**GLOBAL INSOLVENCY PRACTICE COURSE 2023 / 2024**

**Case Study 1 Answers**

**Question 1:**

In answering this question, I have first sought to understand more about the size and context of FMW Work BV and the other trading subsidiaries. The case study does not provide details of each operating subsidiaries’ financials or their relative size in the overall group. It does, however, note that FMW Work BV is the “main subsidiary” and the working capital loans and other loans of €360m and €55m respectively were provided to FMW Work BV directly, suggesting that it accounts for a significant majority of the business. The case study further notes that the entire group from FMW Holding BV downwards employees over 3,000 people and has more than 200,000 cars in its fleet. I will therefore assume that FMW Work BV accounts for 75% of the business, (e.g. approximately 150,000 vehicles and 2,250 employees).

Based on information from a report by Vereniging van Nederlandse Autoleasemaatschappijen (“VNA”), in 2013 there were c. 516,000 leased cars and light commercial vehicles in the Netherlands. Based on the above assumption that FMW Work BV has about 150,000 (i.e. 75% of 200,000) of those, it would have been a significant and sizeable player in the local market with a c.29% market share.

Interestingly, the VNA data from the report also shows that in 2013 leasing companies in the Netherlands had an average of c.190 cars per full time equivalent employee (though the VNA did qualify the accuracy of the data may be skewed by the way in which certain companies are organised and the outsourcing of services). Nonetheless, with the overall group having 3,000 staff and some 200,000 vehicles leased (only c. 66 vehicles per employee) this is a concerning difference (versus the VNA average) and suggests that employee costs may have been one of the drivers of the losses incurred.

In my experience, failure and distress are usually caused by a combination of internal and external factors. This view is supported by the summary of the literature in Mellahi et al. (2002) that concludes that generally it is a combination of the two with the balance amongst them varying case-to-case.

However, from the information provided in the case study there does not appear to be any major external factors that have impacted the company situation significantly. In particular, I note that the company appears to have been able to relatively easily agree price increases with key customers suggesting it was not under significant commercial pressure from competitors.

Based on the information available, it appears the main causes of the financial distress are internal and largely fall under the organisational studies and organisational psychology literature rather than the industrial organisation and organisation ecology view. The organisational studies and organizational psychology theories as outlined in Mellahi and Wilkinson (2004) seem to best capture the issues at play here.

While it is not clear how long FMW Work BV has been operating, it does not appear to be a particularly new company given its size, including market dominance, and ability to obtain high levels of funding. As such, it does not appear likely that the causes of failure and system deficiencies are due to the liability of newness or lack of time to build up proper systems (Nelson and Winter (1982) as cited in Mellahi and Wilkinson). Additionally, the concept that smaller firms are more likely to face distress or failure due to their size and higher administrative costs (Aldrich and Auster (1986) as cited in Mellahi and Wilkinson) does not fit the scenario here noting the size and market position of FMW BV Work as discussed above.

The key issues causing the financial distress came around through poor financial controls, financial accounting, and forecasting including a ‘formula error’ which led to significant undercharging. The wrongfully issued bonus to the CEO and CFO are, in the circumstances of the internal causes of the distress, particularly egregious with no suggestion in the case study that these were clawed back or voluntarily returned.

Whilst details are not provided as to the tenure of management, there are indications that they have been in place for some time (e.g. the large bonus) and there may be an element of what Miller (1990) cited in Mellahi and Wilkinson noted as ‘success can breed over confidence and arrogance’. Indeed, the initial reaction of management to the issues identified appears to be underwhelming and, with the benefit of hindsight, clearly was not sufficient to address the problems. Why it took so long for the CFO to be replaced given the fundamental issues in the financial recording and forecasting of the company is unclear and a more decisive move by the board could have benefited the overall process. The CFO would have been naturally inclined to downplay the issues at the outset given his culpability in the hope that they would resolve themselves in time. The initial difficulties were compounded by the failure of the company to make accurate projections further eroding any trust the banks had.

Given the above, it does appear that a large part of the financial distress could have been avoided if the company had better financial controls and forecasting processes in place. At the very least, the problems should have been identified much earlier and a proper rectification plan put in place.

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**Question 2:**

The main advantages of an out-of-court restructuring are usually a reduced cost, more flexibility on the terms and less negative publicity. This is summed up by Adriaanse and Kuijl (2006) as “flexibility, silence and control”.

