Global Insolvency Practice Course 2022/2023

Take home Case Study I

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In this memo, the following terms shall have the following meanings:

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| **“FMW”** | Flow Management Work BV |
| **“FMH” or “Company”** | Flow Management Holding BV |
| **“Shareholder Company” or “Shareholder”** | Lease Group Holding |
| **“FMII”** | Flow Management II BV |

**Q1.** **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?**

1. **The causes of financial distress**
2. General causes of financial distress

* Framework proposed by Mellahi, K., & Wilkinson, A. (2004)
* A company’s financial distress can be seen as “organizational failure” and there are a couple of elements that need to be comprehensively considered when understanding the cause of the failure: (i) environmental factors, (ii) ecological factors, (iii) organizational factors and (iv) psychological factors.
* In specific, each element above includes the following factors that affect the failure:
  + Environmental factors: technological uncertainty, regulatory changes, demographic changes, economic changes
  + Ecological factors: density, size, age, industry life cycle
  + Organizational factors: top management tenure, top management homogeneity, management successions, past performance
  + Psychological factors: managerial perceptions

1. Flow Management’s Case

* Environmental factors:
  + - * There are no indications of changes in the environmental environment, such as downturn of the industry as a whole or changes in consumer trends.
        + Generally speaking, leasing sales are greatly affected by private demand, so if the economy deteriorates, business performance is likely to deteriorate. However, in this case, as of November 2013, the management of the Company judged that there was market demand, and it seems that the economy had not deteriorated.
        + In general, the purchase of leased property is likely to be financed by borrowing. Therefore, if the market interest rate has increased and the procurement cost has increased but the cost cannot be passed on to the price, profit is be decreased. However, this case does not indicate that market interest rate increased.
* Ecological factors:
  + - * Competition: There is no indication that competition with competitors was intense.
      * Size:
        + Generally speaking, a larger size of leasing business tends to be more profitable than a smaller one, since the larger the company, the lower the cost of acquiring the leased property and the lower the cost of system establishment and maintenance.
        + However, if the size of the company becomes too large (especially when it has many overseas subsidiaries), it will be difficult for the group companies as a whole to make appropriate performance forecasts, profit management, and strategic decisions without an appropriate cost management system or management information system.
        + In this case, the Company has many subsidiaries in various countries. Therefore, if the Company did not have such systems, it may have been difficult to properly manage the group.
* Organizational factors:
  + - * Homogeneity of the top management:
        + The Johnson family and two investment companies are the only shareholders in the Shareholder Company, so we can guess that the management has not changed frequently (In other words, the tenure of top management should be relatively long).
        + Long term homogenous management may not be able to correctly identify the cause of the distress (Mellahi & Wilkinson, 2004, 29).
        + In this case, management may not have been properly aware of the cause and seriousness of the situation.
      * Inaccurate accounting
        + In 2021, a wrongful payment of € 3 million for the CEO and CFO of FMH, a wrongful booking of € 1.6 million for contingency gain, and an improper booking of € 2.8 million for unrealized paper gain happened. These amounts are significant considering the size of the earnings of the Company and these are considered to be serious errors.
        + It seems that not only did employees in the finance and accounting departments not have sufficient knowledge, but they may also not have received sufficient advice and checks from finance and accounting experts.
      * Inadequate management information systems within the company (see the comments in Ecological factors)
        + There have been a number of downward revisions to earnings forecasts although the Company was in a situation where it was necessary to provide the creditors with accurate information.
        + It appears that the management was not able to accurately grasp the business results of the group companies due to insufficient management information systems.
      * Insufficient cost control
        + The Company was unaware of the cost price calculation error that caused the loss in 2013 because it had not checked it regularly.
      * Other possibilities:
        + Insufficient customer and asset management may have prevented appropriate credit management and maintenance and repair of leased assets, resulting in poor profitability.
* It is also possible that cash management was insufficient. Generally speaking, lease companies often acquire leased property using borrowed funds and recover such expenses through lease payments. Therefore, it is important for them to properly manage the timing of payment of loan and the timing of recovery of lease payments.
  + - * + It is possible that some group subsidiaries other than FMW were unprofitable. If FMH and/or FMW provided financial support to such unprofitable group subsidiaries, it could have led to a deterioration in the financial position of FMH and/or FMW.
* Psychological factors:
  + - * If the management was long-tenure and homogeneous, it may have failed to identify the cause of the situation correctly and failed to properly respond in a timely manner (see the comments in Organizational factors)
      * Inaccurate accounting and poor cost controls appear to be major factors in the distress, but the Company tried to deal with the situation with price increases and spending cuts. This may be due in part to their long-term and highly homogeneous management.

