Global Insolvency Practice Course 2023

Take Home case study module A

Flow Management

Question No 1: What were in your opinion the causes of financial distress at Flow Management? Could the financial distress have been prevented? If yes, explain how. If no, why not?

Answer No 1: As per the information available in the case study, in my opinion financial distress at Flow Management could be prevented as per the material provided in the reference text. Will examine it at length.

Any organization is an abstract legal entity run by natural persons. So even if we believe that environmental aspects may affect decisions of key managerial personnel (KMP), these key people are supposed to be alert and should be foresighted enough as much as possible to take decisions and implement them as well not only for future course but also enough MIS (management information system) tools should be created to keep an eye on day to day business and should have warning signals so that corrective measures can be taken in real time.

Now, the question in hand is, what would be called financial distress. In a simple language of business when a company does not have enough working capital to fund operations or cannot pay to its creditors (especially financial creditors) and its profit and loss statement shows losses, the company is in distress. From the text below it is evident that the Flow management is in distress:

"On 16 November 2013 the four banks (A, B, C and D) of Flow Management Holding BV are invited by the board of Flow Management Holding for a meeting (at that moment, financing of working capital at the main subsidiary called Flow Management Work BV totals € 360 million, other loans from these banks at Flow Management Work BV amount to € 55 million). The main reason for these talks is that the reported pre-tax profit until September 2013 of € 8 million really turns out to be a loss of € 5.4 million. In addition, faults have been found in the annual accounts of 2012. The result of € 3 million must be downgraded by € 8 million. The causes of the losses and negative corrections (as communicated by company management) are stated below:
- large management bonuses (€ 3 million) have been wrongfully issued (concerning salaries of the CEO and CFO of Flow Management Holding BV);
- 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;
- in 2012, in anticipation of book profit ('paper gain') to be realised in 2013, a € 2.8 million book profit is made. This book profit was neither realised in 2012 nor in 2013;
- the 2013 loss is the result of the basic principles used in the cost price calculation deviating from reality (because of a 'formula error' in a spreadsheet, it emerges later). Since 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.
In order to remove the causes, management presents the following plans:
- discussions will be held with the main clients about possible price increases. The other clients will be notified about the price increases;
- spending cuts will be implemented (with regard to labour costs in particular)."

From above it is apparent that somehow KMPs of Flow Management were ignored of operational challenges and wrongdoing. Also, although it is not clear that from when the basic principle for calculating cost price have been put wrongly, it could have been for many years as sometimes if the business is doing good the impact surfaces much later.

As per for the environmental issues, again below text from the case study shows that as far as the industry and market demand is concerned it is there.

''Since the business structure is there and operates properly, there is market demand and the forecast for so-called "hiring and leasing days" are consistent with reality, management expects that, in view of the measures to be taken, a profit will be made again from January 2014."

Further, many a times financial creditors demanded that shareholders should put more skin to the game. But for a long time, the main holding company i.e., Flow Management Holding BV, kept sort of deaf ears. They kept delaying the infusion of the funds and when restructuring process was started by the creditors, the information provided by the company kept changing.

So, I conclude that if the KMP and promoter companies were aware the financial distress could be avoided, at least it could be minimized for sure.

Question No 2: What are in general advantages and disadvantages of an out-of court restructuring (workout) as compared to a formal bankruptcy procedure? More specific, what are the advantages versus disadvantages *in your country*?

Answer No 2: No matter what is been done, some businesses will fail. This is to say that as much the entry and operating of a business is important, exit is also as important. Needless to say, to keep this in mind all the governments are having a robust insolvency and bankruptcy regime to address domestic as well as cross border insolvencies. When in 2016 India notified its 'Insolvency and Bankruptcy Code 2016', it jumped many levels in the international ease of doing business rankings.

There are certain business failures because of redundancies such as of the product, technology or of management which are genuine failures. But some business failures can occur in a thriving industry environment which may be seen as not so genuine. To deal with failures whether genuine or ingenuine, creditors need restructuring of the debts with the debtor. They can either go for out of court settlements or if that is not an option debtor can be dragged to courts/tribunals to either resolve the insolvency or if the business not viable any more then selling the assets in liquidation and satisfying creditors' claims as much as possible. Both these options have their own advantages and disadvantages. We will now examine them, but before that I would like to do a brief introduction of what are the options available in India.

Pre-Insolvency Regime – Practices followed by the Indian Banking System:

The Indian Banking system has been extending credit facilities to Corporates, Firms and Individuals. The norms relating to asset classification, provisioning and reporting to the regulator had been framed in the decade of 1990. The Regulator, Reserve Bank of India had been keeping a close watch and had been formulating various policies and setting up norms

for restructuring of their Credit Facilities, extended to the Corporates, to ensure that basic lending norms are followed and they continued to breathe as going concern.