The main disadvantages are there is no stay on proceedings against the company and you need to achieve unanimous consent with no ability to cram down any dissenting creditor.

Out-of-court restructurings tend to work best when there is fewer creditors that need to be compromised (as is the position in the case study) and the company’s structure is not too complex.

Hong Kong does not have any corporate rescue mechanism despite several attempts over the last nearly 30 years or so to introduce one. The most recent attempt was made in 2021. The Hong Kong Government tabled the Companies (Corporate Rescue) Bill (“CCRB”) into the Legislative Council in November 2021 (Chan and Wong (n.d.)). The CCRB, if it is eventually enacted, envisages a process to be known as Provisional Supervision which will be able to be commenced by a company (or liquidator or provisional liquidator) which will apply a statutory moratorium preventing civil proceedings and actions being brought against the company and its property.

Presently in Hong Kong, the options for restructuring are a consensual restructuring or the use of a Scheme of Arrangement. In terms of a consensual restructuring there exists a set of guidelines issued by the Hong Kong Association of Banks and the Hong Kong Monetary Authority called “Guidelines on the Hong Kong Approach to Corporate Difficulties”. The official release on the HKMA website regarding it states it “sets out formal but non-statutory guidelines on how banks should deal with corporate borrowers who are in financial difficulties and the way in which corporate workouts should be handled by banks”. The Hong Kong Corporate Insolvency Manual Fourth Edition (2018) notes that per a judicial decision in Credit Lyonnais v SK Gloval Hong Kong Ltd [2003] 4 HKC 04, the Guidelines have no statutory force and are not legally binding on banks. The Hong Kong Corporate Insolvency Manual Fourth Edition further notes that the guidelines do not apply to the numerous other creditors which may be involved in a restructuring such as bondholders, trade creditors etc.

Whilst the Scheme of Arrangement is an in-Court restructuring process, importantly it does not come with any kind of moratorium. In practice, the Hong Kong Court is often willing to adjourn a winding up petition if the company in question can show it has a coherent plan to restructure and has the support of a significant number of creditors. This is being seen quite often during the current real estate crisis in mainland China which has impacted numerous Hong Kong listed property developers. The Hong Kong Court appears to evaluate each case on its merits and if it feels the company is not making genuine efforts to restructure or does not have the support of enough creditors it will make a winding-up order. This is best explained in the reasons for decisions issued by the Honourable Madam Justice Linda Chan In Re Jiayuan International Group Limited (佳源國際控股有限公司) [2023] HKCFI 1254 where she stated:

“If the company opposes the petition on the ground that there is a reasonable prospect of being able to restructure and compromise the debts and restore its solvency, it has to demonstrate to the court that a concrete restructuring proposal or a scheme of arrangement has been prepared and put forward to the creditors for their consideration, and such proposal or scheme has the support of the requisite majorities of creditors… Unless the company is able to demonstrate that there is some useful purpose in adjourning the petition, there is no proper basis for the court to delay the creditor’s right in seeking an immediate winding up order against the company.”

In the case study, the business is primarily based in the Netherlands. I understand that on 1 January 2021, the Act on the Confirmation of Private Plans (known by its Dutch acronym - WHOA,) came into effect in the Netherlands and that it is possible for either the debtor or creditors to apply under the WHOA (Loyens Loeff, (n.d.)). There is not much information provided in the case study regarding the discussions that led to the restructuring agreement or if the shareholder resisted what broadly amounted to a debt for equity swap which wiped out the shareholder’s interest, though it is noted that the banks had security for their loans and they may have effectively forced the shareholder to agree. If the shareholder agreed it is likely because the equity was out of the money though there is no indication that any valuations were done to confirm this. If the shareholder felt that there was equity value remaining in the business then they could potentially have sought to utilise the WHOA process, though this may have led to a dispute with the banks on valuation. Broekema and Adriaanse (2022) note that it can be difficult to properly value the going concern value of a business in distress for the WHOA process given the many assumptions involved. With the benefit of hindsight and the information provided about the business performance post the restructuring and noting the significant debt write-offs as part of the restructuring, it does seem that the value did break in the debt and this is likely why the shareholders agreed to effectively give up their interest in the business.

**References**

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**Question 3:**

In the case study, we can see a number of the turnaround approaches discussed in the literature in practice, some more successfully implemented than others. Adriaanse and Kuijl (2006) talk about four steps in the process - stabilise, analyse, reposition and reinforce.

