mid-April 2014.

Although in Sudarsanam, S., Lai, J., 2001, it was said that the *“effectiveness of managerial restructuring in turnaround is yet to be conclusively established”*, managerial restructuring avoids the incumbent management sticking with the habits which may be harmful to the restructuring plan or disregarding new practices which may be crucial to the turnaround.

For example, the incumbent management was initially (i.e. in December 2013) confident with the business structure and operation in place, its view to the market demand and its forecast for the performance ratios (e.g. hiring and leasing days) which was relied upon by the incumbent management to propose the restructuring plan. However, it turned out that the few forecasts varied significantly with the actual results. At a later stage (e.g. at the end of June 2014 and in early August 2014), the banks threatened to cancel the credit and were disappointed with the constantly changing information given by FWH. However, they contended about the new management, including the Chief Restructuring Officer, and the slight result improvement due to the reorganisation.

Therefore, managerial restructuring can assist in regaining confidence from lenders and creditors which contributes to a successful turnaround.

Operational restructuring

Operational restructuring refers to the cost reduction, revenue generation and operating-asset reduction strategies which is primarily designed to generate cash flow and profit improvement in short term (Sudarsanam, S., Lai, J., 2001).

At various times, operational restructuring plan was proposed (or executed):

*Cost reduction*

* Initially, the management presented that spending cuts would be implemented, in particular with the labour costs. When the plan was drawn up in December 2013, it was expected that 130 staff members would be made redundant to yield an annual saving of EUR3.3 million.
* The extra savings proposed by improving loss recovery, higher excess premiums and savings on car repairs were expected to achieve savings of EUR3.9 million.

*Revenue generation*

* Initially, the management presented that discussion would be held with the main clients about possible price increases while other clients would be notified. In December 2013 it was forecasted that the price increase would generate revenue of EUR7.8 million.
* In April 2014, a plan was drawn up with the strategy to focus on increasing turnover in combination with large cutbacks.
* The entire business mix (product-range) would be evaluated and reassessed.

*Operating-asset reduction*

* The management proposed to sell 350 cars.
* In early August 2014, as a result of the sale of surplus assets, sufficient incoming cash flows were expected.

Therefore, in December 2013, the result was expected to be increased by EUR15 million.

Asset restructuring

Asset restructuring refers to the major reconfiguration of the firm’s assets covering asset divestment and asset investment to achieve long-term strategic change through new product market focus, diversification and acquisition (Sudarsanam, S., Lai, J., 2001).

Asset investment covers business and comprises both internal capital expenditure and acquisition. FMH planned that the management information system would be improved so that the financial figures and reporting would be more reliable. The capital expenditure on improving the management information system could improve efficiency and productivity as it could speed up market response and reduce costs.

In January 2014, it was announced that the short term strategy included restructuring the foreign subsidiaries. In order to achieve asset divestment, in April 2014, it was formulated that the share of the companies held by FMH, except for Flow Management Work BV, would be sold off together with some foreign branches. Among the restructuring agreement signed on 4 July 2015, all operating companies of FMH were to be accommodated in a shell subsidiary such that the firm was reorganised into self-contained strategic business unit. In this regard, FMH could divest non-profit generating or non-core assets to raise cash and concentrate resources on profit generating asset.

Financial restructuring

Financial restructuring is a cash generation strategy to alleviate financial by paying down borrowings, reducing interest cost and improving cash flows. It can be separated into two strategies: equity-based and debt-based. Equity-based strategy covers dividend cuts or omissions and equity issues while debt-based strategy refers to the extensive restructuring of firm debt (Sudarsanam, S., Lai, J., 2001).

The banks’ preference for Lease Group’s monetary injection of risk-bearing capital of EUR35 million by Lease Group to improve the solvency rate bis an example of equity-based financial restructuring strategy. This kind of injection of risk-bearing capital lays a foundation for the future to restore the balance sheet ratios positively (Adriaanse & Kuijl 2006).

In addition, a few debt-equity financial restructuring strategies were proposed and/or carried out including:

* The few postponements of the scheduled repayment;
* The consideration of the debt-equity swap by the banks;
* The proposal in June 2014 to restructure working capital financing and other loans, including the postponements of repayment and waiver of default interest and non-fulfilled contractual obligations.

By May 2016, the net profit returned to positive, and the solvency rate was strengthened to higher than 5% as a result of the financial restructuring.

*Retrenchment vs recovery*

In Schmitt, A., Raisch, S., 2013, two activities were seen in corporate turnaround, i.e. retrenchment and recovery. The purpose of retrenchment activities is to reduce assets and/or improve operational efficiency to increase firm profitability and strengthen the firm’s industry position (Robbins and Pearce, 1992). Recovery activities refer to strategic changes that transform and reposition the firm for sustained growth and profitability (Barker and Duhaime, 1997). Further, the overlapping and joint effects of two complementary strategies may confound the impact of individual strategies (Sudarsanam, S., Lai, J., 2001).