Given below are the names of some schemes of restructuring as out of Court settlement:

1. Corporate Debt Restructuring: In the year 2002, Reserve Bank of India had set up a mechanism commonly known as CDR in the Banking system. Under this arrangement a CDR Cell was set up at Headquarters of IDBI Bank, a Government Bank at Mumbai, to ensure that the total lending facilities of Corporates either from one bank or from multiple Banks, of Indian Rupees 10 Crores or more tending to become non-performing can be referred at CDR Cell for restructuring. The Functioning of CDR Mechanism was three tier hierarchical structure comprising the CDR Standing Forum, CDR Empowered Group and CDR Cell.

Any Member of Lenders Consortium could refer the case to the CDR Cell for Restructuring and a collective 'Call' by all lenders was taken. The Concessions allowed were in the form of waiver of past interest, soft interest for future, elongating the future repayment of loan, unpaid interest on working capital facilities were converted into loan. Besides, to put in promoters skin into the game they were required to make immediate equity contributions to help the company stand on its own feet. While permitting the restructuring it was ensured that there was no prior diversion of funds or malfeasance of past loans.

2. S4A Scheme of the Reserve Bank of India: The appraisal of restructuring of the credit facilities was done keeping in view how much of credit is sustainable in view of projected cash flows of the Company. The unviable portion of credit was converted into equity and shareholding was given to the lenders. Soft options were given to repay the sustainable loan.

3. Restructuring Schemes for Micro, Small and Medium Enterprises (MSME) during COVID 19: This scheme was introduced by Reserve Bank of India to help enterprises cope-up with financial stress caused due to Covid 19, specifically to MSME sector.

4. **Restructuring Schemes Approved under the Powers of Board of Directors of Individual Banks or Financial Institutions:** The Board of Directors of various Banks/ Public Financial Institutions do approve restructuring schemes for lending given to small borrowers/retail traders, agricultural or Farmer Loans. Many a times such schemes have political motives to garner votes from the small borrowers by offering them rebates or concessions.

5. Prior to 2016 the restructuring of debt of Corporates in India was done through Board for Industrial & Financial Reconstruction (BIFR), a government driven Tribunal/Quasi-Judicial Court.

6. Again, prior to 2016 the creditors of companies could move application before respective Hon'ble High Court for Liquidation (Selling assets in piecemeal) of the Company under the Companies Act 2013.

Both laws mentioned above at point no 3 & 4 have since been repealed with introduction of new laws in the year 2016.

Introduction of Insolvency/Bankruptcy Laws in India – Formal Bankruptcy Procedure:

1. **Corporate/Individual Insolvency Process**: The Insolvency & Bankruptcy Code, 2016 (IBC) was introduced taking in India based on learnings from Bankruptcy Laws already in vogue in developed economies of the world. This Code prescribes formal procedure for insolvency or Bankruptcy of Corporates and Individual Persons respectively. The

Creditors or debtor also, can move necessary applications to the designated company court called National Company Law Tribunal to kick start the insolvency process.

2. **Pre-packaged Insolvency Resolution Process (PPIRP)** – This method of restructuring, introduced in the Year 2020, is a hybrid in nature and includes "out of court" and "in the Court" interventions. In this process restructuring arrangement is first concluded between company and the creditors, and thereafter it is put up before the National Company Law Tribunal for final and binding approval.

From the above discussion it is apparent that always creditors have two options in hand for solving financial difficulties of a corporate debtor, namely formal and informal methods. Formal methods include all the actions taken under the insolvency laws of the country which may be moratorium, liquidation or bankruptcy procedures in case of corporate/individual borrowers. An informal reorganization involves all those methods which are taken out of the purview of the law but have some sense of the prevailing laws. Below are the advantages and disadvantages of the out of court workouts:

Advantages and Disadvantages of an out of Court Restructuring as compared to Formal Bankruptcy procedure:

Advantages
Creditor/Bank has their own restructuring policy, the debtor is familiar with the procedure, Policies and staff members, personal touch available
Provides convenience to the Debtor, need not approach any Court, Saves Cost of litigation for the debtor, cheaper without cost.
The Management of the Company remains in the hands of the Current Promoters/Management. The Operations of the company are better handled by the experienced and professional managerial team.
The Bankruptcy process remains private or secret, not known to public at large, thus brand image is protected and doesn't take a hit. The share value of the Company will take a hit if matter goes to the court and becomes public.
The Process is quicker and less time consuming, the rescue efforts can be initiated much earlier.
The restructuring will be done on the basis of current fair market value of assets which would benefit both creditor and the debtor.
Settlement of disputes outside court also leads to reduction in litigation burden on the Court/Tribunals, and as result the time of court is also saved.