The company attempted to stabilize initially by increasing prices, cutting staff and other expenditure reductions expected to save €15m overall. Hofer (1980) as quoted in Sudarsanam and Lai (2001) notes that operational restructuring steps (i.e. cost cutting, increasing revenue and efficiency improvements) are usually implemented first. This is consistent with what we see in the case study where similar actions were implement in December 2013 at the early stages of the restructuring. As demonstrated by the later developments, these initial attempts to stabilise were not sufficient and the company continued to make losses.

In terms of analysing, the company did hire an independent turnaround consultancy though the level of their involvement and scope of work is unclear from the information provided. The consultancy concluded that the company was viable, but the company’s subsequent failure to meet any of the projections calls into question the level of work done. Adriaanse and Kuijl note that “it is important that the plans are realistic”, which in the case study did not turn out to be the case.

In repositioning the company, Adriaanse and Kuijl note the importance of management reporting to stakeholders in an open and timely manner. One thing that struck me from the case study was the CRO announced in a press release the expected loss of €27.5m for 2014. It was not clear to me why there would be an announcement of such an issue given that this is not a public company. One of the major benefits of an informal restructuring is the ability to keep things largely secret. Additionally, I understand that in the Netherlands the WHOA can also be private (Loyens Loeff, (n.d.)) which is a significant benefit not available in many other jurisdictions to the best of my knowledge. In addition, it appears from the case study that the banks learnt of the expected loss from the press release which goes against the principal of open and timely reporting to stakeholders. Any significant issues, such as an unexpected increase in the projected loss, should be communicated directly with the banks with a clear explanation about the causes and any steps being taken to rectify them.

In the reinforce stage, the inclusion of new or outside management is often used to drive the turnaround plan and rebuild trust with stakeholders (Adriaanse and Kuijl). We see this in the case study through the removal of the CFO, CEO and appointment of a CRO.

Elements of the stakeholder influences model set out in Pajunen (2006) can be seen in the case study. Pajunen’s contention that “neither the resources nor the network positions of stakeholders are static” can be seen in the increasing importance of the role played by the banks over time. The role of management as a liaison point also becomes more important once the CRO is brought in. Pajunen also notes that “the promotion of open communication and cultivation of personal connections with the most influential stakeholders are among the practical functions of managers in a crisis organization”. In the case study the introduction of a particular person as CRO at the request of the banks was likely important in keeping the banks onboard and in ultimately being able to finalise an agreement with the banks. Sudarsanam and Lai note that bankers and investors may only continue support if they have confidence in management. Whilst Slatter (1984) as quoted in Sudarsanam and Lai notes that brining in new management can give “tangible evidence” of change to financiers. It is noteworthy that the CRO was given shares in Flow Management II BV as part of the restructuring which is an indication that the banks trusted her sufficiently to complete the turnaround of the business and maximise their recoveries from the eventual sale of Flow Management II BV. Sudarsanam and Lai further note that this is often necessary to change management as existing management can find it hard to change habits and implement reform.

In the case study we see the strategy develop over time to include divestment of subsidiaries. Slatter as quoted in Sudarsanam and Lai notes that divestment of subsidiaries is a very common strategy pursued by most firms except small ones. Sudarsanam and Lai identified that in the firms they reviewed, typically the ones that recovered placed more focus on “forward-looking, expansionary and external market focused strategies”. In the case study we do not see much evidence of an outward looking and growth orientated strategy, more a strategy that aims to stem the bleeding and hope to stabilise the firm sufficiently to achieve a sale, but one that seems to consistently miss targets and projections. From the case study material, the steps implemented do not seem to be working noting the significant ongoing losses post restructuring. In this regard, the finding of Sudarsanam and Lai that “ineffectiveness of restructuring in early years leads to more intensification of strategies” seems likely to be the case here too. Nearly three years on from the discovery of the issues and following a full restructuring and the company is still incurring losses. Very little confidence can be taken from the projected break even result for 2016 given no previous forecasts have been met. This suggests that there may well need to be a second restructuring soon or an “intensification of strategies” as noted above.