The various tools and strategies presented in Sudarsanam, S., Lai, J., 2001 and Adriaanse & Kuijl 2006 can be categorised into the retrenchment phase and recovery phase presented in Schmitt, A., Raisch, S., 2013.

While retrenchment focuses on increasing efficiency through cost and asset reductions, recovery concentrates on improving a firm’s market position through strategic change (Schmitt, A., Raisch, S., 2013). In this regard, retrenchment and recovery also represent, for example, operational restructuring and asset restructuring respectively.

Traditionally, scholars argued that retrenchment and recovery are two contradictory activities and should be addressed sequentially. The dualism of which declines processes, creates tensions and has considerable difficulties focusing simultaneously. However, Schmitt, A., Raisch, S., 2013 presents the interrelation nature between retrenchment and recovery and the duality of which is complementary, although the benefits from integrating retrenchment and recovery cannot be realised without incurring additional costs given the contradictions.

Several actions in Flow Management’s turnaround plan were carried out concurrently to exploit and manage the interrelations between retrenchment and recovery.

The sale of surplus assets by Flow Management, including the redundancy of 130 staff and the proposed sale of 350 cars, was a retrenchment strategy to free up redundant resources. At the same time, it allowed Flow Management to focus on recovery by learning how to do the same work with fewer resources. The asset reduction also created tight resource control during the retrenchment phase while the improvement in management information system provided the resource required for successful recovery.

However, certain conflicting plans were carried out which created competing objectives. The reorganisation plan of Flow Management has heavily focused on short term retrenchment to satisfy the wish of the banks to protect investments. In this regard, it has failed to implement long-term recovery plan to increase employees’ commitment but layoff staff.

The turnaround/reorganisation might have improved should Flow Management have better planning to stage the retrenchment and recovery strategies to engage in higher degrees of retrenchment in the early stages and gradually shift to higher degrees of recovery in the later stages (Schmitt, A., Raisch, S., 2013).

*Stakeholder influences*

Pajunen, K. 2006 stated that the concerns in a turnaround/reorganisation are to define the stakeholder that have an influence on the organisation’s survival and the management of such stakeholders. Arogyaswamy et al. (1995) drew attention to stakeholders by suggesting that an organization in crisis must ensure the support of critical stakeholders.

Although Flow Management did not explicitly conduct stakeholder analysis, its interactions with various stakeholders reflected the doctrine of stakeholder influence analysis.

In the Flow Management scenario, the stakeholders include:

* The management of Flow Management
* The banks
* The shareholder company, i.e. Lease Group
* The clients, including both main clients and other clients
* The staff

The stakeholder influences model is to identify stakeholders’ influence. Stakeholders who have the needed resources and able to control the interaction and resources flows in the network most likely have a strong influence on an organisation’s survival (Pajunen, K. 2006).

The incumbent management at the early stage controlled the information flow and dominated the turnaround process. It relied on its knowledge in the organisation to prepare forecast which emerged later to have significant discrepancy. It also counter proposed alternative plan to dispose 350 cars to improve solvency rate even though the banks’ preference was for the shareholder company to inject risk-bearing capital. Even at a later stage, the new management and the Chief Restructuring Officer appointed by the banks remained the vocal point and linkage with the banks. It also had the direct communication with the clients and staff which demonstrated a relatively centralised position among the stakeholders. In this regard, it had a high network position based power at all time although the resource dependency based power was moderate.

The banks had a large working capital financing portfolio with Flow Management although its linkage with other stakeholders was minimal until later when they appointed the Chief Restructuring Officer to the management of Flow Management to add value to the restructuring process. Combining with the early involvement of the banks by the management of Flow Management throughout the entire reorganisation process, the banks had a high resource dependency based power while its network position based power shifted from moderate to high.

As a separate note, the involvement of financiers in the reorganisation process is also an ingredient to the success of a rescue operation. Adriaanse & Kuijl described that involved financiers are generally prepared to cooperate within an informal reorganisation provided that the focal point in first instance is the deferment of payments rather than the remission.

Lease Group had a passive involvement during the reorganisation process when it was requested to inject risk-bearing capital. In addition, given its limited linkage with other stakeholders, its network position based power was low. Flow Management became dependent on the resources of Lease Group later when it received larger capital. In this regard, its resource dependency based power shifted from low to moderate.