Disadvantages
Under Indian Insolvency law the control of the Company goes away from the promoters into the hands of Insolvency Professional. External Professionals are hired to run the company, who don't have first-hand knowledge of affairs of the Company.
The valuations of the Company diminishes once the news of its court proceedings was out in public.
Many a times Insolvency proceedings are initiated for unnecessary defamation or to pressurize the Management of Corporate Debtor.
The Insolvency/Bankruptcy process are well defined, have definite timelines for every step, are done through public notices and on all interested investors can apply.
No transparency is available here the terms and details of settlement/restructuring were not made public and the investors are not able to take informed decision on their investment made in the Corporate.
Adds to the Cost as professionals are to be hired

Matters can be endless or elongated as there is provision for filing appeal up to Supreme Court of India.

In short, we can say that advantages of formal workout are the disadvantages of informal workout and vice versa. In my view, if the corporate debtor is operating in a thriving business environment and has a willingness to take all the necessary steps to turnaround, informal workout is the best as it is more time and cost effective. But if the corporate debtor is behaving badly and trust of creditors is not there then a formal reorganization will fetch better results for the creditors.

Question No 3: Were the turnaround/reorganization approaches as presented in the reading material applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.

Answer No 3: Yes, the turnaround approach applies in the case study presented in the reading material. It is apparent from the case study that the banks have used informal reorganization approach to solve the financial difficulty of the corporate debtor. Although in my opinion after 2014 banks could take a route of formal methods but they still continued with informal measures.

An informal reorganization as we understand is the route taken by the creditors to work out a framework for reorganization out of the statutory framework of insolvency or bankruptcy. In this a plan is generally drawn keeping in mind the end result. This consists of two processes:

1.Businesss restructuring
2.Financial restructuring

Success of informal workout depends on a wholistic approach where business operations are looked upon and restructured with the measures taken in the financial arena. Solving problems should also involve removing the causes thereof.

Now we will discuss in detail what and how both the parts of informal restructuring entails and while I am explaining the process, I will keep mentioning simultaneously that how it was adopted in the case study.

Business Restructuring: This is achieved through a four phased process. These phases can overlap with each other at times.

Phase I. **Stabilizing**: In this phase the emphasis is on reducing the outflow and increasing the inflow of the cash to quick fix the problem of working capital requirements in the short term and to restore the trust in the management. These can be achieved by various methods:

- ***Cutbacks the expenditure***: So, in the case study cutting the labour cost was decided (130 staff members - employees and independent contractors - will be made redundant. This will yield an annual saving of € 3.3 million;)
- ***Optimizing the stock situation***: selling of extra cars and vehicles was decided. (Extra savings will be realised through improved loss recovery, higher excess premiums and savings on car repairs. The total amount of savings is expected to be € 3.9 million.)
- ***Optimizing turnover times of the accounts receivables***: It was decided that one to whom less price was quoted would be asked for recovery and also in future some price

hike is envisaged. (The main clients have been visited and they agree upon the price increases. Other contacts/clients (approximately 5,000) have been informed that prices will increase; only a few negative replies were received. A result increase of € 7.8 million is forecasted on the basis of these price increases)

- ***Asset stripping***: It was decided during the discussions that 350 cars would be sold to improve the solvency rate.
- ***Optimizing of spontaneous financing***: This requires increasing the payment periods among existing financiers of the company.

Phase II. Analyzing: Here, an analysis of the possible reasons of the financial crisis is done so that confidence of the relevant interested parties such as long-term financers and the shareholders can be achieved.

Subject Matters within a Reorganization Plan: As per provided in the reading material vis a vis what is done in the case study:

1. *A strategic and financial analysis ex post to trace the causes of the negative state of affairs*- From the case study we can understand that a meeting of the management and the bankers were called and later the causes of the losses were found:

- *large management bonuses (€ 3 million) have been wrongfully issued (concerning salaries of the CEO and CFO of Flow Management Holding BV);*

- *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;*

- *in 2012, in anticipation of book profit ('paper gain') to be realised in 2013, a € 2.8 million book profit is made. This book profit was neither realised in 2012 nor in 2013;*

- *the 2013 loss is the result of the basic principles used in the cost price calculation deviating from reality (because of a 'formula error' in a spreadsheet, it emerges later). Since 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.*

2. An inquiry into the actual financial position and an assessment as to whether the company still offers sufficient basis for recovery. (*In December 2013 it emerges that the afore-mentioned loss of € 5.4 million only concerns Flow Management Work BV. On top of that, the foreign subsidiaries have made a loss of € 6.3 million as a result of which total losses of 2013, including a loss of the holding [Flow Management] of € 11.4 million, amount to € 23.1 million. 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. Furthermore, at that moment the following measures have been taken / plans have been drawn up)*

3. Proposed measures and the calculated effects thereof on long-term exploitation overviews and balance projections. This was also done at length, multiple meetings held, and a turnaround specialist was also hired to look into the situation.