1. **Whether the financial distress could have been prevented**

* Management should have been changed regularly so that the Company could correctly recognize current situation and problems.
* The Company should have established an accounting check system and a cost control system. It should have been regularly advised and checked about accounting and cost control by appropriate external advisors.
* The management information systems should have been established at the level of the Shareholder or FMH so that they can timely obtain accurate information about the group companies. If such a system had been in place, the Company could have avoided repeatedly providing incorrect information to the creditors.
* If there were unprofitable group subsidiaries, concrete measures to improve profits should have been considered as early as possible (such as differentiation from competitors and cost reduction). If profitability of the subsidiaries was still poor, restructuring (such as the sale of the business) should have been considered.

**Q2.** **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?**

1. Advantages:
2. Confidentiality and preservation of going-concern value

* In Japan, the reputational risk for legal insolvency proceedings is considerable, even in the case of rehabilitation type.
* Also, in the case of legal insolvency proceedings, the protection of trade creditors is merely an exception, so the business value of the debtor may be substantially damaged by creditors terminating transactions or requesting more favorable terms and conditions.
* On the other hand, out-of-court workouts are confidential and do not involve commercial creditors, so damage to going-concern value would be much smaller.

1. Flexibility:
   * + Out-of-court workouts provide greater flexibility for tailored agreements to suit the debtor's needs, including priority of new funding.
2. Faster and lower cost
   * + Out-of-court workout is generally faster and cheaper than legal insolvency proceedings.
3. No change in management control
   * + In our-of-court workouts, debtors can retain management control, incentivizing management to participate while the management may be replaced by the trustee appointed in the legal insolvency proceedings.
4. Transparency – Easy access to necessary information

* In Japan, the legal insolvency proceedings provide creditors with a certain limited scope of access to information about debtors, which sometimes frustrates creditors.
* On the other hand, in the case of out-of-court workouts, sufficient information is generally be disclosed by a debtor to creditors.

1. Less regulatory issues

* In Japan, legal insolvency proceedings filed by listed companies are generally grounds for delisting.
* The commencement of legal insolvency proceedings may affect the viability of the debtor's licenses and may also make it difficult for the debtor to obtain public works contracts.

1. Disadvantages:
2. Unanimous consent required

* In Japan, an out-of-court workout requires the unanimous consent of all creditors subject to a restructuring plan, which is often difficult to obtain, especially where there are many financial creditors with different positions/classes.

1. No automatic stay protection

* Out-of-court workout does not provide any legal protection or stay against the debtor or its assets by dissenting creditors.

1. No statutory protection of new finance

* Japan has no laws that directly protect a new funding to a financially distressed debtor.[[1]](#footnote-1)

1. Only financial creditors can be included

* In principle, trade receivables are not included in an out-of-court workout. Also, potential debt cannot be canceled by an out-of-court workout.
* Therefore, if it is necessary to cancel all or a part of these claims to improve the balance sheet, out-of-court workout may not be appropriate.

1. No ability to recover preference or fraudulent conveyances

* Out-of-court work out cannot deal with case where such acts have been founded and the recovery of the property is required.

**Q3.** **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.**

1. Adriaanse’s approach:
   * Business Restructuring: First, there are several business restructurings in each phase that Adriaanse points out.
     + - Phase 1 (Stabilization): To allow time for cash flow increase, for example, the following were considered or implemented.
         * Price increases: Price increases were proposed in November 2013 and implemented after that.
         * Savings: Spending cuts were proposed in November 2013 and plans for extra savings (i.e., improve loss recovery, higher excess premiums and savings on car repairs) were planned or implemented in December 2013
       - Phase 2 (Analyzing)
         * An independent turnaround manager was retained and business turnaround plan was developed.
         * Also, the following items were considered:

Excess layoffs: Layoff of 130 excess staff members were under consideration for cost cuts

Sale of business: The sale of shares in companies other than Benelux-countries and some branches outside Benelux-countries controlled by FMW was proposed in May 2014.