The network position based power of the clients was low given its weak relationship with other stakeholders of Flow Management and the reorganisation process. In addition, it did not appear that the clients could exert significant influence as it did not appear to have great bargaining power during the negotiation of the price increment which indicated that the product might be price insensitive, despite a few negative responses. In this regard, the resource dependency based power of the clients was also low. The resource dependency based power of the main clients might be moderate given their portfolios and that the attitude of the management of Flow Management in relation to the price increment was to initiate a discussion at the first instance.

The resource dependency based power and the network position based power of the staff were low given the weak linkage to other stakeholders and the passive attitude in relation to the employment loss.

Pajunen, K. 2006 further explicated six factors in the management of governing stakeholders – in this case, the banks. Flow Management has done well to secure the continuing support of the banks and enhanced frequent and open communication between the managers and the banks. The banks have consistently held the view that it was of benefit that Flow Management operated as a going concern with the positive attitude towards signing a standstill agreement. Although the banks were not happy with the regular change of information provided by Flow Management (e.g. the inconsistent forecasts), Flow Management has attempted to provide regular updates to the banks (e.g by reporting actual costs and turnover each month). At a later stage, the banks also considered that the management of Flow Management and Lease Group constructively worked together on a solution. This had increased the probability of Flow Management’s survival due to the banks’ association of the new management with good firm performance.

In contrast, Flow Management has not built a personal relationship with the banks or unlocked the brokerage position between governing stakeholders. It was evident that Banks C and D have taken a contradicting view against Banks A and B which might jeopardise the reorganisation process. The failure to obtain consensus on long-term goals among the banks could have undermined the continuing support of the banks and decreased the probability of Flow Management’s survival.

*Strategy implementation*

While the turnaround/reorganisation strategies of Flow Management have reflected certain approaches in the reading material, the implementation of such has almost led to the failure of the reorganisation.

Sudarsanam, S., Lai, J., 2001 stated that corporate turnaround often requires swift managerial actions. For a strategy to be effective, it may have to be carried out swiftly, intensively and competently. Adriaanse and Kuijl 2006 further stated that one of the factors that determines the success of a rescue operation is the adequate and speedy reorganisation of the business operations (preferably with the help of third parties).

An independent turnaround consultancy was hired to assess the viability of Flow Management, the market share, and the estimated turnover at the start and throughout the process to assist the banks. However, at the end of June 2014, Flow Management continued to suffer in loss and experience liquidity shortage due to a delay in the reorganisation being carried out regarding the price increase and expenditure cutbacks. It is evident that despite prominently selected turnaround strategies, the reorganisation process is not foolproof without proper and appropriate managerial actions. As Hoffman 1989 suggested, the difference between successful and failed turnarounds lies more in the strategy implementation process than in its content.

**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?*

A few events occurred throughout the process may be attributable to the behaviour of Banks C and D:

* The reported pre-tax profit until September 2013 required to be revised due to incorrect accounting treatment, costing error and poor corporate governance in relation to the years 2012 and 2013.
* The forecasts, which formed the basis of reorganisation plan, were changed regularly with significant adverse revision.
* The lack of confidence of the banks in the management of Flow Management due to the progression and the execution of the reorganisation plan.
* The delay in securing the capital injection from Lease Group and the initial counter proposal to improve solvency rate as an alternative of capital injection.
* The absence of significant and promising financial improvements at the early stage.
* The delay in managerial restructuring to address the lack of confidence in the incumbent management.
* The delay in signing the standstill agreement.

It is proven in a few literatures that continue support from governing stakeholders, particularly the banks, are crucial to the success of a reorganisation. Therefore, the attitude of the banks contributes significantly to the process of any possible reorganisation.

In Adriaanse & Kuijl 2006, it was stated that one of the major bottlenecks in an informal reorganisation was the *“breach of trust between the company and its creditors”*. It further stated that the causes of the breach of trust include:

* Financial results which structurally deviate from prognostications;
* Management failed to observe (restructuring) agreements (with creditors) and,
* More generally, the (imminent) absence among the creditors of confidence in management and/or viability of the company.

It is reasonable to expect that Banks C and D had doubts in the incumbent management given the reporting errors and poor corporate governance (e.g. the erroneous bonus payment). Combing with the constantly changing forecasts, Banks C and D would have minimal confidence in the incumbent management. This issue was not resolved due to the delay in managerial restructuring (i.e. to replace the incumbent management). The lack of confidence in Banks C and D is evidenced by the improving confidence and more positive attitude towards the new management group after the change and the newly appointed Chief Restructuring Officer.

The inaccurate forecast was formed the basis of the reorganisation plan. Therefore, the constant failure to produce an accurate forecast cast doubt on the reorganisation plan. Furthermore, the financial performance did not improve at early stage where forecasted profit turned out to be actual loss (which may be attributed to the inaccurate forecast) which raised further questions to the viability of the company and the reorganisation plan.