4. Cash flow projections in the short and long term from which it appears that the obligations entered into (and to be entered into) can be performed. (*So, on the short term the firm expects an increase of € 15 million in the results. Although, the banks are shocked by the entire company's situation, legal action will not yet be taken against the company, pending the final report from the consultancy agency. It is concluded by the bankers 'not to panic'. Moreover, it is decided that action must be taken jointly and in a controlled manner. Banks are of the opinion that the board of the shareholder company must take measures regarding*

management (the CFO in particular) and 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), and to raise an amount of € 12.5 - 15 million to further strengthen the equity capital position. Furthermore, default interest will be charged in order to put healthy pressure on the relation.)

5. Cash flow projections which show a future improvement in the liquid assets (*The result for 2014 is estimated to be € -/- 5.7 million. This forecast is based on an expected profit in the Netherlands of € 7.5 million, continuing losses abroad, as well as a loss of € 14.4 million in the holding (predominantly based on write-off of goodwill). It is also expected that the management information system will have been improved so that the figures will be more reliable).*

Not only the company needs to see its short-term viability, but it also needs to chalk out long term strategy

Measures to Restore Long-Term Profitability:

- Adjusting strategy and marketing
- Cutting overhead costs
- Dismissing excessive personnel
- Rationalizing the product assortment
- Improving purchasing processes
- Improving management information systems Improving working capital and cash flow management Closing loss-making business units
- Capitalize (excessive) fixed assets
- Selling (profitable) operations which are not part of the core activities.

So, if we see all the above measures, more or less, these were taken in order to solve the financial crisis of the company. Such as meeting with stakeholders, decisions about cutting the cost like labor and other costs, selling some of the assets like some cars, improving MIS for early warning signs and appointing CRO (Chief restructuring officers).

Phase III. Repositioning: At this phase of the informal restructuring of business plan, generally the management together with the specialized officer or with the creditors tries to do repositioning of the company after the rough weather. This is done by creating inherent value in the company and having back the faith of the creditors.

The first two parts of the process are apparent but as far as this part of repositioning is concerned, the efforts were definitely made although it looks like that the efforts could not bear many fruits.

Phase IV. Reinforcing: This involves more attention in terms of bringing in new management if so required, hire external experts or looking for a new company to hand hold and take over the old company, specially where creditors think that the crisis were majorly because of the lack of the old management's competence or intentions. From the text below it is evident that decision on the same line were done.

On 4 July 2015, a Restructuring agreement is finally signed. This is outlined as follows:

1. *all operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV;*
2. *the shares in Flow Management II BV are transferred to the consortium of banks (A, B, C, 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);*

3. *Flow Management Holding BV will be liquidated in an undisclosed manner. All claims against this BV will be cancelled by the banks and the shareholder of Flow Management Holding BV;*
4. *Flow Management Holding BV and its shareholder will cancel all claims against Flow Management II BV and its subsidiaries;*
5. *the banks (C and D) which in the past provided Flow Management Work BV with additional working capital will waiver an amount of € 32.5 million. In fact, the entire debt is written off ('haircut');*
6. *the consortium who in the past provided Flow Management Work BV with working capital will waiver an amount of € 97.5 million. A € 240 million claim against Flow Management Work BV remains;*
7. *the € 55 million loan in Flow Management Work BV is cancelled in full.*

Financial Restructuring: When a company goes through the crisis generally only business restructuring will not be enough as company with same set of assets and revenues will not be able to carry out past burdens of financing and other obligations. So, to cure the situation, two-pronged approach is required, that is on the one hand restructuring of the debt (haircuts in principal and interest by the creditors both financial and operational) and also fresh infusion of the equity or debt by the stakeholders and/or creditors (whether risk bearing or non-risk bearing) would be required.

In the case study if we see above points no 5, 6 and 7, indicate that financial restructuring as part of the informal reorganization was also done.

Therefore, I can conclude that all the efforts were done in the form of informal reorganization in the present case study to deal with the financial crisis of the Flow Management Work BV, although in my opinion there were signs and suggestions that a formal workout or moratorium could have fetched better results.

Question No 4: Banks C and D seem to frustrate the process at a certain point. What could have been the (rational and/or opportunistic) reason(s) for them to behave like that? What would you have done in that situation in your role as advisor of the other two banks?