* Financial restructurings: We can also see several methods of financial restructuring that Adriaanse points out.
  + Deferral of repayment: The payment of €35 million debt due on December 31, 2013 was postponed.
  + Risk-bearing capital contribution:
    - On December 1, 2013, creditors requested a capital injection from the Shareholder Company to recover the solvency rate.
    - On December 20, 2013, the banks requested the debtors contribute €12.5 million.
    - Following these requests, at the end of June 2014, the Shareholder announced that it would deposit €10 million in the short term and contribute the remaining €25 million in September and October 2014 (on the condition that a standstill agreement would be signed).[[2]](#footnote-2)
  + Risk-avoiding capital contributions:
    - In mid-April 2014, the Shareholder deposited €10 million as an interest-bearing unsecured loan to FMH.
    - In May 2014, shareholders proposed an additional €27.5 million of interest-bearing unsecured loans to FMH.
  + Cutting of claims: All or a part of the banks' and the Shareholders' claims were cut under the Restructuring Agreement.
* However, among the approaches that Adriaanse points out, certain items do not appear to have been adequately addressed, such as:
  + Sale of excess assets and inventory: From a cash-flow perspective, the sale of 350 vehicles out of a total inventory of 200,000 seems too low.
  + Recruitment of professionals to ensure the trust of the creditors: In this case, despite requests from the banks to replace the CFO of FMH, the Company did not accept it.
  + Developing a realistic business revitalization plan: In this case, the profit forecast had been downwardly revised many times and may not have been realistic.

1. Pajunen’s approach:
   * Pajune’s approach, in essence, is to identify the most influential stakeholders, increase their support and enhance the potential of survival.
   * In this case, the banks are considered to be the most influential stakeholders. However, the Company did not meet their expectations and failed to increase their support. The following are the examples that the Company did not meet the banks’ expectations.
     + Not accepting capital contribution: The Shareholder did not respond to the bank's request to contribute risk-bearing capital to restore the solvency rate. Subsequently, the Shareholder offered a loan rather than capital contribution in May 2014 and it was not until in June 2014 that the Company made a concrete proposal for risk-bearing capital.
     + Refusal to replace Management: The Shareholder did not respond to requests from the banks to replace management (especially CFO). The CEO of FMH was replaced in mid-April 2014, but it was not the CFO.
     + Inaccurate profit forecast: The downward revision of the profit forecast were repeatedly provided to the bank.
     + Insufficient investigation of the cause of distress: It does not seem that the Company thoroughly investigated and removed the causes of the accounting errors reported to banks in November 2013.
     + No Return of salary: It seems that the salary wrongfully paid to FMH’s executives were not returned, which may have led the loss of trust of the banks.
2. Sudarsanam’s approach: Sudarsanam lists managerial restructuring, operational restructuring, asset restructuring and financial restructuring as approaches for the turnaround strategy. These approaches are seen in this case, for example, with respect to:

* Managerial restructuring:
* The CEO of FMH was replaced
* The CRO was added to the board of FMH
* Operational restructuring:
  + Cost reduction: A reduction in the employment costs of the extra 130 staff and extra savings (as described as the events around in December, 2013).
  + Revenue generation: Prices for existing customers were raised.
  + Operating-asset reduction: On December 1, 2013, the CFO of the Shareholder Company proposed selling 350 cars. Also, the sale of some branches outside Benelux-countries controlled by FMW was proposed in the plan drawn up by the Company in mid-May 2014.
* Asset restructuring:
  + In May 2014, it was proposed by the Company to sell its shares in subsidiaries other than Benelux-countries
  + There is a description that "As a result of the sale of surplus assets, sufficient incoming cash flows are expected" regarding the announcement made on October 31, 2014. Therefore, we can guess that necessary asset reduction was made by that time.
* Financial restructuring:
* Equity-based strategies:
  + - In June 2014, the Shareholder proposed increase their capital contribution.
* Debt-based strategies:
  + A deferral of debt payments of €35 million due on December 31, 2013 was implicitly permitted.
  + The financial restructuring proposal for FMW proposed by the Shareholder in June 2014 offered a maturity extension for working capital finance and other loans.
  + In October 2014, conversion of debts into shares was proposed as one of the scenarios
  + The Restructuring Agreement provides for a debt reduction.

1. Schmitt’s approach:
   * Schmitt argues that two strategies should be used simultaneously: recovery (i.e., downsizing, divestiture and cost-cutting) and recovery (i.e., strategic changes that transform and reposition the firm for sustained growth and profitability[[3]](#footnote-3)).
   * In this case, in May 2014, the debtor formulated a plan to focus on increasing sales in combination with a significant cutback. However, there is no description of specific measures to increase sales, and there is no indication that any measures to increase sales were subsequently implemented.
   * Therefore, only retrenchment appears to have taken place in this case.