There has been delay in progressing the reorganisation plan particularly to the price increment and spending cutbacks. The passive attitude provided less faith to Banks C and D of the incumbent management and the feasibility of the reorganisation plan. In addition, this passive attitude contributed to the poor strategic, operational and financial measures taken by the incumbent management which created a vicious cycle of poor forecast and non-improving operational performance.

The delay in securing the risk-bearing capital from Lease Group also left the impression that even the shareholder had doubt over the viability of FMH and the reorganisation plan. This, as a result, caused confidence issue in Banks C and D which might have caused the delay in signing the standstill agreement, and the delay of which further impaired the level of confidence of Banks C and D to the company and the reorganisation plan.

Given the doubtful viability of the company attributed from the above, Banks C and D might have considered that there was no prospect of going concern and that FMH should be liquidated immediately, potentially under fire sale, to avoid further loss of realisable assets in a formal procedure.

Banks C and D might also have attempted to be opportunistic and exploited the circumstances to protect their positions. While working towards the signing of a standstill agreement and ultimately of a restructuring agreement, Banks C and D might have sought to obtain interim recovery or additional security to avoid further loss. They might have done so to improve their positions relative to other creditors and/or to obtain a more favourable position in the restructuring agreement.

As an advisor of the other two banks, the other two banks should be advised to continue to follow the principles set out in the *“Statement of Principles for a Global Approach to Multi-Creditor Workouts II”*. The First and Second Principles suggested that the creditors should be prepared to co-operate with each other and refrain from taking any enforcement action to reduce their exposure or improve their position relative to other creditors. The Fourth Principle further suggested that creditors are best served by co-ordinating their response to the debtor.

While the act of Banks C and D are understandable, it might have jeopardised any potentially successful restructuring agreement. The banks should work together to allow sufficient time to obtain information so that they could be fully informed with the financial circumstances and make assessment to the viability of the restructuring plan. In the meantime, they should not take actions which may prejudice others’ positions.

It would be advisable to Banks A and B to request meetings and discussions with Banks C and D to understand their concerns which might have caused by information asymmetry or imbalanced position. The importance of collaboration among the banks should be reinforced during the meetings. It should be agreed that any action should be taken jointly or with consensus. In the event that the concerns of Banks C and D could not be addressed, other mutual agreements could be further considered among the banks so as to maintain the overall status quo towards FMH (e.g. to explore the options for Banks A and B to buy 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)?*

During the workout process of Flow Management, the following principles of the *“Statement of Principles for a Global approach to Multi-Creditor Workouts II”* can be found.

First Principle

All relevant creditors should be prepared to co-operate with each other to give sufficient time (i.e. standstill period) to the debtor for information and for restructuring proposals to be formulated and assessed.

The process should ideally include all creditors whose co-operation is needed in order to make any attempted rescue or workout succeed. On the other hand, there usually be merit in limiting the number of participants to the minimum necessary to see that objective achieved. It is necessary first to identify the classes of creditors which need to be included in the process and then to decide which creditors in the affected classes are to be included. Given the banks’ large working capital financing portfolio, they should be included as relevant creditors. It is also beneficial to build long-term and mutually beneficial advantages even if the banks are less exposed. Given the relative influence of the clients and the staff that could be exerted on Flow Management, it would not be advisable to include them as they would not enable the rescue to progress.

On 16 November 2013, the banks were invited for a meeting. On 1 December 2013, the banks agreed to discuss the Flow Management’s situation which concluded among themselves “not to panic”, even though they were shocked by Flow Management’s situation. The banks further decided that action must be taken jointly and in a controlled manner. In January 2014, the banks also recognised that a joint approach from the banks was desired and that a standstill agreement must be signed.

The standstill commencement date is often the date on which the banks were first notified by Flow Management of a meeting called to allow Flow Management to explain its position to the banks (i.e. 16 November 2013) (“the **Standstill Commencement Date** ”).

Second Principle

All relevant creditors should agree to refrain from taking any steps to enforce their claims or to reduce their exposure but are entitled to expect that their position relevant to other creditors and each other will not be prejudiced.

In December 2013, the banks decided that legal action would not be taken against Flow Management. Although the banks had sufficient legal reason to terminate the credit agreements, this was not done. The agreement that any action must be taken jointly also an indicator that the banks’ position relative to each other would not be prejudiced but prepared to proceed on a co-ordinated basis.

It should be noted that the intention of Banks A and B to buy out Banks C and D (i.e. debt trading) did not infringe this principle. It will be discussed in the Seventh Principle.

Third Principle

The debtor should not take any action which might adversely affect the prospective return to relevant creditors as compared with the position at the Standstill Commencement Date.