Answer No 4: In 2014, Banks realised that company's management and the shareholder must constructively work together on a solution, a joint approach from the banks is desired and target that standstill agreement be signed by 31.03.2014 is set.

During February 2014, the process to arrive at standstill agreement is in jeopardy. As Banks C and D are all of a sudden not cooperating. Banks A and B are worried, since this reduces the negotiating power towards the company as a result of which, in the eyes of the bankers of A and B, required restructuring measures will possibly not be taken (the injection of necessary capital by the shareholder in particular). Furthermore, there could be (increased) discord among the now two groups of banks and the cooperation from the company could be jeopardised, so that the company's liquidation draws nearer.

by March 2014, standstill agreement is not yet signed, differences between two bank groups continue, besides friction between shareholders and banks in finding solution due to banks lack of confidence owing to developments of the past 6 months. At one stage banks A & B are attempting to buyout banks C & D at 15-20% discount in order to hold control over negotiations.

The Banks A & B appear to be splitting from the other group of Banks C and D. In June 2014, the shareholder holding company of Flow Management Holding BV made the proposal in order to effectuate financial restructuring at Flow Management Work BV so that the equity capital, which is now negative (solvency is -/- 9.5%), returns to 5% again. This proposal envisaged the change in terms and conditions of working capital financing, other loans, besides, the shareholder would contribute at least € 27.5 million. Since a going concern sale at that moment is no longer an option (no interest) and a liquidation scenario will probably have low proceeds (a maximum of 55% of the total in outstanding debts), banks A and B were open to negotiations with regard to the proposal, provided that an amount of at least € 35 million is injected.

Towards June 2014, the Chief Restructuring Officer announces the expected loss of € 27.5 million and imminent liquidity shortage due to delay in the reorganisation to be carried out (in respect of price increases and cutbacks among other things). At that moment Banks C and D threaten to cancel the credit to pressurize the Company to hurry up.

What could have been the (rational and/or opportunistic) reason(s) for them to behave like that?

The restructuring of facilities, the continuation as going concern, not letting the companies go into liquidation should have been the main aim of all four banks namely A, B, C and D. From the facts it is apparent that subgroup of banks A & B were more serious in approach than the subgroup of Banks C & D.

One reason given in the question problem is that the Banks C & D lacked confidence in the flow management company considering the developments of past 6 months. Besides, the attempts of banks A & B to buyout Banks C & D at 15-20% discount may have irked the Bank C & D.

If the restructuring and the standstill agreement had to be arrived at by 31 March 2014 all four banks needed to be on the same page, which was not there.

It was more rhetoric and opportunism on the part of Banks C & D rather than a consistent and rationale driven approach. Probably, these two Banks C & D wanted more share in the pie then they deserved. It appears to be case to scuttle the process and work to gain more irrationally.

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

The Banks A & B during the entire restructuring process have held on to their nerves, always preferring ongoing concern status over the liquidation despite irritations injected by Banks C & D on many occasions. The banks A & B shown patience, resilience and even waited for better times to emerge and finally net profit is positive and equity capital is strengthened. The reorganization has taken place without delay. In spite of situation being critical parties forecasts a better future and remain optimistic.

However, Banks A&B should have kept Bank C & D with them in the process. Because of division of opinion amongst two group of Banks, the Company must have taken advantage. Moreover, if Banks C & D had been taken along with the standstill agreement could have been signed much earlier and all four Banks would have got a better financial deal.

Question No 5: Which of the eight principles of the "Statement of Principle for a Global Approach to Multi-Creditor Workouts II" can be found in the workout process of Flow Management (explicit or implicit)?

Answer No 5: As provided in the reference text, eight principles of the "Statement of Principle for a Global Approach to Multi-Creditor Workouts II" have been created by the master minds to help creditors and to an extent debtor to facilitate cooperation amongst while dealing with the financial difficulty of a corporate debtor. These are stated below as provided in the text, I will state simultaneously, that as per my understanding of the case study these principles are found in the workout agreement or not.

1. ***FIRST PRINCIPLE****: Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a "Standstill Period") to the debtor 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, unless such a course is inappropriate in a particular case.*

Case Study: Banks A, B, C and D were invited to have discussions on 16 November 2016 by the board of the Flow Management Holding BV for a meeting and from thereon they have been cooperating with each other to find out a solution. In between although it seems for some time that Banks C and D were behaving weird but in later stage it is been seen as a tactic to put pressure on the management of Flow to hurry up.

2. ***SECOND PRINCIPLE****: During the Standstill Period, all relevant creditors should agree to 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 but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced. Conflicts of interest in the creditor group should be identified early and dealt with appropriately.*

Case Study: So as per the case study no conflict of interest amongst the banks is apparent. And none had taken any step to enforce any security during the standstill period or later at the time of signing the restructuring agreement.