**Q4.** **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?**

1. Reason for the behavior of Banks C and D

* We understand that Banks C and D have a larger amount of unsecured claims than Banks A and B.[[4]](#footnote-4) If so, Banks C and D should have tried harder to collect than Banks A and B.
* Nevertheless, at the latest in mid-February 2014, Banks C and D have become uncooperative with the process.
* The most likely reason is that Banks C and D lost confidence in the Company's current management and believed that they could no longer cooperate.[[5]](#footnote-5),[[6]](#footnote-6)  The following are possible reasons why Banks C and D may have lost confidence in the Company and may have been dissatisfied with the Company:
* The profit forecasts provided by the Company have been revised downward many times.
  + In general, during the restructuring phase, the reliability of the figures provided by debtors seems to be the minimum requirement for creditors to cooperate in the restructuring. However, the repeated downward revision of the figures seems to have made the Company's plan unreliable.[[7]](#footnote-7)
  + Banks C and D may have been doubted that the Company was not diligently taking measures to deal with the cause of the financial difficulties.
* Continuance of the CFO of the Company: The CFO was not replaced while he/she seems to be responsible for the inaccurate accounting.
* Slow reorganization process[[8]](#footnote-8)
* Insufficient measures to recover the solvency rate:
  + Despite being asked to contribute capital to raise the solvency rate, the company tried to respond by selling only 250 out of 200,000 cars.
  + As a result, the banks may have been doubted about the sincerity of the Company's efforts to revitalize its business.[[9]](#footnote-9)

1. **What would you have done in that situation in your role as advisor of the other two banks**

* The easiest and most practical approach is to ask openly Banks C and D about the reasons for their dissatisfaction and to consider cooperating with them to the extent possible depending on the reasons.
* The reasons for the dissatisfaction of Banks C and D may overlap with those of Banks A and B. For example, if Banks C and D are dissatisfied with the reliability of information, the change of CFO, the slowness of reorganization process, and the low solvency rate as described above, Banks A and B could make a strong request to the Company in cooperation with Banks C and D since Banks A and B would benefit from improving these points as well.[[10]](#footnote-10)
* If Banks C and D do not cooperate, Banks A and B may consider buying the debt from Banks A and B with a discounted price.
* It may be prudent for Banks A and B to consider whether there is a legal system that would allow suspension to take effect or pass a restructuring plan without going through legal insolvency proceedings even assuming the opposition of Banks C and D.

**Q5.** **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)?**

1. First Principle (Creditor cooperation period): The first principle can be found in the workout process.
   * All relevant creditors involved:
     + - All the relevant creditors are included in the discussion for the standstill agreement. The four banks (A, B, C, and D), which I understand are all the relevant financial creditors of FMH, cooperated with each other and agreed with providing the company with the standstill period.
   * Duration:
     + - In the First Principle, the standstill period needs to be sufficient (though limited) time for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed.
       - According to the commentary, the length of the period will vary from case to case, depending on the complexity of the information to be gathered and the nature of any restructuring proposals, but should be no longer than necessary for the carrying out of the above process in each particular case, and it is customarily for an initial period of weeks or months, usually with a capacity for extension if all relevant creditors so agree.
       - In this case, a 120-day standstill agreement was signed in the mid of August 2014 to give the company time to prepare sales scenarios and a liquidation scenario, which was expected to be drawn up no later than September/October 2014. Therefore, the standstill period appears reasonable and does not seem to be longer than necessary.
2. Second Principle (Agreement not to enforce):
   * The second principle can be implicitly found in the workout process.
   * No details of the standstill agreement are indicated in the case. However, given that it appeared that there was no substantial negotiation over the agreement and there is no indication that any creditors took actions to enforce their claims during the standstill agreement, we can assume that the standstill agreements included the following customary elements, which are required by the second principle.
     + All relevant creditors refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor.
     + All relevant creditors are entitled to expect that during the standstill period their position relative to other creditors and each other will not be prejudiced.
3. Third Principle (No detrimental actions):
   * The third principle was not explicitly indicated in the workout process. However, we see no facts that indicate that the Company acted during the standstill period in a way that might harm the interests of creditors.
4. Fourth Principle (Creditor coordination):

* No representative co-ordination committees were seen in this case.
* It can be inferred, however, that the responses of creditors were aggregated into one or more, since there were several occasions where the banks as a whole conveyed their views to the Company. [[11]](#footnote-11)

1. Fifth Principle (Access to debtor’s information)

* This is seen explicitly.
* Access to the Company's relevant information had been provided to the creditors. For example, since around December 2013, accounting firms and independent turnaround consultants were hired, and FMH was required to report monthly actual costs and sales. [[12]](#footnote-12)

1. Six Principle (Respect the positions of creditors):

* It is seen explicitly. The Restructuring Agreement reflected the position of each creditor.