Example of such prejudicial action would be offering security. On 31 October 2014, Flow Management agreed to provide EUR10 million of tax refunds as additional security. In some cases, the relevant creditors will insist that security be given for their collective benefit in return for their support.

Fourth Principle

The interests of relevant creditors are best served by co-ordinating their response to a debtor.

The banks announced they want to appoint a Chief Restructuring Officer in the board of FMH. Although this was not in the form of a co-ordination committee, it served as a co-ordinated approach to progress dialogue with Flow Management and to help manage the evaluation process and the standstill agreement.

Fifth Principle

The debtor should provide and allow relevant creditors and/or their professional advisers reasonable and timely access to all relevant information.

On 16 November 2013, the banks were invited for a meeting held in December 2013 when it was agreed that Flow Management must report the actual costs and turnover each month. In the meantime, an accounting firm was called in to investigate the procedures within Flow Management. Despite the constantly changing information, Flow Management did regularly provide relevant information in order to enable proper evaluation to be made of its financial position and restructuring proposal.

Sixth Principle

Proposals for resolving the financial difficulties of the debtor and arrangements between relevant creditors should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.

The contents of the financial restructuring agreement signed on 4 July 2015 reflected the relative positions of the financiers involved.

Seventh Principle

Information should be made available to all relevant creditors and should be treated as confidential.

It is preferred that all relevant creditors are provided with the same information and see all the proposals put by the debtor. There was no indication that the banks were provided with different information during the restructuring process of Flow Management.

Debt trading associated with the sensitivity that it can lead to an increase in the number of, and a change in the identity of, creditors. The consideration of such by Banks A and B to buy out Banks C and D did not create this issue as there would be no change in the identity but led to a decrease in the number of creditors. In the event that it creates sensitivity issue, the use of professional advisers and co-ordinating committees to progress negotiations with Flow Management and to receive and analyse confidential information relation to Flow Management may reduce the sensitivity associated with debt trading.

Eighth Principle

If additional funding is provided, the repayment of such additional funding should be accorded priority status.

In January 2015, the paid back of a total of EUR25 million to the providers of the additional working capital reflected the spirit of this principle.

**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?*

The spirit of the Statement of Principles is to facilitate rescues and workouts by laying guidelines and best practices on debtor, creditors and possible rescue proposal to ensure that, in summary, sufficient time is allowed for the debtor to provide information and propose plan to restructure the business; sufficient information is received by creditors to make fully informed decision and consider any proposed plan; any proposed plan reflects applicable law and the relative positions of creditors; and any return to creditors is not adversely affected or prejudiced.

In the event that the Statement of Principles is not adopted by creditors, the British Virgin Islands (“**BVI**”) lacks other possible “soft law” to reflect the spirit of the Statement of Principles. Given the asset-holding structure characteristics and creditor-friendly approach in the BVI, the insolvency and restructuring regime does not focus heavily on the rescue of distressed enterprises. That being said, some of the principles in the Statement of Principles are reflected in the statues of the pre-insolvency regimes under the British Virgin Islands Business Companies Act and Insolvency Act including the company creditors’ arrangement (“**CCA**”) and the schemes of arrangement (“**Scheme**”).

The CCA and the Scheme require that a proposal is submitted which the creditors will later vote to agree or disagree with. The involvement of an independent practitioner who reports on the proposal ensures that information in relation to the assets, liabilities, business and prospects be made available to the creditors. These requirements have reflected the spirit of the First, Fourth, Fifth and Seventh Principles of the Statement of Principles. Given they are statutory regimes, any proposal will comply with applicable law which also reflects, to a certain extent, the spirit of the Sixth Principle.

However, the statues have not reflected other principles, nor a guideline or practice note to explain how other principles can be achieved. For example, the absence of moratorium or guidelines on what constitutes an act of the debtor affecting prospective return. Further, the rights of the creditors or the terms of a debt can be varied in whole or in part under the CCA.

Such shortfall to reflect the principles in the Statement of Principles may be compensated by, for example, mutual agreements between the debtor, creditors and/or other stakeholders. In order to reflect the priority status of any additional funding provided, an agreement may be formed to govern the repayment of such funding, or a security may be given to the extent of additional funding provided.

As mentioned, the structure of the BVI’s corporation is usually of investment/asset-holding nature. In this regard, the restructuring target is usually at the subsidiary level within the corporation. An alternative to adopt the principles in the Statement of Principles is by way of “soft touch” provisional liquidation which gives the effect that the company remains under the control of the director to carry day to day operation while being protected against any enforcement actions by the creditors given its interim relief characteristic and the power to stay or restrain proceedings pursuant to section 174 of the Insolvency Act. The power and terms of a provisional liquidator appointment lies within the order made by the court for the purpose of maintaining and to the extent necessary to maintain *“the value of assets owned or managed by the company”* (sections 170 and 171 of the Insolvency Act).

