Global Insolvency Practice Course 2023 – Take home case study module A

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1. **Question 1**
2. **My opinion on the causes of financial distress at Flow Management group**

According to the Mellahi & Wilkinson, 2004, there are two viewpoints to analyze what factors may cause organizational failures: the deterministic view and the voluntaristic view.

The deterministic view arises from industrial organization (IO) and organization ecology (OE) and the situation in the industry matters more than how the organization made decisions. On the contrary, the voluntaristic view derives from the organization studies (OS) and organizational psychology (OP), which focus more on how firms operate the management.

From the deterministic view, there are several factors that affect how long an organization sustain itself, such as technological uncertainty, regulatory changes, demographic changes, economic changes, population density in industry, industry life cycle, age of firms, size of firms.

From the voluntaristic view, the elements are top management tenure, top management homogeneity, management successions, and past performance as organizational factors, and managerial perceptions (managerial cognitions) as psychological factors.

The facts below in this case study are applicable to the factors above causing organizational distresses.

First, the first loss which was discovered in November 2013 resulted from several accounting errors, including the following.

* A contingency gain relating to three years has been received in 2012 and has been wrongfully booked as a result in 2012. A negative correction of € 1.6 million must be made.
* The book profit anticipated to be realized was neither realized in 2012 and 2013.

The reason why these accounting faults occurred is unclear, but at least there appears an organizational problem(s) in perceiving the financial situation correctly in the firm.

Second, the one below also seems related to accounting, but that could be because there was no regular check system or personnels that can detect mistakes in the cost price calculation.

* Because of a formula error in a spreadsheet, they failed to periodically check the real costs against the results of the cost price calculation, the prices charged were too low, resulting in a loss, which was found in November 2013.

Third, contracts regarding securities were not properly reviewed from the legal standpoint, since it was realized in December 2013 that the proceeds would be substantially lower (or even zero) in the event of liquidation.

According to the Mellahi & Wilkinson, research suggests from OS/OP perspective that the longer tenured top management is likely to be associated with increased rigidity and commitment to standardized practices, a reduction in information processing over time, reliance on increasingly narrow and restricted sources information.

In this case, based on the three facts listed above, the company probably lacked the processes necessary to examine or identify its financial positions, errors, and legal issues. The specifics of this situation needs to be investigated, but it’s possible that the longer tenured top management it to blame because the corporation relies on the routine check of accounting and compliance and has not updated its system to catch significant errors. This led faults in loss anticipation.

On the other hand, we could not see any problems with the debtor’s standing in the market, taking into account the ensuing facts.

* There is market demand and the forecast for so-called “hiring and leasing days” are consistent with reality as of November 2013.
* In December 2013, a recently hired independent turnaround consultancy agency concludes that the company is viable, with a view to the market share and achieving the estimated turnovers.
* In reality as well, in February 2014, a profit forecast of € 9-10 million for the Dutch subsidiary with a turnover of € 200-250 million, which is an increase compared to earlier expectation.

In addition to that, Flow Management Holding BV operates six other companies both domestically and internationally, and the overall organization employs over 3,000 people. This indicates that the company is already mature as a large size company and can be considered enduring.

According to the Mellahi & Wilkinson, the external environments affect the length of organizations. For example, Industry Life Cycle approach suggests that “failure results from demand saturation, supply running out or a new technology that promises more value.” Furthermore, it is said “high mortality risk facing new ventures relative to their more mature counterparts, several studies have examined the relationship between age and failure of new ventures and found that most organizations die young.”

However, in this instance, as was already said, the market demand and the company’s market share are strong, therefore the state of the industry as a whole is not the root of financial difficulties. Moreover, the size and the duration of this business promote its overall stability. As a result, these external influences are not regarded as the origins of the financial distress.

Adriaanse & Kuijl, 2006 from the reading materials, also supports this as a general view by suggesting that “the popular belief to the contrary notwithstanding economic circumstances are often not the (major) cause of the problem, at least in The Netherlands.”

1. **Whether the financial distress could have been prevented, if yes how**

In my opinion, the financial distress could have been prevented in the following ways.

First, as was noted in 1) above, the company's accounting and bookkeeping functions were improperly managed. The business ought to have updated the accounting and legal management to prevent this. I concur with the Banks' assertion from December 2013 that the shareholder company's board must take action with regard to management, especially the CFO. The shift in management in this organization was successful, as evidenced by the fact that the results of the restructuring emerged following the appointment of the Chief Restructuring Officer. The assertion that succession boosted growth rates and financial returns is backed by Mellahi & Wilkinson's description as well.

Second, and related to the first, it should have upgraded the management information system earlier to make the figures more trustworthy.