1. Seventh Principle (Confidentiality):
   * Although there is no explicit mention of confidentiality, we can assume that confidentiality was kept in this case.
2. Eighth Principle (Priority for new funding):

* There is no mention of new funding by the banks in this case.[[13]](#footnote-13)
* In April 2014, the Shareholder extended an interest-bearing, unsecured loan of €10 million to FMH, but this loan does not seem to have a preferential right. [[14]](#footnote-14)

**Q6.** **Suppose it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, are there any other possibilities for “soft law” to use (perhaps specifically in your country/region)?** **If yes, explain in what way.** **If not, do you see any alternative (informal) possibilities?**

* In Japan, there are some non-binding guidelines for out-of-court workouts (For example, the Out-of-Court Workout Guidelines and the Out-of-Court Workout Guidelines for SMEs).
* These guidelines set forth procedures that are considered to be practically fair and principles of conduct for interested parties, which may overlap with the contents of the Statement of Principles.
* The Out-of-Court Guidelines for SMEs, which have been in effect since April 2022, include, include the following[[15]](#footnote-15):
  + Timely and appropriate disclosure by obligors of their business and financial conditions
  + Good Faith Consideration by Creditors
    - When the creditor receives a request for relaxation of terms and conditions from a small or medium sized enterprise entity, the creditor shall consider it in good faith insofar as the creditors finds it necessary and reasonable.
    - If a creditor receives a request for debt reduction from a small or medium-sized enterprise entity, the creditor shall consider the request in good faith if there is a need for debt reduction and economic rationality, equity between financial institutions is ensured, and management responsibilities and shareholder responsibilities are clarified.
  + The small and medium sized entity may make request from suspension to the applicable creditors after the commencement of the procedures if it is necessary for stabilization of cash flow, and the applicable creditors shall faithfully respond to request from suspension in the event that certain requirements are met.[[16]](#footnote-16)
  + The creditor and the debtor shall have a confidentiality obligation with respect to the information shared in the course of the procedures.
* Therefore, assuming the Japanese subsidiaries are included in the group companies in this case and the Japanese subsidiaries, and the creditors of the Japanese subsidiaries oppose the adoption of the Statement of Principles, the adoption of such guidelines might be helpful to obtain cooperation from the creditor similar to that under the Statement of Principles.

**Q7.** **Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015.**

* Sale of the operating subsidiaries:
  + Accommodate operating companies to shell subsidiary (i.e., FMII) and sell shares in the FMII to the consortium of banks and board members.
  + FMH and the Shareholder have cancelled all claims against FMII and its operating subsidiaries. This appears to be the result of a shareholder responsibility.
  + There are several possible purposes and backgrounds for the sale of the subsidiaries.
    - There should be a tax reason that it was not a sale of operating companies themselves but a sale of shell subsidiary that owns the operating companies.
    - It seems that the benefits to the consortium of banks of acquiring shares in FMII are that they can indirectly acquire operating companies whose financial obligations have been cut (other than the remaining their own claims), and that they may earn capital gains if a third-party buyer is found in the future.
    - Board members also acquired shares. One of the purposes of this should be to provide Board members with incentives to increase corporate value by improving management.
* Waiver of original working capital claims.
  + The consortium of banks A through D waived an original working capital of €97.5 million for FMW.
  + Although the consortium did not convert its claims to FMW into equity, it did cut its claims to FMW and indirectly acquired FMW's equity through FMII. Therefore, it can be substantially the same as Debt Equity Swap for FMW.
* Waiver of all additional working capital claims.
  + Bank C and D, which provided their additional working capital to FMW, waived all of their claims of €32.5 million. This may be due to the fact that the additional working capital financing was unsecured and the possibility of receiving proceeds was substantially low in the event of liquidation.
  + However, the additional working capital of €25 million was repaid in January 2015, which may have given some consideration to the interests of Bank C and D.
* Liquidation of FMH:
  + FMH is supposed to be liquidated with unclosed manner
  + The banks' and the Shareholder's claims against FMH will be cancelled in full.[[17]](#footnote-17),[[18]](#footnote-18)
* Cancel of other loans:
  + The loans of €55 million to FMW will be cancelled in full.