Another cause to the often failed workout when some creditors did not observe the spirit of the Statement of Principles is due to the ipso facto clause which allows a party, usually supplier and/or creditor, to terminate agreement/contract upon the occurrence of an insolvency event. This has to a great extent hampered the ability of the debtor to restructure the business even if the business and the reorganisation plan are viable. Chances for any workout or restructuring will be enhanced should parties recognise the adverse impact and seek to remove or modify the ipso facto clause. The removal of such clause will not prejudice the creditors’ rights as there would be other options to protect creditors’ position, e.g. to seek to continue the services with cash on delivery term.

**Question 7**

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

The restructuring agreement as signed on the 4th of July 2015 (“the **RA**”) demonstrated the features of a pre-packaged sale (“**pre-pack**”), credit bidding and disposal of assets to connected parties. The effect of the RA was that:

* The operating subsidiaries (i.e. the assets of Flow Management Holding BV (“**FMH**”)) were transferred to the banks and a number of board members
* Part of the claims of the banks against FMH were extinguished
* FMH was then liquidated in an undisclosed manner

Pre-pack is a regime where restructuring plan is set prior to a company being liquidated. An independent practitioner is then appointed to ensure the creditors are repaid with the funds that they are owed through the pre-pack before the formal proceedings. In the RA, the operating subsidiaries were bundled in the newly formed company (i.e. Flow Management II BV (“**FMII**”)) in which the shares were transferred to the banks and a number of board members. Therefore, the banks and a number of board members became the new owners. In addition, FMII would not assume the liabilities of FMH so that it could have a new start.

FMH was then liquidated in an undisclosed manner where an independent practitioner would represent the interests of the creditors with the duties to monitor the pre-pack but not taking over the management of FMH. The role of the practitioner in this aspect was to ensure the pre-pack has gone through proper process (e.g. marketing, auction, etc.), report the marketing strategy, and disclose the main features of the pre-pack to the stakeholders.

The creditors against FMH included the banks only as all claims against FMH would be cancelled by the banks and Lease Group Holding. In any event, creditors would have the right to object against, or approve, the pre-pack.

A pre-pack arrangement benefits the stakeholders in various aspects. FMH had the opportunity to maximise the returns from selling the operating subsidiaries through a competitive bidding process (in which the practitioner would ensure that it was conducted properly). Any purchasers would have the chance to acquire the operating subsidiaries at a bargain price.

The consideration provided by the banks under the pre-pack would be the forgiveness of part of its working capital debt provided to FMH and whole of its other loans advanced to FMH. This cancellation of part of the debts owed by FMH to the banks featured a credit bidding characteristic. The banks were not restricted to making a cash bid for FMII but entitled to the option to bid the whole or part of the amount of debt owed by FMH to acquire FMII.

The pre-pack in this case also raised the concerns of disposal to connected parties as it included a transfer to a number of board members. Caution should be exercised to avoid disposal to the connected parties being made less than market value and/or to determine if more favourable terms could be secured from a third party. While in certain circumstances a disposal to connected parties is more favourable (e.g. when the asset would have no value to third parties in the absence of the management know-how or intelligence), it would, again, be the duties of the independent practitioner to ensure that the transfer was fair.

As a result of these arrangements, the viable operating subsidiaries could survive and started afresh whereas the exposure of the banks would be reduced.

**Question 8**

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

Cross-border issues arose when, for example, a corporation group structure involves companies incorporated in different jurisdictions whereas the holding company is incorporated in one jurisdiction as an investment holding company while the operating subsidiaries are incorporated in other jurisdictions of which the business is operated.

Flow Management Holding BV, being a privately held company, was part of an international group of companies based in the Netherlands and acted as the centre of main interest of six operating subsidiaries at home and abroad; all operating under local company laws. The entire company employed over 3.000 people and had more than 200,000 cars in its fleet. The restructuring (and also insolvency) process of which would involve dealing with assets and creditors and give rise to cross-border issues.

Model Law

The United Nations Commission on International Trade Law developed the Model Law in 1997 to promote the cooperation between the courts in different jurisdictions, greater legal certainty for trade and investment, fair and efficient administration of cross-border insolvencies, protection and maximisation of the value of assets, and the facilitation of the rescue of business. With this in mind, one would expect that cross-border issues in restructuring and insolvency process always surround these aspects where Flow Management would also face.

