GLOBAL INSOLVENCY PRACTICE COURSE

2023/2024

CASE STUDY 1

Anna Lin
Hong Kong
4 November 2023

1. What were in your opinion the causes of financial distress at Flow Management (see e.g. Mellahi & Wilkinson, 2004)? Could the financial distress have been prevented? If yes, explain how. If no, why not?

Based on the information provided in the materials, the causes of financial distress at Flow Management can be attributed to a combination of factors identified as follows:

Internal inadequacies (Mellahi & Wilkinson, 2004)

1. *Poor financial management*: The company's financial management exhibited clear deficiencies, as evidenced by the CEO and CFO receiving substantial management bonuses (amounting to € 3 million) that were not justified by the company's financial performance. Moreover, the company's accounting practices fell short of standard requirements, with errors identified in the annual accounts, such as the wrongful booking of a contingency gain and the inclusion of book profits that should not have been recorded. Additionally, the company's financial statements lacked reliability, as the fundamental principles used in cost price calculations deviated from reality, and regular checks to verify the accuracy of cost allocations were not conducted, resulting in formula errors in the financial statements.

2. *Lack of cost control*: The company encountered losses due to inadequate management of its cost structure. The management neglected regular monitoring of actual costs, which resulted in delayed price adjustments. Consequently, the inaccurate pricing of the company's products and services resulted in financial losses for the organization.

3. *Failure to address negative corrections*: The company's failure to promptly address negative adjustments led to the discovery that, in addition to Flow Management Work BV's loss of €5.4 million, the foreign subsidiaries incurred a loss of €6.3 million, resulting in a total loss for 2013. The financial statements and forecasts proved to be unreliable, as the actual total loss exceeded the reported amount on 1 December 2013, and the solvency level was virtually zero at 0.1%. The company's financial information exhibited significant unreliability, as losses in the years 2013 to 2015 were reported unexpectedly, deviating from the company's expectations.

While the information provided in the case study is limited, there could be other reasons which contributed to the financial distress of Flow Management, and these may include:

1. *Poor governance*: The company's governance structure could be inadequate, resulting in the board of directors did not have sufficient independence and expertise to effectively monitor and control the company's management.

2. *Groupthink*: As set out in Mellahi & Wilkinson, 2004, "*Groupthink*" refers to the tendency of decision-makers in small groups to make suboptimal decisions. When there is an overwhelming pressure for unanimity, it can create a tightly-knit group that overlooks potential threats and lacks the norms of thoughtful decision-making. Once "groupthink" takes hold, various problematic behaviours emerge, including self-censorship among managers who suppress any doubts or concerns, collectively rationalising flawed practices, fostering a false sense of invincibility, perpetuating stereotypes about external groups, conducting a limited search for alternative solutions, disregarding external information, overestimating the group's chances of success, and engaging in biased information processing. As a result, managers inaccurately assess events and make decisions that may lead to failures.

3. *Curse of success*: As set out in Mellahi & Wilkinson, 2004, the "*curse of success*" pertains to the phenomenon wherein prosperous companies are prone to failure because their successful routines gradually transform into ingrained habits and traditions, thereby reinforcing the organisation's established way of operating. Consequently, the very organisations that were highly successful in the past become the most susceptible to failure in the future.

In my opinion, the financial distress at Flow Management could have been prevented. Here are some steps that could have been taken to prevent the financial distress:

1. Implement appropriate financial management practices: The company should have had a robust financial management system in place, which would have enabled them to monitor their financial performance accurately and make informed decisions.

2. Conduct regular internal audits and financial reviews: Regular internal audits and financial reviews would have helped identify errors in the company's financial statements and prevented the accumulation of losses.

3. Implement cost control measures: The company should have implemented cost control measures to ensure that their costs were aligned with their revenue.

4. Diversify revenue streams: The company should have diversified their revenue streams to reduce their dependence on a few key products and services. For instance, the Flow Management group could have explored opportunities such as expanding into delivery services for goods, pets, and flowers. Additionally, they could have considered forming partnerships or cooperatives with travel agencies and hotels, leveraging their existing fleet of cars. By embracing these possibilities, the company could have broadened its offerings and reduced its dependence on a few key products and services.

5. Strengthen corporate governance and internal control: The company should have strengthened their corporate governance structure by appointing independent directors with relevant expertise to the board, which would have provided better oversight and control over the company's management. The company should also establish effective internal controls, including segregation of duties, and checks and balances, would have helped detect and prevent financial mismanagement.

6. Cutbacks in expenditure: The company could have reduced its operating expenses by cutting back on non-essential spending, such as travel and entertainment expenses, and by renegotiating contracts with suppliers.

7. Optimising the stock situation: The company could have optimised its car inventory levels by implementing better inventory management systems. This would have helped to reduce inventory costs and ensure that the company had enough capacity on hand to meet customer demand.

8. Optimising turnover times of the accounts receivable (trade): The company could have improved its accounts receivable management by implementing a more efficient invoicing and collection system. This would have helped to reduce the amount of time it took to collect payments from customers and improved cash flow.