The focus of management seems to have been heavily on retrenchment, both in terms of personnel and of assets. This is seen in the initial reaction to dismiss 130 staff. Taking this measure at the start of the downturn and before developing any overarching recovery strategy. Schmitt and Raisch (2013) note that the focus on retrenchment is often to fix some existing issues to achieve some stability and breathing space for the wider restructuring. The rationale for implementing retrenchment upfront as in the case study is reinforced by the need to keep the lenders onside. Khandwalla (1983) as mentioned in Schmitt and Raisch notes that banks often want to see the company make quick improvements to protect their investments in the company so retrenchment can demonstrate that the company is taking concrete steps. However, in the case study we do not see a major recovery plan later implemented, rather more piecemeal changes (divestment of some subsidiaries etc.) which do not have the desired effect (given the continued losses). The case study alludes to a strategy of increasing turnover in combination with large cutbacks, but it is unclear whether any detailed strategy was prepared. Additionally, there is no real mention of management’s efforts to link the retrenchment (cutbacks) and recovery plan (revenue growth) and to engage with stakeholders, particularly employees, to sell that. Morrow et. al (2007) as noted in Schmitt and Raisch suggests that by presenting a proper recovery plan and demonstrating how the retrenchment supports that plan, it is possible to get buy in for the cutbacks. If, as appears from the case study, management here just implemented cutbacks and sought revenue growth without a clear and well communicated plan, then that could well create disgruntlement among employees and may be one of the reasons that the recovery had not yet succeeded. More emphasis should have been placed on mapping out and conveying a future for the business.

Overall, it appears to me that various aspects of the turnaround / reorganisation approaches from the reading material can be seen in the case study, though it many of the situations the actual implementation appears to ineffective or at least less effective than would be desirable.

**References**

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**Question 4:**

From the information provided, it appears that initially all four banks were broadly aligned on the approach to be taken with the company and agreed that steps should be taken calmly and jointly to maximise value.

The change in position from banks C and D in mid-February to one of non-cooperation with the other lenders appears to be designed to try to improve their position. Ferry (2023) summarizing Lienau (2014) and Asonuma and Joo (2020) notes that whilst all creditors are focused on maximising profit / outcome, they may have different specific objectives depending on their specific circumstances. Whilst that paper was focused on sovereign debt restructuring, in my experience it applies to company restructurings too. I have seen this dynamic in action in Asia where we often encounter large bank groups with banks based in different countries on mandates. In matters I have worked on in Indonesia, the local banks’ focus was often to avoid any principal write offs so they would favour reductions in interest rates and long-term extensions for principal repayment, whereas international banks who may be subject to much stricter capital requirements on any non-performing loans in their home market would want a shorter-term outcome with a much more realistic solution implemented based on the real financial position. My experience with most mainland Chinese banks is that they have bureaucratic structures with decision making centred in a few individuals at head quarter level. For this reason, mainland Chinese banks often needs weeks or months to make basic decisions as part of a banking group which can frustrate other banks and increase timelines and advisors need to be aware of this and build it into their considerations.

A recent illustration of this divergence in creditors priorities in Asia and how it can be addressed is seen in the proposed restructuring of Yuzhou Group Holdings Company Limited (“Yuzhou”), a Cayman Islands incorporated and Hong Kong listed real estate developer. On 6 August 2023, Yuzhou filed an announcement regarding the terms of its proposed restructuring of c. USD6.8 billion in offshore debt. Youzhou provided creditors with three options to choose from, broadly bonds of different maturities and terms. Those who took the short-term bonds had to forego a higher amount of principal, whilst those accepting the longer payment terms were compensated by a higher recovery rate. This type of proposal would have been made in an effort to address the divergent priorities of different creditor groups and is a recognition that sometimes a one size fits all approach will not work.

If I had been advising banks A and B in Hong Kong, then I likely would have tried to get the other banks onboard noting the terms of the Hong Kong Approach to Corporate Difficulties as issued by the Hong Kong Association of Banks and supported by the Hong Kong Monetary Authority. The guide notes that:

“the work-out will need unanimity. Where however a clear majority of banks is agreeable to a stand-still and/or work-out, other banks should carefully review their position and explain their objections clearly. Banks should be aware of the need to work to the overall good of the banking group rather than purely individual interests in the knowledge that if they fail to co-operate in a work-out, they may suffer a similar disadvantage if in a subsequent case the roles are reversed.”