3. ***THIRD PRINCIPLE****: During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.*

Case Study: From the case study, there is no evidence of any action taken by the debtor which might affect adversely to the creditors from the perspective of possible returns.

4. ***FOURTH PRINCIPLE****: The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.*

Case Study: So, again not only creditors were cooperating, they agreed to appoint a CRO, (Chief Restructuring Officer) instigated by bank A, to the board of the Flow Management as she could be valuable in the restructuring process.

5. ***FIFTH PRINCIPLE****: During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.*

Case Study: Here, although the information provided by the corporate debtor was not very reliable and the stands were changed time and again, still safely it can be concluded that the information was provided about the operations, assets and liabilities etc.

6. ***SIXTH PRINCIPLE****: Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.*

Case Study: Below is the standstill agreement which was signed in the middle of August 2014:

1. *a going concern option if the company proves viable, with shareholder and banks agreeing to an additional 180-day 'stand still' or refinancing. The starting point here is that the shareholder contributes another € 30 million, and the banks will transfer security rights of € 45 million to the shareholder;*
2. *selling Flow Management Holding BV if viability is not sufficiently proven. A buyer must be found soon;*
3. *a Debt equity swap (conversion of debts into shares) with or without the cooperation from the shareholder;*
4. *a moratorium [formal suspension of payments procedure] or restart following liquidation, with the company being sold in a 'controlled' manner. However, banks must be willing to provide a bridging loan.*

From the above one can understand that the provisions for relative positions of the creditors and shareholders were made.

7. ***SEVENTH PRINCIPLE****: Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.*

Case Study: So from the above point no 4 of the agreement drawn it is apparent that there was sense of confidentiality amongst the group.

8. ***EIGHTH PRINCIPLE****: If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.*

Case study: Provisions were made for this as well.

So, one can conclude that more or less all these principles were practically used by the creditors of Flow Management Holding BV while they were trying to solve the insolvency of the company during the period and up till reaching a standstill agreement.

Question No 6: Suppose it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, are there any other possibilities for "soft law" to use (perhaps specifically in your country region)? If yes, explain in what way. If not, do you see any alternative (informal) possibilities?

Answer No 6: As I have apprised is earlier answers, in India right now there is no informal restructuring method available or any soft law possibility. Although appointing experts like auditors or monitoring auditors always a possibility. Another one is of OTS (one time settlement) where terms are decided, and payment schedule is chalked out but, in many cases, it becomes non result oriented as there is no backing of the law. Another possibility in case of MSME is of prepackaged insolvency where the process of restructuring is run out of the court interference but once there is a viable and approved resolution plan by the creditors, resolution professional is supposed to get a stamping of the court to make it binding on all the creditors and if the plan is not implemented in full, she can approach the court to start the formal CIRP or take the company for liquidation.

Mediation is another tool which is getting traction. There are specialized mediation centers and qualified arbitrators who are generally senior lawyers, ex-judges or senior professionals in the field of finance. But this is also better used for corporates for their own recoveries, in case of banks this is still a new subject. Actually, in India still 80% of the funding is done by the Nationalized banks. And any decision taken out of the purview of the law may put the decision makers under the spot, so not many restructuring options out of the law are possible.

Another option for an individual banker or as a consortium is of debt assignment to an ARC (Asset Recostruction Company). The asset reconstruction companies or ARCs are registered under the RBI and regulated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act, 2002).

Now, there is National Asset Reconstruction Company Limited (NARCL), and India Debt Resolution Company Limited (IDRCL) for aggregation and resolution of Non-Performing Assets (NPAs) in the banking industry. These are also made by the bankers under the aegis of Government.

Question No 7: Explain in detail the essence and result of the restructuring agreement as signed on the 4th of July 2015.

Answer No 7: **<u>Background of Restructuring</u>**:

Flow Management Holding BV –Netherlands based company having Six Operating Subsidiaries (In Netherlands, Spain, France, Australia, South Africa & USA) - is part of an international group of companies that leases trucks and private cars and is also active in short leasing, real estate and truck repair. The Holding company acts as centre of main interest (COMI), employs 3,000 people and owns a fleet of 2,00,000 Cars.

In November 2013 the holding company invites four financing Banks (A, B, C & D – having working capital limit of € 360 million, and other loans amounting to € 55 million) for talks conveying reasons of fall in estimated pre-tax profit and faults in the annual accounts of 2012. The Main Cause attributed to this downgrade were reported to be large management bonuses, a contingency gain relating to three years has been received in 2012 and has been wrongfully booked as a result in 2012, anticipated book profit ('paper gain') neither realised in 2012 nor in 2013, Formula Error etc. as provided in the case study listed below:

- large management bonuses (€ 3 million) have been wrongfully issued (concerning salaries of the CEO and CFO of Flow Management Holding BV);
- 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;
- in 2012, in anticipation of book profit ('paper gain') to be realised in 2013, a € 2.8 million book profit is made. This book profit was neither realised in 2012 nor in 2013;
- the 2013 loss is the result of the basic principles used in the cost price calculation deviating from reality (because of a 'formula error' in a spreadsheet, it emerges later). Since 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.