**Q8.** **Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process?**

1. Legal cross-border issues
2. It is not easy to revive the business as a group for the following reasons:
   * No uniform rules on workouts
     + Laws and regulations governing rehabilitation/turnaround may differ from jurisdiction to jurisdiction.
     + Therefore, each debtor and its creditors may act in accordance with different rules for each legal entity, which may make a turnaround as a group difficult.
   * Potential conflicts of interest among interested parties of each entity:
     + A director of each legal entity owes a duty of due care (or fiduciary duty) to the creditors of the entity. As a result, group subsidiaries may act from the perspective of maximizing proceeds to their creditors, rather than simply following the direction of the parent company.
     + In this regard, the interests of creditors of the Shareholder Company or FMW may differ from those of the group subsidiaries.[[19]](#footnote-19)
   * Debtor-in-possession (“DIP”)-type proceedings are not always available:
     + DIP-type legal insolvency proceedings may not be available in some jurisdictions. Assuming non-DIP legal insolvency procedures is used for a subsidiary, management will be transferred to a trustee, which increases the likelihood that the subsidiary will not comply with the parent company's rehabilitation policy.
   * Potential conflict among group companies:
     + If any of its subsidiaries enters legal bankruptcy proceedings, there may be a dispute among group companies over the existence and amount of obligation among the companies. Also, information necessary for the restructuring as a group may not be shared among the group companies.
3. Should the group companies be considered as a single entity?

* Whether the group companies should be treated as single entity:
  + If creditors extended credit to the group as a whole, it may be more equitable to evaluate assets and liabilities of the group as a whole and then distribute them to creditors, rather than distributing proceeds to creditors on a entity basis.
  + For example, if there are creditors who have claims only in the parent company and creditors who have claims against the subsidiary and have a guarantee from the parent company, the creditors of the subsidiary will receive proceeds from the parent company as well as from the subsidiary. As a result, the creditor's claim to the parent company may be substantially diluted by the guarantee claim, and there may be a question as to whether this is fair.
  + However, in this regard, for example, the following problems may arise.
    - When should an integrated evaluation be conducted?
    - Whether such evaluation can be theoretically and practically recognized in each jurisdiction
    - How to legally realize such distribution
* Whether to allow the subordination of claims (how to deal with internal claims):
  + There may be an issue that intergroup claims, especially the parent company's claims against group subsidiaries, should be subordinated from the viewpoint of shareholder responsibility.

1. If the group is transferred as a whole and the only available evaluation by the buyer is for the group as a whole, how will the consideration be allocated to creditors of each entity?
2. “Accommodation” of all operating companies of FMH under the Restructuring agreement

* Depending on the meaning of “Accommodation”, at least six countries’ laws are involved, so it will take some time for the scheme to be considered and implemented.[[20]](#footnote-20)
  + Based on the expression “shell subsidiary”, it is highly likely that the seller side is to establish a new shell subsidiary (probably for tax reasons) and have the new subsidiary hold the shares of each operating company.[[21]](#footnote-21)
    - In this case, the scheme can be implemented by establishing a new subsidiary and transferring the shares of each operating company. Therefore, even if there are multiple jurisdictions involved in the scheme, it is unlikely to require such complicated consideration (except for the tax issues discussed below).
    - However, since there are changes in the foreign shareholder of each operating company, it would be necessary to carry out the procedures required by FDI regulations in each jurisdiction, and the closing may take some time.

1. Tax implications in each jurisdiction:
   * When restructuring, it is essential to consider the tax perspective of each legal entity (including the method of accommodation).
   * Since the transaction spans multiple jurisdictions, tax considerations may be complicated.
2. Jurisdiction:
   * Assuming utilizing of legal proceedings involving a court for the restructuring of (all or part of) the group companies, there should be an issue about which court should the companies file an application in:
   * Although it is possible to file a petition in the country in which each corporation is incorporated, the companies may want to file a petition in any jurisdiction (or one or more) to smoothly rehabilitate the business of the group as a whole. In such a case, court jurisdiction over foreign entities should be an issue.
3. Whether to allow the continuation of intergroup transactions
   * If there are transactions from FMH or FMW that provide substantial financial support to other group companies that are not profitable, or if FMH or FMW has permitted deferment of repayment of intra-group loans, the issue may be whether to allow the continuation of such transactions.
4. Governing law: Because the group companies exist in various countries, claims and obligations among group companies may be complex, and rights relating to collateral may relate to multiple jurisdictions, there may be issues as to which governing law should be applied to various rights.
5. Non-legal cross-border issues

Difficulty in smooth communication between the parties

* Local counsel and advisors may be appointed for each group company. When consultation between group companies (consultation between advisors) is necessary, it is not easy because of the time difference.
* The countries where the debtor group is established are basically English-speaking countries, but the language barrier might still exist.