In this regard, trying to understand banks C and D’s objectives and working with them to achieve them would hopefully be able to keep the bank group aligned and functioning. Banks C and D’s move to cease cooperation nearly had the desired effect from their perspective, with banks A and B considering buying them out at a 15-20% discount. Given the terms of the eventual restructuring and the new company’s ongoing losses, had banks A & B completed that buy-out of banks C and D’s debt at such a small discount from par they would have significantly increased their overall losses on this case.

In June 2014, banks C and D also threatened to cancel the loans / enforce, but as the case study explains, it was really a pressure tactic to keep the company focused. This type of threat is not uncommon in restructuring situations and usually arises if the company is not adequately engaging with creditors or is consistently failing to meet deadlines or to keep commitments.

**References**

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**Question 5:**

The first principle involves the utilisation of a standstill period to allow time for all parties to evaluate the situation. In the case study, a standstill period is agreed around August 2014 which is some eight or so months after the problems emerge. Generally, one would expect to see the standstill period be agreed much earlier in the process after the discovery of the initial issues. Indeed, a standstill period was being discussed from as early as January 2014, but given the issues between banks A and B (in one camp) and banks C and D (in the other camp), discussions on the standstill period stalled in February 2014. The standstill signed was for 120 days from mid-August 2014 and so it ended in mid-December 2014. The case study does not confirm if any further extension was agreed though the restructuring was not completed until July 2015. As such, most of the workout period was spent without a formal standstill period in place.

The second principle states that creditors should refrain from enforcing their claims during the standstill period. It appears from the case study that the standstill period was only in place for 120 days and as no creditors enforced their claims at all during the workout process despite some threats of enforcement. As such, this principle seems to have been abided by.

The third principle involves the debtor not taking any action which might adversely affect the creditors during the standstill agreement. In the case study, Flow Management does not take any specific steps during the 120-day standstill that would adversely impact the creditors. It actually provides the creditors with security over €10m of tax refunds during the period, thereby improving their position.

The fourth principle involves the creditors coordinating, potentially through coordination committees and / or through the appointment of advisors. In the case study, the four banks initially do coordinate their response in line with this principle, but then they diverge into two groups and banks C and D take a more aggressive approach with the debtor. Eventually a standstill is agreed and in the end a restructuring is agreed. The case study mentions the engagement of an accounting firm to review the procedures of the company though it’s unclear if the engagement is by the company or the banks. Reference is also made to a turnaround consultancy concluding the company is viable in December 2013. Again, it is unclear which party engaged the consultancy and there is not much further mention of the involvement of advisors. A restructuring of this scale would have benefited from a more in-depth review of the company’s situation at the outset which one would expect should have identified at least some of the issues that led to the further losses being incurred in spite of projections for breakeven or profitable trading. If the four banks had engaged a single advisor, this may also have helped in keeping the banks united as a group.

The fifth principle relates to the provision of all information to the creditors and / or their advisors during the standstill period to allow a proper evaluation of any proposals. As noted above, the standstill agreement was agreed quite late in the process and it is unclear if the banks had actually engaged their own advisors during the process. In the case study, there appears to be a reasonable flow of information generally, but the quality of it is very questionable due to the constantly changing estimates of losses. It is noted that the banks appear to be generally happy with the new management when they agree to the standstill period and that in October 2014 (midway through the standstill period) the provision of information is said to have improved.

The sixth principle notes that proposals should reflect the relative positions of creditors. The case study specifically notes that the financial restructuring reflects the relative positions of the financiers with those with security (the original working capital providers) receiving the majority of the shares in Flow Management II BV. The other financiers are said to have no or subordinated security rights and are expected to receive nothing on liquidation.

The seventh principle relates to there being a common information platform for all creditors and that the information should remain confidential. In the case study it appears that all four banks are receiving the same information at the same time, though, unfortunately, the quality of the information appears unreliable. Strangely, the case study notes that the new CRO announces an increased expected loss in June 2014 through a press release. As it is not a listed company, it is unclear why they would publicly announce such information. It also appears that the banks learn of the situation from the press release which is clearly not how such matters should be dealt with as this is likely to annoy the banks and reduce trust in management.

The eight principle involves the concept that additional funding provided during a standstill period or under rescue proposals should be repaid in priority. In the case study it is noted that €25 million is repaid to the providers of the additional working capital, though the case study does not make it explicitly clear who this is. Based on the information in the case study the shareholder provided €35 million (some €10 million initially before the standstill and a further €25 million in September / October) on the condition a standstill is agreed. As such, it seems that reference to €25 million being repaid in January 2015 is likely to be a repayment of the €25m provided during the standstill period. That would be in line with the eight principle of giving priority to funding provided during a standstill period.