The Discussions, negotiations, iterations continued for almost two years and the restructuring agreement signed on 04th July 2015.

Essence of the Restructuring Agreement:

1. All operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV;

The intent is to bring control of all operating companies under a new company named as Flow Management II BV. The idea behind this is to consolidate the business by merger of active companies to take these forward as going concern.

2. The shares in Flow Management II BV are transferred to the consortium of banks (A, B, C, 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);

Transferring shares of Flow Management II BV to Consortium of Banks, Board Members & Chief Restructuring Officer (CRO), means giving control of Board of Directors to them for effective management and better performance.

3. Flow Management Holding BV will be liquidated in an undisclosed manner. All claims against this BV will be cancelled by the banks and the shareholder of Flow Management Holding BV;

This move to liquidate Flow Management Holding BV in undisclosed manner is not to make this event a public affair, to save the reputation of the group and to ensure the new Company Flow Management II BV doesn't carry past ills with them.

4. Flow Management Holding BV and its shareholder will cancel all claims against Flow Management II BV and its subsidiaries;

These steps will smoothen the transition without hue & cry and will help the new Company Flow Management II BV to start on a clean slate.

5. the banks (C and D) which in the past provided Flow Management Work BV with additional working capital will waiver an amount of € 32.5 million. In fact, the entire debt is written off ('haircut').

Very Common in Financial restructuring to permit waiver of loan and take up/ own the shares under agreement.

6. the consortium who in the past provided Flow Management Work BV with working capital will waiver an amount of € 97.5 million. A € 240 million claim against Flow Management Work BV remains;

This exercise amounts to part waiver of Working Capital and maintaining Claims of part amount on the Company on Flow Management Work BV to be paid out of the liquidation proceeds of the company. Part waivers of loans under restructuring is common for better realisation in the long run and continuation of the company as going concern.

7. the € 55 million loan in Flow Management Work BV is cancelled in full.

The Consortium of Banks have been given shares in lieu of cancelling their Loan amount as a matter of prudence in restructuring exercise.

Results of Restructuring Agreement:

The Banks who gave original working capital continue to hold pledges on most assets of Flow Management Work BV (the main partner in the group) and will receive part of their claim on liquidation.

The other financiers (both banks and shareholder) will have no or subordinated security rights and will (most probably) receive nothing from their claims on liquidation. The intent is to sell new company named Flow management II BV as Going Concern.

Going forward in May 2016 the new company incurs operational losses despite forecast of break-even results. The brighter side however was that as a result of the debt reduction, the net profit is positive, and the equity capital is strengthened. The reorganisation takes place without delay.

Meetings are held with three parties active in the same industry. The talks pass off with difficulty and management has the impression that the takeover candidates prefer to buy the company following liquidation.

Considering the negative results and the troubled takeover talks, this refinancing is postponed until July 2017 in order to prevent liquidation.

The situation continues, better future is predicted, and optimism prevails.

Question No 8: Which (potential) legal and/or non-legal cross-border issues – if any – do you recognize in the Flow Management restructuring process?

Answer No 8: In the case study there is a mention of two legal entities in the name of Flow Management. The question does not specify that which entity we are talking about, though for my answer's sake, I am presuming that both the entities being in Netherlands, question of cross border does not arise. But when we talk about Flow Management Holding BV, this being holding company of 6 international subsidiaries and also being held by other international investor firms, there will be cross border challenges if it was put through a legal/informal and insolvency/restructuring process. The major issues in cross border situation are:

1. COMI: Centre of Main Interest
2. Access: Access of foreign representatives and creditors to courts in this state
3. Recognition: Recognition of a foreign proceedings and relief

4. Cooperation: Cooperation with foreign courts and foreign representatives
5. Concurrent Proceedings: Multiple proceedings and coordination amongst each other

In the case Flow Management Holding BV, COMI should be Netherlands because both the holding company and main subsidiary, where the loan amount and revenue of the company are highest are based at Netherlands. So, this issue is almost sorted.