COMI

Given the multi-jurisdiction operations of Flow Management, the issues of the centre of main interest (“**COMI**”) and establishment would arise. The COMI and establishment govern what constitutes a foreign main proceeding or a foreign non-main proceeding. The distinguishment of which has serious implications as it affects how the foreign proceeding will take place in the local jurisdiction, the simplicity of the process and automatic trigger of certain provisions. For example, the mandator moratorium triggered by the recognition of the foreign main proceeding versus the discretionary relief of staying proceedings or suspending enforcement by application associated with the recognition of the foreign non-main proceeding.

The definition of COMI has been a long debate whereas some jurisdictions consider it to be the domicile of incorporation while others consider that the presence of assets or business tie to be the determining factor. Flow Management would experience greater effect given its two subsidiaries incorporated in Spain and France as the European Insolvency Regulation “*has in effect pretty much ignored the concept of multi-entity business groups and for its main goal of providing conflict of law rules for cross-border insolvency issues, focused on sing entities”[[3]](#footnote-3)*.

Assets and securities

Asset realisation, especially when it involves security interests and rights, would also be an issue. Treatment of security, including the registration, perfection, enforcement and realisation, is different in different jurisdictions. For example, security interest is enforceable during moratorium period in some jurisdictions in contrast to others. Further, there may be issue of competing interest. The issues surrounding the securities (pledges) on the assets established at the banks in the Flow Management matter might need to be carefully reviewed and assessed with consideration of the registration and perfection rules in different jurisdictions.

Investigations

One of the roles and functions of an insolvency or restructuring practitioner is to carry out investigations for the purpose of discovering assets, identifying antecedent transactions and determining the causes of failure of the business in order to maximise recoveries for the benefits of creditors.

In order to perform the duties, the practitioner needs to recover books and records from different parties, including the banks, accountants, auditors, legal advisors, etc. and if necessary, conducts public examination against officers of the company. However, the rules and the extent of the powers of the practitioner in different jurisdictions are not clear.

Flow Management Holding BV (“**FMH**”) was an investment holding company with operations pertained to the operating subsidiaries in other jurisdictions. In this regard, only limited information or records might be held with FMH. The majority of the books and records which could assist the investigation would be held in other jurisdictions where the practitioner would need to seek information from. The obligations for the local service providers in different jurisdictions may vary. The service providers in some jurisdictions provide such information to a foreign practitioner only with a recognition order (e.g. due to bank secrecy law in Switzerland) while others follow case laws which govern the rules and obligations for the service providers to assist foreign practitioner.

Another tool for a practitioner to maximise recoveries to creditors is through avoidance of antecedent transactions which are strictly governed by rules in different jurisdictions with highly technical avoidance provisions and actions. The details of which vary between jurisdictions including the choice of law, defences, disclosure and discovery tools and the commencement of recovery actions. For example, a transaction may be voided in a jurisdiction but not another. The provision of tax refund as security by Flow Management and the transfer of operating subsidiaries to number of board members might be subject to scrutinisation and capable of being recovered.

Litigation & claims

The issues of choice of jurisdictions and forums to pursue claims would also be expected in the case of Flow Management. While a contract/agreement usually include terms and clauses governing how parties of the contract should resolve disputes including the jurisdictions and forums, it is not usually the case when one party is subject to an insolvency proceeding. Since Flow Management operated its business in multiple jurisdictions, in the event that there was a dispute over creditor claims, the question of which court would have jurisdiction to resolve the dispute might arise. In essence, the following questions may arise:

* whether statutory insolvency claims can be pursued in a court other than the court with jurisdiction over the winding up?
* if not, whether a forum selection clause will be enforced when to do so will deprive the insolvent company of those statutory insolvency claims?
* if statutory insolvency claims can only be brought in the court with jurisdiction over the winding up, how will the court treat any related claims which are being pursued at the same time?[[4]](#footnote-4)

Others

The above has demonstrated cross-border issues which may arise in the Flow Management restructuring process in jurisdictions where the Model Law may come in play. The issues may be complicated in jurisdictions where the Model Law or the rule of recognition has not been adopted, e.g. in South Africa, one of the jurisdictions where Flow Management operated its business. Notwithstanding that the South African Parliament has assented to the Cross-Border Insolvency Act, no countries have been designated by the Minister of Justice to which the act would be applicable. Therefore, the act has no practical application yet. Should the practitioner of Flow Management wish to manage the affairs or deal with the assets, a separate fresh application in South Africa might be required.

**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? [you are allowed to give your opinion based on your own countries’ Bankruptcy Act; be as detailed as possible]*

Moratorium provision under the legislations of the British Virgin Islands is available under Individual Creditors’ Arrangement which applies to an individual only, and under the Administration regime pursuant to Part III of the Insolvency Act (“the **IA**”) though not yet in force.