**References**

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**Question 6:**

“Soft law” and other types of guidelines or principles can sometimes provide a path to steer restructurings and insolvency matters and be used as a way to try to keep stakeholders focused on achieving a fair outcome.

Wessels and Boon (2021) note that soft law can be influential and that in the restructuring and insolvency context, courts have made specific mention of recommendations made by standard-setting organisations. They further found that in recent times there has been a significant increase in the number of soft law instruments or guidelines for international restructuring and insolvency to more than fifty.

In considering the situation in Hong Kong, it is important to bear in mind that Hong Kong has no statutory rescue mechanism and no way for a company to obtain a statutory moratorium during a restructuring. The main mechanism for a restructuring is therefore a scheme of arrangement and in multi-jurisdictional matters there are certain complications with this in the Hong Kong context. One “soft law” concept that can help is the use of court-to-court communications which are often used for restructurings. The main courts with which Hong Kong has a regular need to communicate with are the Cayman Islands Court, British Virgin Islands Court, Bermuda Court and to a lesser extent the US Court. Unfortunately, Hong Kong has not adopted the Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters, also referred to as the JIN Guidelines though all the other Court listed above have adopted them (specifically Delaware and New York for the US) (Wilson et. al (2023). This leaves Hong Kong operating outside these formal guidelines. Such court-to-court communication can be highly important in the Hong Kong context given that most Hong Kong listed entities are incorporated in one of the Caribbean jurisdictions and many issue New York law governed bonds. For this reason, restructurings in Hong Kong are often completed by way of multiple schemes of arrangement with recognition sought in the US under Chapter 15 of the US Bankruptcy Code. Had Flow Management Holding been based in Hong Kong, a restructuring may well have been completed under such a mechanism.

In Hong Kong there is a set of guidelines issued by the Hong Kong Association of Banks and the Hong Kong Monetary Authority called “Guidelines on the Hong Kong Approach to Corporate Difficulties”. The guidelines are non-statutory and non-binding. The guidelines note “Banks should be aware of the need to work to the overall good of the banking group rather than purely individual interests in the knowledge that if they fail to co-operate in a work-out, they may suffer a similar disadvantage if in a subsequent case the roles are reversed.” In my view this point is of particular importance and part of how one would try to keep parties from pursuing solely selfish goals. In Hong Kong, one tends to see many of the same banks on most cases. In relation to case study, if these principles were followed it may have avoided the divergence between banks A and B and Banks C and D which appeared to slow progress on the restructuring.

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**Question 7:**

The core of the restructuring agreement was the transfer of all the trading subsidiaries to a new company (“Newco”), the shares of which were provided to the four banks, with some shares provided to board members including the CRO. This effectively means that due to the inability to settle the liabilities, the shareholder has lost all economic interest in the trading subsidiaries. As part of the process, the shareholder has also waived any claims against Newco. The shares provided to certain board members will have been done as a retention and performance incentive. The banks will likely have been keen to ensure continuity of management with a view to maximising value from the eventual sale of Newco. The outcome is broadly in line with the third of the four strategy options developed in October 2014 which envisaged a debt for equity swap.

Flow Management Holding is to be liquidated, but given that it is said to be a holding company, it’s only assets should be the shares in the subsidiaries which have been transferred to Newco. Therefore, there is unlikely to be any realisations in the liquidation.

The banks have agreed a series of write-offs of debt, reducing the debt of Flow Management Work BV by a total of €185m. This will have been done with a view to ‘right sizing’ the balance sheet in order to make the debt of Newco and Newco’s subsidiaries sustainable so that a buyer can be obtained. If the debt is unsustainable, then no purchasers would be willing to purchase the equity, with which the banks will be hoping to in time recoup, at least some of, the written off debt. However, the post restructuring performance of Newco remains concerning and the business continues to miss forecast targets. The planned sales process has not achieved the desired results. Some of the terms of the restructuring appear to not be conducive to achieving the desired outcome. For example, the working capital of Newco which appears to be €240m was originally to be refinanced in November 2016. This means that any purchaser would be buying a currently loss-making company with an imminent need to refinance a substantial debt. In these circumstances, it is not surprising that the sales process failed. Indeed, the extension of the refinancing to July 2017 still does not really address the underlying issues.