**Q9.** **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]**

* I understand that the “moratorium” is a system that legally justifies suspension of payments by a court decision.
* In Japan, there are several systems that protect debtors from enforcing creditors' rights by court decisions, but all of them are part of legal insolvency procedures. In other words, there is only a system to protect a debtor who has filed for legal insolvency proceedings for a very short period of time from the filing of the petition until the commencement of legal insolvency proceedings.[[22]](#footnote-22) We have no system in which only suspension of payments is permitted by the court without filing a petition for legal insolvency proceedings.
* In Japan, when a petition for legal insolvency proceedings is filed, the fact that the petition is filed is immediately publicized, and trade receivables are generally subject to haircut, which greatly damages the going-concern value of the debtor.[[23]](#footnote-23),[[24]](#footnote-24) In addition, there is a possibility that the management rights of the debtor may be transferred to a trustee appointed by the court.[[25]](#footnote-25) Therefore, it may not be a good idea to file a petition for legal insolvency proceedings unless there are specific imminent necessity, such as some financial institutions explicitly indicating the possibility of exercising their rights or debtors are unable to pay their trade claims due to cash flow shortage. In this case, no such special circumstances appear to exist.[[26]](#footnote-26)
* In addition, in order for each entity to be protected from the enforcement of creditors' rights, it would be necessary to file certain procedures in the courts for each entity.[[27]](#footnote-27) Because there are multiple jurisdictions for each entity, it is likely that such filing could raise a variety of issues (see the response to Question 8).[[28]](#footnote-28)

1. The Industrial Competitiveness Enhancement Act of Japan was recently amended to give priority to a financing under Turnaround ADR proceedings, but it is subject to the court’s decision and the protection is not guaranteed. [↑](#footnote-ref-1)
2. Although not specified in the case, these monies appear to be contributions of risk-bearing capital based on the context. [↑](#footnote-ref-2)
3. More specifically, this includes market penetration, product launch, market entry, acquisitions and structural change (Schmitt, 1218). [↑](#footnote-ref-3)
4. According to this case, Banks A and B provided original working capital financing (with collateral) as part of a consortium, but also additional working capital financing with unsecured or subordinated collateral. [↑](#footnote-ref-4)
5. Indeed, it was stated in this case that “general lack of confidence in the Flow Management company was most specifically felt by the bankers of C and D” in March 2014. [↑](#footnote-ref-5)
6. Another possible reason is that Banks C and D tried to make a more favorable recovery by holding out. However, it does not seem to be a rational reason for their sudden non-cooperation.