Third, although it only pertains to a tiny fraction, the corporation should have been entitled to compensation for the € 3 million in management bonuses that were improperly awarded because they constituted an internal payment to the management team.

1. **Question 2**
2. **General advantages of an out-of-court restructuring (workout)**

**Private (= maintain going-concern value):** Out-of-court workout could be processed in a private way typically with only financial creditors (particularly banks), not trade creditors, unless the case falls into an exception where the process must be disclosed to the public such that a debtor is a publicly traded company. Conversely, court procedures are public in general. This benefits debtors a lot to preserve more going-concern value, whereas an announcement of in-court insolvency proceedings causes a huge concern or harmful rumors in a debtor’s distressed situation among its creditors and its customers and may make them terminate even existing transactions with the debtor or change terms and conditions to unbeneficial to the debtor. The more going-concern value can be kept in workouts, the more assets can be distributed in the restructuring. Consequently, it also benefits financial creditors eventually.

**Simpler/Less complex:** The workout is simpler and can be flexible as the process is based on the unanimous approval and consent of creditors. Nether judges nor trustees need be appointed to start an informal reorganization. On the contrary, the court proceedings require various individual processes under the law such as investigation of claims, the submission of documents to the court and notices to creditors. This is to guarantee due process, in other words, to legitimate the procedure which forces the claims to be discharged based on a restructuring plan with the majority votes. Furthermore, as the court or/and a trustee have to be involved in the in-court proceeding, the process would be more complex than the workout.

**Faster resolution:** Due to the above-mentioned simpler approach, typically, out-of-court restructurings often take less time than 1 year, such as half a year to 10 months, while in-court proceedings may take longer to complete. It implies a debtor firm can successfully restart its business sooner following the restructuring.

**Less costly:** Another effect of simpler process stated above is that, in general, out-of-court processes are far less expensive than the court proceedings, which necessitate court-related expenses such as the deposit or the trustee’s fee. Attorney’s fee also typically tends to run higher in court proceedings.

1. **General disadvantages of an out-of-court restructuring (workout)**

**Less due-process:** As stated above, the main base of out-of-court process is unanimity of all interested creditors (not legally binding without the consent), while a court proceeding conforms to the legal provisions. This flexibility reduces transparency of the process, whereas court procedures call for more disclosure on the claims and debtor’s financial status. Since the court is not overseeing the workout, creditors question the fairness of the process and equal treatment among the creditors especially on repayment under a restructuring plan. Practically, transparency and fairness are one of the key components when banks participate in the workout and approve a restructuring plan in the out-of-court process.

**Need of unanimous approval:** As repeatedly mentioned, a unanimous consent by all the creditors is required to bind the creditors by the restructuring plan, unless the country adopts a majority voting rule for out-of-court workout. In contrast to a court restructuring, where a restructuring plan would be authorized with vote, it is therefore harder to get an approved restructuring plan in a workout.

**No standstill to trade creditors:** A standstill during the workout could prevent finance creditors from collecting loan principal. Trade creditors, however, normally do not participate in the workout, as was already mentioned. Therefore, if a debtor is experiencing urgent problems with its ability to pay its commercial creditors, it might not be able to survive until the completion of the workout and will likely need to move into the court proceeding which can stop its repayment to the creditors, such as an automatic stay under Chapter 11 of the US Bankruptcy Code.

1. **Advantages versus disadvantages especially in Japan**

In general, the pros and cons listed in 1) and 2) also apply to workouts in my country, Japan. When I would point out some characteristics in Japanese workouts different from general out-of-court restructurings, there are several types of rule-based out-of-court workouts which must follow certain rules, guidelines or even laws. The first two of the following procedures are primarily employed in Japan, and the third one was installed last year. All are designed to standardize a workout process and help facilitate the negotiations between a distressed debtor and its creditors.

* **Turnaround ADR (Alternative Dispute Resolution)**

The procedure was established under the present Act on Strengthening Industrial Competitiveness. The process is supervised by experts (usually attorneys) who are selected as “operators” by the Japanese Association of Turnaround Professionals (“JATP”), which is a private organization but certified under the Act on Promotion of Use of Alternative Dispute Resolution. These operators would preside over the process and review a proposed restructuring plan. It mainly targets large to medium-sized companies due to its higher procedure fees than the latter, the Councils scheme.

* **The Councils Scheme**

Small and Medium Enterprises Vitalization Councils, a public institution, support the process and organize “the review committee” to assign the examination of a proposed restructuring plan from the objective standpoint. This framework has been used rather by smaller or mid-sized enterprises.