Moratorium commences on the filing of an application for an administration order (subject to whether an administrative receiver of the company is in office). Such application may be made by the company or the board of the company. The Court may make an administration order in respect of a company if it is satisfied that the company is or is likely to become insolvent and it considers that there is a reasonable prospect that the making of the order will achieve one or more purposes as follows:

* The rehabilitation of the company
* The survival of all or any part of the company’s undertaking as a going concern
* A better return for the company’s creditors than would result from an immediate liquidation
* The approval of a Company Creditors’ Arrangement
* To facilitate an application, or the provision of cooperation, under Cross-border Insolvency provisions or Orders in Aid of Foreign Proceedings

Given the circumstances of Flow Management, it would be entitled to make an application for an administration order to trigger the moratorium provision.

The effect of the moratorium, pursuant to section 84 of the IA, is that, except with the leave of the Court or the consent of the administrator:

* No order may be made and no resolution may be passed for the appointment of a liquidator
* No steps may be taken to enforce any security interest over the company’s assets
* No steps may be taken to repossess assets that are being used or occupied by or are in the possession of the company
* No proceedings, execution or other legal process may be commenced or continued or distress levied against the company or its assets
* No share may be transferred and no alteration may be made in the status of the members of the company
* No resolution of the members may be passed

However, the moratorium provision does not have effect on enforcement or repossession commenced before the commencement of the moratorium period.

In this regard, the application of Flow Management for the administration order would have the effect of preventing creditors from appointing liquidator, secured creditors from enforcing security interest and repossessing assets, and anyone from commencing or continuing legal proceedings. Nonetheless, the Court may still appoint liquidator if it is of the opinion that it is in the public interest for a liquidator to be appointed.

On the other hand, the moratorium provision would also bar Flow Management from disposing of or otherwise dealing with any assets subject to a charge, assets subject to a floating charge otherwise than in the ordinary course of business, or assets in the company’s use, occupation or possession of which another person is the owner or lessor.

On the making of the administration order, the administrator shall take into his or her custody the assets to which the company is or appears to be entitled, and shall manage the business, assets and affairs of the company. The directors and other officers of the company remain in office and their powers, functions and duties continue except to the extent that they are inconsistent with the powers, functions and duties of the administrator.

The possible reasons that Flow Management might make an application for an administration order in order to call for a moratorium in October 2014 may include:

* To prevent creditors, in particular Banks C and D, from making application to appoint liquidator or enforcing their security.
* To prevent any repossession of leased or hired purchased assets, e.g. leased vehicles or real estates.
* To prevent any other legal proceedings from being commenced or proceeded with by other stakeholders against Flow Management.

However, the “by-product” of the moratorium under the BVI legislations is that an independent administrator is appointed to take control of the assets and manage the affairs of Flow Management, even though the powers of the management of Flow Management remain. Further, no shares may be transferred, no alteration can be made to the status of the members and no members’ resolutions can be passed, without the leave of the Court or the consent of the administrator.

Such by-product would affect the control of the management over the business and assets of Flow Management and the flexibility to propose a reorganisation plan which terms include the transfer of shares and disposal of assets which might subject to a charge. Even though such reorganisation might still be proposed and/or effectuated, it would not be done without extra time and costs.

In this regard, it would appear that calling for moratorium in October 2014 would impose unnecessary limitations, reduce flexibility and impair effective control of the management and Flow Management throughout the reorganisation/workout which would have been the original main features and benefits of undertaking the turnaround process.

Furthermore, the moratorium provisions offered in the administration, being to prevent the creditors and the banks from taking enforcement actions or appointing liquidator, would be of no significant merits to Flow Management in October 2014 as:

* the banks, although not happy with the constantly changing information given by Flow Management, were content about the new management
* the banks noticed a slight result improvement due to the reorganisation
* a 120-day standstill agreement was signed in the middle of August 2014 which would allow sufficient time for Flow Management to formulate a restructuring plan
* the banks were convinced that a going concern was a better option

Accordingly, the banks were not prepared to initiate appointment of liquidator nor take enforcement action. Therefore, the moratorium would not offer extra protection to Flow Management given the circumstances in October 2014.

To conclude, calling for a moratorium in October 2014 was not a good option given the situation at that time.

1. S C Gilson, “Creating Corporate Value through Corporate Restructuring”, p 7. [↑](#footnote-ref-1)
2. S C Gilson & et al., “Troubled Debt Restructurings: An Empirical Study of Private Reorganisation of Firms in Default”, p 345. [↑](#footnote-ref-2)
3. R v d Sigtenhorst, “Finding COMI in Group Insolvencies: Taking a Page from the Chapter 15 Playbook”, p 3. [↑](#footnote-ref-3)
4. J D Kars & et al., “When ‘Where’ Matters: Anchoring Jurisdiction in Insolvency”, p 1. [↑](#footnote-ref-4)