As for the access, as found on Google, after 25 years of the Model Law of Cross-Border Insolvency of UNCITRAL (The Model Law), the Netherlands has not yet adopted it. Although the Dutch Bankruptcy Act (DBA) contains a chapter on cross-border insolvency matters, this chapter only contains three brief sections that merely regulate dealing with assets of a Dutch debtor located abroad. Though Netherlands is **bound** by Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the EIR), which provides the recognition of insolvency proceedings of Member States (Except Denmark). In the recent past there are examples where Dutch courts have accepted the foreign main proceeding and recognized it and have given access and relief to resolution professional. One case for India, namely **Jet Airways** is a big example of this.

Similarly, for recognition, cooperation and concurrent proceedings, although the DBS does not provide many solutions, and the sections which are related to cross border issues are actually skewed towards to protect the rights and interests of the home country's creditors. Although in practice it is happening, and courts are providing relief to other states' creditors as well.

And as for the case study, other than the Benelux countries, it was decided that they will be sold off. And there is another understanding of these three countries (Benelux-Belgium, the Netherlands and Luxemburg) to resolve insolvency in a cooperative manner.

In conclusion I would say that I do not foresee major cross border issues if Flow Management is put through a restructuring process.

Question No 9: In October 2014 four scenarios have been drawn up. Why was or wasn't calling for a moratorium (see scenario 4) a good option given the situation at that time? [you are allowed to give your opinion based on your own countries' Bankruptcy Act; be as detailed as possible]

Answer No 9: There is marked difference in the strategy for resolution of insolvency of the companies if we compare the procedures adopted for the group of Companies in the Question as compared to laws in India. Let me present below the procedure followed for invoking moratorium under Insolvency Laws of India (My Country) as compared to what is followed in the "Jurisdiction" of Flow Management Holding BV.

A. **Moratorium & Insolvency Resolution in India. – Insolvency and Bankruptcy Code, 2016 (The Code).**

Step – 1:

The Company under default to pay its debt is taken to National Company Law Tribunal (NCLT) by the creditors for declaring it insolvent. After the default is proven, the NCLT by a formal order admits the Company in the "Corporate Insolvency Resolution Process" (CIRP). An

Insolvency Professional, registered with the Regulator, takes over the custody & control of the affairs/assets of the Company and runs it as a going concern.

The Claims of all the creditors of the Company are invited and crystalized as on date of CIRP commencement.

Step – 2:

Moratorium under Section 14 of the Code. The relevant text is given below:

14. Moratorium. –

(1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely: -

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b)transferring, encumbering, alienating or disposing off by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);

(d)the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

1[Explanation.-For the purposes of this sub-section, it is hereby clarified that notwithstanding anything contained in any other law for the time being in force, a licence, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of the license, permit, registration, quota, concession, clearances or a similar grant or right during the moratorium period;]

(2) ----------

(3) ----------

(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

Step – 3:

Inviting Resolution Plans (Bids from Prospective investors), through transparent public auction notice for takeover of the company as going concern.

B. Opinion based on my countries' Bankruptcy Act:

The term "Moratorium" under Indian laws broadly implies that:

i. fresh suits or ongoing suits against the Company cannot be continued for the recovery of the debts and outstanding's in case of goods and services suppliers.

ii. any asset of the Company cannot be transferred, encumbered or disposed off.

The outstanding dues of the Company prior to the commencement of CIRP will be paid from the proceeds of resolution amount to be given by the prospective investor. The Insolvency Professional will run the business of the Company as going concern and Company will be handed over to the successful bidder/investor who quotes the highest value after the due approval of the resolution plan by the NCLT.

C. Understanding of the Term Moratorium from the question problem:

Although, after initiating CIRP in India by NCLT, there is a declaration of moratorium whereby any payment towards the financial debts of the company stops. So, any payment towards the principal or the interest of financial debt is stopped also payments to operational creditors due prior to CIRP date are stopped. So, in that sense moratorium is a full-fledged part of the formal restructuring process under the Insolvency and Bankruptcy Code 2016 of India. I understand that moratorium in the jurisdiction of Flow Management Holding BV means formal suspension of payments procedures. So, while actions taken under moratorium may seem similar in the two jurisdictions, the intent and outcome are quite different from Indian Laws.

D. Findings

The process of moratorium followed in the question problem doesn't fit into the scheme of moratorium followed under the Indian Law.

E. Why was or wasn't calling for a moratorium (see scenario 4) a good option given the situation at that time:

All the Four Banks (A, B, C, & D) have shown tremendous restraint in handling the bankruptcy of group of Flow Management Holding BV. The warning signals started appearing as back as in the year 2012 when anomalies appeared in the financial statements. The permutations and combinations on the levels of financial accommodation given to the group continued till July, 2015 when the restructuring was finally signed. Post Restructuring there have been positives like net profit appeared and equity capital was strengthened.

Thus, not calling of moratorium was a wise decision which ultimately led to good results and some group companies could be saved as a going concern.