* **Rehabilitation-type out-of-court workout for Small and Medium Enterprises**

This type of workout was newly adopted in 2022 under the Guidelines for Restructuring of Small and Medium Enterprises (“SME Restructuring Guidelines”). A distressed debtor which would like to use the scheme will appoint third-party supporting experts such as lawyers from the public list of accredited experts, with the consent of major creditors, to examine whether a proposed restructuring plan is fair. This scheme focuses on smaller or mid-sized enterprises. The difference between the first two and the third is that debtors may/have to choose the third-party experts.

Each type of workouts has common steps (i) multiple creditor meetings would be held for discussion on restructuring and in the interim, debtors draft a restructuring plan and (ii) parties aim at the unanimous approval in favor of a restructuring plan in the end.

These types of workouts preserve the benefits of out-of-court proceedings while overcoming their general drawbacks. Some instances are the enumerated below points.

**More transparent and foreseeable:** The guidelines and the rules for the procedures stipulate the steps to be taken during the workout. They were formed by the representatives from financial institutions and experts, and academics. Though they are not legally binding, they should be respected and followed by parties engaging in a workout. This improves the transparency and foreseeability of the process to the parties.

**Fairer/More equal:** In addition to conforming to the rules, as neutral experts would review the proceedings and a restructuring plan, the process can be more objective than when only a debtor and its concerned creditors handle a workout.

**Tax benefits for creditors:** Creditors are permitted to include the amount in deductible expenses for tax reasons if they waive their claims based on a restructuring plan in compliance with the requirements of the three rule-based workouts. This is done to provide creditors in out-of-court workouts with the same advantage as court proceedings.

**Protection for the management (guarantor) for the next step:** In Japan, there is a system wheremanagements such as directors can be protected such that they don’t have to file a bankruptcy for the personal liability of guarantee against the corporate’s creditors and can maintain its real estate to live in or other incentive assets if they comply with the requirements. It can be used even when a firm files the court procedure, but it tends to be easier to be approved by creditors in a workout process, if the corporate restructuring plan is consented unanimously. It serves to safeguard the management, especially if they have a lesser share of blame for the insolvency, and to encourage the making of restructuring decisions more quickly.

**Still less costly than court procedures:** Although these rule-based out-of-court workouts need third parties to be involved, the costs are still less expensive than in-court processes.

**Remain listed:** As for the cases of listed companies, Turnaround ADR workout does not trigger delisting unlike the court restructuring procedures.

1. **Question 3**
2. **Business and Financial Restructuring presented in Adriaanse & Kuijl, 2006**

Adriaanse & Kuijl, 2006 offers some specific effective measures of informal reorganization in (i) each stage of business restructuring and (ii) financial restructuring. Some of them are adopted in this case study as shown below.

1. **Business restructuring**

Business restructuring is defined as “a comprehensive plan the aim of which is to restore the (operational) profitability of a company in financial difficulties.”

* **Phase 1: Stabilizing**

This phase focuses on increasing the cash flow relatively in the short term. Actions are exemplified as cutbacks in expenditure, asset stripping and optimizing of spontaneous financing.

In this instance, in December 2013, extra savings would be realized through improved loss recovery, higher excess premiums and savings on car repairs. Some of them are related to cutbacks in expenditure.

Regarding asset stripping, in November 2013, CFO of the shareholder company proposed to sell 350 cars to improve the solvency rate, though the banks preferred an actual equity injunction.

As for optimizing of spontaneous financing, in June 2014, the postponement of repayment and refinancing was proposed.

These intentions or actions are in line with examples in the stabilizing phrase.

* **Phase 2: Analyzing**

In this phrase, a well-founded reorganization plan should be drawn up with measures to restore long-term profitability. The measures should be, for example, cutting overhead cost, dismissing excessive personnel, improving management information systems, improving working capital and cash flow management, and selling operations which are not part of the core activities. To draw up a plan, a distress company should hire or consult individuals with expertise in carrying out turnaround processes.

In this case, numerous times saw the creation of restructuring plans or the signing of agreements, which shareholders and financiers jointly assessed.

As for the measures in the plan, it was intended to reduce spending with regard to labor costs in particular in November 2013. In December 2013, the plan was designed to dismiss 130 redundant employees and independent contractors. In December 2013, it was expected that the management information system would have been improved so that the figures would be more reliable. In June 2014, a plan on the working capital financing was drafted. Furthermore, at the end of March 2014, a proposal was developed that stated that the shares of the firms outside the Benelux-countries (not a main subsidiary) would be sold off.

Furthermore, an independent turnaround consultancy agency was hired through these plannings.

According to these circumstances, this case likewise through an analyzing phase.