   In addition, there is a possibility that information was not sufficiently provided to Banks C and D as compared to Banks A and B since they were subordinated creditors, but this seems unlikely. Banks C and D were also members of a consortium of original working capital financing and were likely to have received the same information from the Company as Banks A and B. [↑](#footnote-ref-6)
7. The case clearly stated that the bank as a whole was dissatisfied with the constantly changing information provided by the company as of August 2014. [↑](#footnote-ref-7)
8. At the end of June 2014, Banks C and D threatened to cancel the credit in order to send a signal to the Company to hurry up, while the Company announced that the liquidation shortage is imminent due to a delay in the planned reorganization (particularly price increases and cutbacks). This suggests that Banks C and D had long been dissatisfied with the debtor's delay in reorganisation. [↑](#footnote-ref-8)
9. In the first place, selling inventory does not raise the solvency rate, so it does not seem to be a reasonable response to a request from the creditors. [↑](#footnote-ref-9)
10. Improvements in these points and the signing of a standstill agreement with Banks C and D would increase the chances of avoiding liquidation. In this case, Banks A and B were providers of original working capital financing and the financing seemed to be secured. However, as of December 2013, there were doubts about the validity of the security and they wanted to avoid liquidation. [↑](#footnote-ref-10)
11. There is a response as Bank A through D (e.g., the banks requested to contribute at least €12.5 million on December 20, 2013), but there is also a response made as each group when the groups were divided into Bank A and B and Bank C and D (e.g., Bank C and D threatened to cancel the credit at the end of June 2014). [↑](#footnote-ref-11)
12. Because the information provided by the Company (particularly revenue prospects) has changed many times, there may be argument as to whether the creditor was given "reasonable and timely access to all relevant information," but there are no circumstances in which the debtor refused to disclose or delayed providing some information. [↑](#footnote-ref-12)
13. Additional working capital should have been repaid at the end of 2013. Therefore, it is not considered to fall under "additional funding during the Standstill Period and/or the immediate aftermath of any rescue or restructuring" under the Eighth Principle. [↑](#footnote-ref-13)
14. Consideration may have been given that priority should not be given to the shareholder contributions from the viewpoint of shareholder responsibility. [↑](#footnote-ref-14)
15. The process by which an independent expert checks the appropriateness of the rehabilitation plan and the adequacy of the relevant procedures and submits an examination report to creditors. [↑](#footnote-ref-15)
16. (i)A request for suspension is made to all applicable creditors simultaneously, (ii)debtor disclose information in good faith, and (iii) in cases where a proposed rehabilitation plan may include a request for debt reduction or forgiveness, the basic policies for rehabilitation have been indicated to applicable creditors, etc. [↑](#footnote-ref-16)
17. The reason why the banks and the Shareholders' claims against FMH would be cancelled in full seems to be from the perspective of shareholder responsibility. [↑](#footnote-ref-17)
18. FMH’s indirect shares in the group subsidiaries will be sold to the consortium and the board member through shares in FMII. However, there is no indication in this case as to whether FMH received any consideration for the sale. There is a possibility that the payment was not made in a case where equity in the balance sheet was nearly zero (or minus). Since FMH is likely to have no other substantial assets other than the shares of FMII, no dividends would be expected in the liquidation proceedings of FMH, even if a third party other than the bank and the shareholders had claims against FMH. [↑](#footnote-ref-18)
19. As FMH or FMW is the group's core legal entity, it might seek to formulate the most advantageous rehabilitation plan for their creditors at the expense of other group subsidiaries. In other words, there is a theoretical and structural conflict of interest between FMH or FMW and other group subsidiaries. [↑](#footnote-ref-19)
20. Additional jurisdictions may be involved depending on the country in which the shell subsidiary is established. [↑](#footnote-ref-20)
21. Although unlikely, if FMII is supposed to aggregate the assets and liabilities of each operating company, the focal issue would be how to legally implement the consolidation.

    In the case of a merger, the question arises as to which jurisdiction's corporate law it should be based on and whether the scheme is legally feasible. It is also expected that the process will be complex and take some time to close.

    On the other hand, the transfer of assets and liabilities of each operating company to one entity while retaining the legal personality of each operating company may be conducted by business transfer, etc. However, since the transaction involves multiple jurisdictions, it is expected that, like a merger, the process will be complex or time-consuming. In addition, transfer of contracts and transfer of employees (depending on the relevant jurisdiction) may require the consent of the other party, which may be more difficult to implement than merger. Also, each entity after the business transfer needs to be liquidated. [↑](#footnote-ref-21)
22. In practice, it is only a few weeks. [↑](#footnote-ref-22)
23. In practice, certain trade receivables are often protected, but this is an exceptional treatment in laws and there is no guarantee that they are protected. [↑](#footnote-ref-23)
24. In case of the legal insolvency proceedings, creditors tend to cancel the transaction or request more favorable the terms of the transaction. In addition, customers (especially individually customers) tend to have a strong negative impression of a company that has gone through legal bankruptcy proceedings. [↑](#footnote-ref-24)
25. In Civil Rehabilitation Proceedings (which are one of the rehabilitation type proceedings in Japan), debtor-in-possession is the principle, but there are exceptional cases where a trustee is appointed. In the Corporate Reorganization Proceedings (which are the other type of rehabilitation type proceedings), a trustee is appointed in principle. [↑](#footnote-ref-25)
26. In June 2014, Banks C and D threatened to cancel the credit, but as of October 2014, when the four scenarios were drawn up, a standstill agreement was executed, which would have reduced the possibility of Banks C and D exercising their rights. [↑](#footnote-ref-26)
27. My understanding is that there are jurisdictions in which the effect of moratorium can be obtained by court decision as pre-insolvency proceedings. [↑](#footnote-ref-27)
28. Issues can arise especially in the case of legal insolvency proceedings. For example, it is difficult to reconcile the interests of each creditor of a group company or to proceed in a uniform manner, because one court or trustee does not conduct all entity proceedings and the underlying insolvency laws can be different. Issues concerning reconciling the interests of each creditor could be, for example, whether to allow (i) the subordination of intergroup claims (especially claims from the parent company to its subsidiaries) or (ii) the creditor's right to claim the guarantee against the parent company of the subsidiaries. In addition, there is no guarantee that necessary and sufficient information will be mutually disclosed between the bankruptcy proceedings of group companies. [↑](#footnote-ref-28)