If the banks wish to maximise their outcome, then in my view if would make sense to set Newco up for long term success. The banks appear to be supportive of management, but given the company is still loss making some 2.5 years after the initial problems emerged and following a comprehensive restructuring, there must be some concern as to the details of the restructuring or the competency of management. In addition, the working capital position needs to be evaluated further and a sustainable package put in place, so that a purchaser will not need to immediately refinance unless they wish to do so. The banks could consider offering some type of funding package to potential purchasers to facilitate a takeover and in return seek further security or guarantees from the purchaser.

I would suggest that further focus needs to be placed on returning the business to profitability and demonstrating a sustainable growth path before further efforts are made to sell Newco. Sudarsanam and Lai (2001) found that firms that placed a focus on expansion and growth tended to recover more than firms that focused solely on cost cutting. This may mean that to really recover, Newco may need to consider an acquisition or some type of consolidation with another firm. This would require further investment and given the past few years the banks may be reluctant to support this, though it may be that the banks need to take those steps to really engineer a solution and an exit from this matter as if the current loss making continues, then ultimately, they face likely further write offs in a liquidation scenario.

**References**

Sudarsanam, S, Lai, J., (2001), ‘Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis’, British Journal of Management, Vol. 12, 183-199.

**Question 8:**

Flow Management group is a geographically diverse business, with a Netherlands holding company and six operating subsidiaries. The operations are in three European countries, South Africa, Australia and the USA.

It is noted in the case study that the foreign subsidiaries are incurring losses though it is not explicitly stated if all of them are incurring losses and which ones are incurring the most. One of the cross-border issues that may arise in the restructuring is how to deal with the foreign subsidiaries and local creditors in these subsidiaries. For example, it is not uncommon for foreign subsidiaries to have their own funding lines from local banks, particularly as the case study does not mention Flow Management adopting any type of central treasury management system across the group. These local lenders may in turn have security over the assets of that individual foreign subsidiary to secure their lending and that could trump security held by the four banks if their security over the foreign subsidiaries is limited to share charges or second ranking charges over the assets. Incorporating these local lenders into a wider restructuring may prove challenging, particularly if the local lenders consider that they are fully secured.

Additionally, if any of the foreign subsidiaries are severely loss making and the view is formed that they cannot be restructured without being a significant drag on the other entities this may complicate the overall restructuring. In these circumstances, it may be necessary to place such subsidiary into an insolvency process in its local jurisdiction (such as Voluntary Administration in Australia) to reduce its drain on the overall group. In this scenario, it would be important to be mindful if any of the other entities had provided guarantees or security for the debts of the subsidiary as placing it into an insolvency procedure would then not be effective in reducing the burden on the overall group.

On a practical basis, the geographic spread of trading entities here and the fact that many groups (at least in my experience of conducting financial reviews) are not well centralised meaning local units have lots of autonomy, maybe operate on different financial information systems (particularly if they were acquired rather than set up from scratch) and this could be one reason for the poor quality of information from the group and is an additional challenge for the four banks.

In these multi-jurisdictional matters, one should always try to consider the local issues that can arise. Whilst I do not have much familiarity with the insolvency processes in most of these jurisdictions, except Australia, it is important that any impediments to the restructuring are identified early and considered as part of any overall plan. By this I mean considering issues such as if there are any local restrictions on terminating employees or otherwise downsizing or closing a business. For example, in the Peoples’ Republic of China the priorities are different to those in many of the western countries we are more familiar with and there is a high focus on social stability and workers’ rights. It can therefore be difficult to exit a business there.

It is not stated in the case study what exact security is held by the lenders, but it is noted that some issues with the security and its enforcement were identified. In a structure such as this, lenders would usually want to have a holistic package of security including pledges over the shares of each subsidiary and charges over the assets of each subsidiary assuming there was no debt in the other subsidiaries provided by local banks which may already have taken a first ranking charge over the assets of that subsidiary. If Flow Management Holding went into liquidation, then in my experience and assuming no specifics of Netherlands law to prevent such a process, I would expect that the liquidator would want to try and sell the shares of the subsidiaries relatively quickly given the entities appeared to be continuing to incur losses. Whether a single buyer would emerge for all of the entities or the sales would need to be conducted entity by entity would likely depend on the financial position. Indeed, some entities may be seen to have no value and may be shut or placed in liquidation within the local jurisdiction.