* **Phase 3: Repositioning**

At the phrase 3, the management needs to initiate the reorganization as outlined in the plans. In this instance, it's not obvious whether all the actions were taken as intended; however, some of them might be performed in light of the latest developments.

* **Phase 4: Reinforcement**

At the phase 4, it is examined whether an existing management can run the company in the future.

In this case study, a CEO of Flow Management Holding BV was replaced and a new CFO and a CRO (‘Chief Restructuring Officer’) was appointed during the reorganization. Eventually, a debt equity swap was conducted, and the management was partly replaced by the Banks according to the Restructuring agreement on 4 July 2015.

1. **Financing restructuring**

Financial restructuring is divided into two ways. One is for the pertinent creditors to voluntarily agree to new terms with regard to the funding they made available. The second is that lenders of debt and/or equity make new funds accessible.

Regarding this case study, while the postponement or default interest being no longer charged were proposed in June 2014 but probably not performed, the debt equity swap (converting debt into equity) was intended in the Restructuring agreement on 4 July 2015. The debt equity swap will be explained more thoroughly in the answer to Question 7.

1. **Corporate Turnaround Strategies presented in Sudarsanam, S, Lai, J., 2001**

Sudarsanam, S, Lai, J., 2001 argues some corporate turnaround strategies. This case study embraced some of the strategies as below. Most facts are overlapped with 1) above, so the explanation below will be simplified.

1. **Managerial restructuring**

To improve the firm’s performance, top management change is widely accepted.

In this case as well, a CEO, a CFO and a CRO were replaced/appointed as mentioned above. As a result, some developments were recognized in early August 2014.

1. **Operational restructuring**

One of the operational strategies is to pursue stringent cost and operating-asset reductions at the efficiency/operating turnaround stage in order to stabilize operations and restore profitability.

As was already indicated, the debtor in this case study sought the savings by cost expenditures and the asset reduction such as selling cars.

1. **Asset restructuring**

For asset restructuring, there are asset divestment and asset investment.

In this case, the sales of the shares of the companies outside the Benelux-countries was planned (but not performed), which can be asset divestment.

1. **Financial restructuring**

Two types of strategies are shown, equity-based strategy as equity issues and debt-based strategies such as interest or principal reduced; maturity extended; debt-equity swap.

In this case, equity injection by the shareholder was proposed by the Banks many times. Moreover, interest being not charged, and maturity extended were planned, and in the Restructuring agreement in July 2015, debt-equity swap was agreed as stated above.

1. **Retrenchment and Recovery as a Duality presented in Schmitt, A., Taisch, S., 2013**

Schmitt, A., Taisch, S., 2013, suggests that retrenchment and recovery, which look contradictory forces, should be interrelated and may have to be integrated in distressed turnaround situations to complement each other. Recovery focuses on strengthening a firm's position in the market through strategic change, whereas retrenchment focuses on boosting efficiency through cost and asset reductions.

With regard to this case, a retrenchment strategy was considered by cost and assets reductions as already mentioned above. Contrary, the debtor had not adopted recovery such as product launch, market entry, acquisitions, and structural change. Indeed, the company did increase the prices of the products, but it stemmed from the prior wrong calculation, so that was not the active market strategy.

However, in my opinion, it was correct decision that the active recovery plans were not conducted in this case. It is because the market demand and share were not the debtor’s concerns as answered to Question 1 and the market strategy was not a cause of the distress. Contrary, it was suffering from the imminent liquidity shortage at the end of June 2014, and they should prioritize stabilizing its cash flow as they actually did rather than promoting the sales and its position in the market.

1. **Stakeholder Influences in Organizational Survive presented in Pajunen, 2006**

Pajunen, 2006 identifies influential stakeholders and analyzes some propositions on the relationship between stakeholder management and organizational survival.

The stakeholders of this case reorganization are mainly the creditors (Banks), the management of the shareholder company and its shareholder.

In my view, the propositions below were seen in this case study.

* **Proposition 1:** **The more secure the continuing support of governing stakeholders in an existence-threatening crisis, the more probable is organizational survival.**

It might look difficult to find who are the most governing stakeholders in this case but since the debtor had the imminent liquidity shortage at a point, the Banks have governing power by deciding whether the credit agreement should be terminated, or postponement of repayment should be accepted. In this case, the Banks are overall supportive with the financial restructuring by planning reorganization jointly, though they demanded the shareholder contribute more equity. Without the Banks support, the restructuring agreement should not have been signed.

* **Proposition 2:** **In an existence-threatening crisis, frequent and open communication between managers and governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.**

At first, the Banks were not satisfied with the communication and the provision of the information by the distressed company. However, as it was gradually getting improved and the Banks could trust the developments, the Restructuring agreement could be signed in July 2015.

However, the situations in two propositions below appeared challenging to achieve in this case.

* **Proposition 3: In an existence-threatening crisis, personal relationship between managers and governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.**
* **Proposition 4: In an existence-threatening crisis, management’s unlocked brokerage position between governing stakeholders will tend to enhance (rather than undermine) the continuing support of those stakeholders and increase (rather than decrease) the probability of organizational survival.**

The management, representing the shareholder company, was asked at times by the Banks to inject the contribution of equity, but they had not accepted it for a long time. Afterwards, a CEO, a CFO and a CRO were newly appointed. This conflict between the past management and the creditors made it difficult for the management to build personal relationship with Banks and to behave neutrally in the distress situation.

1. **Question 4**
2. **The reasons why Banks C and D frustrated the process**

Mid-February 2014, Banks C and D got all of sudden not cooperating with the process and it became clear that the process to come to a standstill agreement passed off with difficulty. It appeared that Banks C and D would not like to move forward the standstill agreement.

To analyze the facts regarding Banks C and D, the difference between Banks A and B group and Banks C and D group is that Banks C and D provided Flow Management Work BV with the additional working capital of € 35 million. This was reduced to € 32.5 million after a total of € 25 million was paid back to the providers of the (additional) working capital in January 2015. In other words, only € 2.5 million was repaid to the claim of the additional working capital at that time.

This claim of additional working capital is not secured or is subordinated security rights so Banks C and D will receive nothing from their claims of this additional working capital on liquidation. This is because the providers of the original working capital (the consortium of banks A, B, C and D) possess pledges on most assts of Flow Management Work BV. The amount of the original working capital was originally €360, €240 after performing the Restructuring agreement as of 4 July 2015.

The amount of € 35 million of additional working capital was supposed to be paid back at the end of 2013. In December 2013, Banks were of the opinion that the shareholder must be put under pressure to raise €35 million in order to repay “part of the debts, originally planned on 31 December 2013,” which refers to this financing of additional working capital. However, it had not been paid as of mid-February 2014. It implicates that Banks C and D were frustrated with the fact that this € 35 had not been repaid.

At the end of March 2014, no standstill agreement has been signed yet. The main reason is the banks’ general lack of confidence in the Flow Management company, considering the developments of the past six months although most specifically felt by the bankers of C and D.

At the end of June 2014, when a liquidity shortage was imminent, Banks C and D threatened to cancel the credit. Somehow this gave off a signal to the company to hurry up and the shareholder was subsequently willing to deposit € 10 million in the short term and to contribute the remaining € 25 million in September/October 2014, conditioning that it was truly needed and that a standstill agreement would be signed. The 120-day standstill agreement was subsequently signed in the middle of August 2014, but it seems that the shareholder did not contribute € 35 million eventually, and as mentioned above, only € 2.5 million out of € the total 25 million was repaid to the claim of the additional working capital on the payment in January 2015.

The details of the standstill agreement are not made explicit in the description of this case study, but standstill agreements in general provide that creditors agree to defer repayment and secured creditors agree not to enforce their securities.

Based on the aforementioned facts, the reason why Banks C and D frustrated the process appears because as Banks C and D desired to be paid as much as possible before the standstill agreement was entered into and the repayment would be suspended for a while as they anticipate they will not be able to receive anything for the additional working capital upon liquidation and they might guess they have no effects whatsoever about the additional working capital even though the consortium of banks (A, B, C and D) would enforce their pledges.

1. **What an advisor of the other two banks (Banks A and B) would have done**

As stated in the case description, with increased discord among the two groups of banks, the cooperation from the company could be jeopardized and the liquidation draws nearer.

Bankruptcy of the company will negatively affect the proceeds of the assets. Moreover, the proceeds will be substantially lower (or even zero) in the event of liquidation according to the banks’ legal opinion on the contracts, which establish the securities (pledges) on the assets for the banks. It is unsure that this legal opinion was solved, but if they still have that issue, the amount of the repayment to the secured creditors from the company’s assets would be reduced upon liquidation.

As Banks C and D are also members of the consortium, a secured creditor for the original working capital, it is beneficial to even Banks C and D to maintain the value of the proceeds as their securities and increase more repayment under a restructuring plan by avoiding the liquidation and providing time during a standstill to consider a restructuring plan with cooperation. Also generally speaking, “each creditor for itself” approach is likely to end up in the debtor being forced into formal insolvency, as mentioned in the commentary of the First Principle in “Statement of Principles II.”

If bankruptcy of the company happens, Banks C and D cannot collect from the additional working capital in any case, so they should aim at how to increase the amount repaid as a secured creditor.