Due to the structure, a holistic restructuring of all the subsidiaries would be very challenging in a formal restructuring regime given the various different jurisdictions of operations and this may well be why the informal restructuring approach was pursued in this case.

I note that the Netherlands has a new restructuring process since 2021, the Act on the Confirmation of Private Plans (known by its Dutch acronym - WHOA,) came (Loyens Loeff, (n.d.)) that could potentially have assisted in this case if a more formal insolvency route was chosen.

It is not clear from the case study what the governing law of the debt provided is or where the banks are based though given the circumstances you would expect they are likely Dutch banks. If, however, the debt was governed by English law for example, then the company may have considered utilising the UK restructuring regime.

One other option that may potentially have been possible to facilitate a holistic restructuring would be to place the debtor entities into Chapter 11 in the United States. The US system is known to have low barriers to entry and in cases I have been involved in, groups which much less connection to the US than Flow Management have utilised the Chapter 11 process to restructure. Walters (2017) notes that the US Courts shun high barriers to having insolvency cases admitted and this makes it a favourable destination for forum shopping. Walters quoting JL Westbrook et. al (2010) notes that the US system has a commitment to providing debtors with an opportunity reorganise without delay that may cause value destruction. In the Flow Management case, it appears that the restructuring took quite some time, over 18 months in total and in the end, the restructuring really amounted to a transfer of the business through a debt for equity swap. It strikes me that a more assertive approach from the shareholder could have driven a better restructuring and potentially one where they did not lose control of the entire Flow Management group to the banks, particularly in circumstances where the shareholder seemed to have the ability and willingness to put additional funds in. The Chapter 11 approach could potentially have been one approach that may have provided the shareholders with a more streamlined approach to protect value though they may have faced challenges from the banks or attacks as to the appropriateness of using Chapter 11. I note that it is not necessary for a formal insolvency process to have been utilised for the shareholder to obtain an improved outcome, the shareholder may also have achieved a better outcome through better and quicker decision making (e.g. change of management, recognising issues in the management information system and forecasting) and through better negotiations with the banks. It appears from the case study that Flow Management / the shareholder conducted discussions with the banks directly and they may have benefited from the processes and procedures a restructuring advisor would have brought to bear on the matter.

**References**

Loyens Loeff, (n.d.), WHOA – Dutch scheme of arrangement, <<<https://loyensloeff.com/dutch-scheme-of-arrangement.pdf>>>, accessed 28 October 2023.

Walters, A. J. (2017). United States’ bankruptcy jurisdiction over foreign entities: exorbitant or congruent? JCLS 17 (2): 367–404.

**Question 9:**

Hong Kong does not have any corporate rescue mechanism and as such, it is not possible for a company to obtain a statutory moratorium in Hong Kong.

In the Hong Kong Corporate Insolvency Manual Fourth Edition, the authors note that

“Hong Kong is one of the few – perhaps only – commercial centre in the world without a formal rescue mechanism on its legislative books….means that in many instances the process of rescuing a distressed company is far more complex, expensive and time-consuming than it should be.”

Due to the absence of a statutory moratorium in Hong Kong, option 4 in the case study would not work as proposed. It might be achieved through a further standstill agreement with the suspension of any repayments until the sale was achieved but this would likely only involve the four banks and trade / other creditors would still be able petition to wind up the company if they were not paid. On a practical basis, option 4 also required the banks to provide a further bridging loan which likely would have been unattractive given the company’s continued failure to actually meet any of its forecasts during the prior period.

The process could have been achieved on an informal basis in this case, if the four banks were willing to commit to a further standstill period and provide some funding. Given the small number of creditor stakeholders here (four banks), the need for a statutory approach is lower than if dealing with numerous creditors.

With the benefit of hindsight, option 4 (a moratorium and controlled sale) would likely not have been in the best interest of the lenders and instead they choose to take control of the business away from the shareholders to complete a sale process. However, even that process has not gone according to plan and at the end of the case study the banks remain in a difficult position and facing potential further losses.

**References**

Booth, CD., Tyler, ELG., Ng, L., Kan, T. The Hong Kong Corporate Insolvency Manual - Fourth Edition. LexisNexis (2018), p. 304.