An advisor of the other two banks should explain to Banks A and B about the merits of cooperation among all the four banks like above, so that they could convince Banks C and D in cooperating to the restructuring of the company, avoiding liquidation.

Apart from this, for Banks A and B, a phenomenon might arise where they make concessions to Banks C and D who are reluctant to agree to standstill and try to somehow put together a restructuring plan in the direction of increasing their own bank's burden and reducing the amount of reduction for Banks C and D, like Banks A and B investigated whether it would be possible to buy out Banks C and D with a 15%-20% discount at the end of March 2014. This phenomenon sometimes happens practically in Japan. However, it should be advised that Banks A and B prevent this because if such a situation continues, more main banks will be forced to make concessions, and informal restructurings may be discouraged in the future.

1. **Question 5 (which of the INSOL 8 Principles are found explicitly or implicitly)**
2. **First principle is found**

In January 2014, the banks conclude that the company’s management and the shareholder constructively work together on a solution, and they also realize that a joint approach from the banks is desired and that a standstill agreement must soon be signed by the banks in order to achieve this. The expectation is that management and the shareholder will not formally commit themselves until banks act as one party.

Though Banks C and D had been unwilling to agree to a standstill agreement due to their situations mentioned in Question 4 since mid-February 2014, the 120-day standstill agreement was signed in the middle of August 2014 in the end. During this 120 days, four scenarios had been drawn up in October 2014. After the 120 days, a Restructuring agreement was also signed in July 2015.

Accordingly, at first, there was difficulty that all relevant creditors cooperate with each other to give a standstill period to the debtor. However, the standstill was agreed eventually for information to be obtained and evaluated for restructuring plans to be designed, which conforms to the First principle.

1. **Second principle is partly found**

In this case, as of 31 October 2014, which was during the 120 days of the standstill, it was said that the company would provide € 10 million of tax refund as additional security. In January 2015, a total of € 25 million is paid back to the providers of the (additional) working capital. These actions might not be triggered by the banks’ demand and the latter was after the standstill period, but the banks could be considered to have tried to collect or enforce its claim to the company during the standstill. Then, it is doubtful that all the relevant creditors agreed to refrain from taking any steps to enforce their claims to reduce their exposure to the debtor, which the Second principle requires.

Regarding conflicts of interest in the creditor group from the Second principle, the Restructuring agreement after the 120 days of the standstill reflects the relative positions of the financiers involved. During the 120 days of the standstill, four scenarios of a going concern, selling the company, a debt equity swap and a moratorium were drawn up. Even during the standstill, the banks seemed at least trying to identify including the different positions among the banks to figure out which scenario fit this case. Therefore, the Second principle was applied in this point.

1. **Third principle is found**

No facts are found that the debtor took any action which might adversely affect the prospective return to relevant creditors during the standstill as compared with the position at the standstill commencement. In October 2014, the sale of surplus assets was done or planned. These assets are not essential to the business but surplus ones and the sale is to make the cash flow stable, so this sale is not planned to adversely affect the return to the creditors.

In addition, the provision of information by the company had improved as of 31 October 2014.

Consequently, the case is applicable to the Third principle as well.

1. **Fourth principle might be partially found**

All the four banks coordinated the restructuring, and no facts are indicated that one or more representative co-ordination committees was selected. However, professional advisers might be appointed, considering that a study was held into the possibilities of a Debt equity swap and that the role of the current shareholder was scrutinized in October 2014. Even if so, it is unclear that these advisers assisted the relevant creditors in the process as a whole or partly, more than just investigation. Therefore, the Fourth principle was not seen in this case.

1. **Fifth principle is almost found**

Until early August 2014, the banks had not been satisfied with the constantly changing information given by the company as it was constantly changing. However, after the standstill started, the provision of information improved when the banks concluded the main strategy of a going concern. It indicates the Fifth principle almost found.

1. **Sixth principle is found**

At least, the Restructuring agreement as of 4 July 2015 reflect the relative positions of the financiers involved, taking into consideration the amount of the repayment to each creditor on liquidation according to the bankruptcy law. Four scenarios in October 2014 were also reviewed with consideration of the relevant laws, especially from the viewpoint on how each option can be feasible under the laws, as the Sixth principle requires.

1. **Seventh principle is found**

No facts are found that are contrary to this Seventh principle, such as unequal disclosure by the company to some creditors or unjust disclosure of confidential information by the creditors.

1. **Eighth principle is not found because it is unrelated**

Additional funding was not provided during the standstill, so the Eighth principle looks unrelated to this case.

1. **Question 6**

As answered above to Question 2, in Japan, the out-of-court proceedings based on soft laws have been used for informal restructuring. The origin of these rule-based workouts is the “Guidelines for Out-of-Court Workouts”, which was prepared based on the INSOL 8 Principles. In these workouts, basically debtors request that creditors involved agree to a standstill which refrains the creditors involved from collecting the repayment of loan principles, which is similar to the INSOL 8 Principles.

Therefore, if some creditors don’t agree to adopt the INSOL 8 Principles or an arrangement based on it, we can suggest that we use one of the rule-based out-of-court processes instead. The outline in what way these are processed is as explained in the answer to Question 2.

If these creditors still don’t agree to a standstill even in the rule-based workouts, the workout process is not able to go forward especially in Turnaround ADR and Rehabilitation type out-of-court workout for SME. Practically, in some cases, one or more creditors involved don’t agree to a proposed restructuring plan. In some countries such as the UK, there are majority voting systems to approve a restructuring plan even in out-of-court processes. However, no system like that has not been adopted yet in Japan, though we are currently under consideration.

1. **Question 7 (The essence and result of the restructuring agreement of 4/7/2015)**
2. **Overall strategy and goal of the restructuring agreement**

Debt reductionという言葉を使う

To see what happened around the restructuring agreement, first, around 31 October 2014, as a result of the sale of surplus assets, sufficient incoming cash flows were expected so that additional deposits seemed unnecessary. And based on recent developments, the banks concluded that a going concern situation seemed to be the best one. A study was held into the possibilities of a Debt equity swap and what role of the current shareholder would be in that case. As a result of the restructuring agreement was signed on 4 July 2015, the foundation was laid for selling the company (Flow Management II) in a going concern situation.

Based on the facts above, it seems that after four scenarios had been drawn up in October 2014, the company and the banks determined that they could still choose a going concern option, taking into account the most recent developments on its cash flow since the end of June 2014. It appears, though, that the company still needed to reduce the debt to continue the business and sell its business to another. Consequently, they aimed to perform a restructuring plan with reorganization and the debt reduction against the banks and among the group companies, followed by the sale of the company in a going concern situation.

According to the analysis below, the restructuring agreement outlined a plan for reorganizing the company's debt with the transfer of part ownership to the creditors.

1. **Transfer** **operating companies to a new company**

All operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV. This arrangement, which can be thought of as a share transfer, goes as follows: (i) Flow Management II BV is first established, (ii) at the same time, the shares of all operating companies of Flow Management Holding BV are transferred to Flow Management II BV in exchange for the shares of Flow Management II BV, and (iii) Flow Management Holding BV then becomes the shareholder of Flow Management II BV. In order to make it simple to exchange the shares of the new company, attached with all of the operating companies, between Flow Management Holding BV and the Banks as seen in step 3), all of the operating companies' shares are put into a single new company. The old holding company will then be liquidated.

1. **Debt Equity Swap to cut financing debts of a main operating company**

The shares in Flow Management II BV are transferred to the consortium of banks (A, B, C, and D) which has financed the original working capital of Flow Management Work BV, as well as to a number of board members including the CRO.

At the same time, the creditors agreed to waive some amounts of their claims as below. The waived amounts reflect the relative positions of the financiers involved, secured or unsecured.

* The consortium of banks waives an amount of € 97.5 million out of its outstanding € 337.5 million for the original working capital of Flow Management Work BV, after the partial repayment of € 22.5 million in January 2015.
* Banks C and D waive an amount of € 32.5 million, which is full of outstanding amount for the additional working capital of Flow Management Work BV, after the partial repayment of € 2.5 million in January 2015.
* The full amount of € 55 million loan in Flow Management Work BV is cancelled.
* All the claims against Flow Management Holding BV of the banks and the shareholder are cancelled.

This is a debt equity swap, in which creditors agree to cancel a part or all of a company’s outstanding debts in exchange for equity (part ownership) in the business. The swap is chosen when both the outstanding debt and the company’s assets are significant and it’s necessary that creditors rather take control of the distressed company as a going concern.

In this case, the consortium and Banks C and D agreed to cancel the part/all the claims related in exchange for equity and control of the new company as a shareholder, aiming to sell the new company in a going concern situation. This swap is the exchange of the shares of not the original debtor (Flow Management Work BV) itself, but its holding company (Flow Management II BV). This is to maintain a new holding company a 100% parent company of Flow Management Work BV for the transfer of all the operating companies to the new company and the following sale of the new company. However, it’s substantially considered as a debt equity swap framework.

1. **Liquidation of an old holding company in an undisclosed manner**

After the transfer of Flow Management II BV’s share, Flow Management Holding BV will be liquidated in an undisclosed manner. This is because Flow Management Holding BV is no longer needed as a new Company was established as a holding company, and to cancel all the claims against Flow Management Holding BV. This restructuring is an out-of-court workout, so this liquidation is done confidentially.

1. **Other debt restructuring**

In addition to the debt structuring above, Flow Management Holding BV and its shareholder cancels all claims against Flow Management II BV and its subsidiaries. In doing so, they could reduce the debts among the related companies in the group.

1. **Question 8**
2. **Legal cross-border issues**
3. **Transfer of the shares of the foreign subsidiaries into Flow Management II BV**

In this case, as for the foreign (non-Dutch) subsidiaries, it was first discussed in January 2014 that some of the possibilities were to continue restructuring the foreign subsidiaries. Between March and June 2014, a plan was considered that the shares of the companies outside the Benelux-countries will be sold off, as well as some (non-Benelux) foreign branches (non-legal entities) controlled by Flow Management Work BV. In the end, in the Restructuring agreement as of 4 July 2015, all operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV.

It all relates to the transfer or sale of the shares of the foreign subsidiaries. The structure to transfer the shares should be considered from the legal viewpoint (as mentioned regarding the Restructuring agreement in the answer to Question 7). Also, the procedures to change the ownerships of the shares should comply with the laws in the countries of each subsidiary.

1. **Sale of Flow Management II BV**

Following the Restructuring agreement, Flow Management II BV will be sold to a third party. Through the scheme of the sale is not stated in the case study, it will probably be the sale of the shares of Flow Management II BV from the Banks and a number of board members (the current shareholders) to a buyer, so that the Banks could gain the sales interest indirectly as the repayment of the claims which was cancelled in the Restructuring agreement. In that case, no changes in the assets of the foreign subsidiaries happen and just the changes of the shares’ ownership would happen only in The Netherland. In that point, basically there is no cross-border legal issue. However, if a buyer is outside of The Netherland, there might be legal issue regarding the transfer of the shares from The Netherland to another country.

1. **Non-legal cross-border issues**

(i) Transfer of the shares of the foreign subsidiaries and (ii) cancellation of the claim against the foreign subsidiaries by Flow Management Holding BV and its shareholder under the Restructuring agreement should have tax and accounting issues in each country of the foreign subsidiaries.

On the sale of Flow Management II BV, the price would be discussed, and the valuation of the foreign subsidiaries should be scrutinized via due diligence from the accounting viewpoint in each country. The research of cross-border tax issues also may have to be conducted.

1. **Question 9 (the reason why a moratorium wasn’t a good option)**

In my opinion, the fourth scenario (a moratorium, formal suspension of payments procedure or restart following liquidation, with the company being sold in a ‘controlled’ manner) was not a good option as of October 2014.

In Japan, this option can be performed by filing/starting a formal bankruptcy or civil rehabilitation procedure and selling the business during the process. In general, a debtor files a formal proceeding when they cannot continue payments which will be due soon mainly to trade creditor(s) because of the cash shortage. In other cases, when any creditor(s) would not approve restructuring in an out-of-court process (if the debtor originally tried an informal restructuring), a formal procedure is filed.

In this case, as stated above, as a result of the sale of surplus assets, sufficient incoming cash flows were expected so that additional deposits seemed unnecessary, though a liquidity shortage was imminent as of the end of June 2014. Therefore, it is no need to suspend the payments to traded creditors with a moratorium. If a formal proceeding starts, it would be public, and the going-concern value would immediately drop off a lot as answered to Question 2. Therefore, we should evade a formal proceeding as long as necessary liquidity is secured to sell its business at a higher price.

In addition, if a bankruptcy commences, a trustee would be appointed by the court. The right to administer and dispose of property that belongs to the bankruptcy estate – all the property of the debtor – shall be vested exclusively in the bankruptcy trustee. In other words, the debtor (and the creditors) cannot manage or take control of the business. If the debtor or the creditors would like to sell its business, they must convince the trustee that the sale of the business would increase the bankruptcy estate, leading to the increase of a liquidating distribution. Moreover, a debtor or creditors cannot choose a purchaser of the business without the trustee’s decision. The business transfer during liquidation must be permitted by the court.

As for a civil rehabilitation proceeding compared to bankruptcy, a debtor can continue its business and a trustee is not necessarily appointed. However, the court appoints a supervisor to supervise the process. The business transfer needs to be consented by the supervisor and permitted by the court. Practically, it is common to sell the business during the civil rehabilitation proceeding and to finish the proceeding after that and liquidate the entity, but it’s less flexible than workouts due to the involvement of courts.

Consequently, if the debtor would like to restart after selling the business and it is possible without involving the court, it is better to prevent a formal moratorium.