9. Asset stripping: The company could have sold off non-core assets, such as unused equipment and property, to raise cash and reduce debt.

10. Optimising of spontaneous financing: The company could have optimised its financing by negotiating better terms with its banks and by issuing debt securities to raise capital.

However, it is worth noting that the financial distress at Flow Management could also have been caused by external factors, such as the economic crisis, which affected the company's revenue and profitability.

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?

Advantages of out-of-court restructuring (workout) compared to formal bankruptcy procedure include:

1. *Flexibility*: Out-of-court restructuring allows for a more flexible approach to restructuring the debt, as the parties can negotiate the terms of the restructuring without being bound by strict legal requirements.

2. *Cost-effective*: Out-of-court restructuring can be less costly than a formal bankruptcy procedure, as there are no court fees, and the process can be less formal and less time-consuming.

3. *Preservation of business relationships*: Out-of-court restructuring allows the debtor and its creditors to maintain their business relationships, which can be beneficial for all parties involved.

4. *Avoidance of stigma*: Out-of-court restructuring can avoid the stigma associated with liquidation, which can be beneficial for the debtor's reputation and its ability to continue operating.

5. *Speed*: Out-of-court restructuring can be a faster process than a formal liquidation procedure, as it does not require court approval and can be completed in a matter of weeks or months.

Disadvantages of out-of-court restructuring (workout) compared to formal liquidation procedure include:

1. *Limited scope*: Out-of-court restructuring may not be suitable for all types of debt or financial situations, and it may not provide the same level of protection as a formal liquidation procedure.

2. *Lack of court oversight:* Out-of-court restructuring lacks the oversight of a court, which can make it more difficult to ensure that the restructuring is fair and equitable for all parties involved.

3. *Limited creditor protection*: Out-of-court restructuring may not provide the same level of protection for creditors as a formal liquidation procedure, which can lead to dissatisfaction among creditors and potentially jeopardise the restructuring process.

4. *No automatic stay*: Out-of-court restructuring does not provide an automatic stay on creditor actions, which means that creditors can continue to pursue legal actions and enforcement actions while the restructuring is ongoing.

5. *Uncertainty*: Out-of-court restructuring can be less predictable than a formal liquidation procedure, as the outcome is not guaranteed and can depend on the willingness of creditors to agree to the restructuring terms.

Formal liquidation or restructuring procedure (e.g. scheme of arrangement), on the other hand, provides a more structured and formal process for restructuring debt, which can offer greater protection for creditors and ensure that the restructuring is fair and equitable for all parties involved. However, it can also be more costly and time-consuming, and may not be suitable for all types of debt or financial situations.

For example, a restructuring by way of a scheme of arrangement in most common law jurisdictions including Hong Kong, the Cayman Islands, the British Virgin Islands and Bermuda, must be approved by 75% of creditors in value and a majority in number and that the scheme must be approved by the court in order to be effective.

Ultimately, the choice between out-of-court restructuring and formal liquidation/ bankruptcy procedure will depend on the specific circumstances of the debtor and its creditors.

Specific advantages and disadvantages of out-of-court restructuring in Hong Kong are similar to the ones set out above, and include:

Advantages:

1. *Flexibility*: Out-of-court restructuring in Hong Kong allows for a high degree of flexibility in terms of the restructuring plan, which can be tailored to the specific needs of the debtor and its creditors.

2. *Cost-effective*: Out-of-court restructuring can be less costly than a formal liquidation procedure, as there are no court fees, and the process can be less formal and less time-consuming.

3. *Confidentiality and Avoidance of stigma*: Out-of-court restructuring can avoid the stigma associated with liquidation, which can be beneficial for the debtor company's reputation and its ability to continue operating.

Disadvantages:

1. *No automatic stay*: Out-of-court restructuring does not provide an automatic stay on creditor actions, which means that creditors can continue to pursue collection actions while the restructuring is ongoing.

2. *Limited ability to cram down dissenting creditors*: Out-of-court restructuring may not provide the same level of ability to cram down dissenting creditors as a formal restructuring. This can pose challenges and make it more arduous to achieve a successful restructuring outcome.

3. *Limited ability to avoid preferential transactions:* Out-of-court restructuring may not provide the same level of ability to avoid preferential transactions as a formal liquidation procedure, which can make it more difficult to achieve a successful restructuring.

3. Were the turnaround/reorganization approaches as presented in the reading material (see e.g., Adriaanse & Kuijl, 2006, Pajunen, 2006, Sudarsanam, S, Lai, J., 2001, Schmitt, A., Raisch, S., 2013) applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.

In their article, "*Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions*", Adriaanse and Kuijl discussed turnaround and reorganisation strategies that companies can use to address financial and operational challenges. These approaches aim to restore a company's financial health and competitiveness, often through a combination of cost-cutting measures, operational improvements, and financial restructuring.

In the case of Flow Management, it appears that the company faced significant financial challenges, including a high level of debt, an inaccurate financial reporting system, and a decline in profitability. According to the case study, Flow Management's CEO and CFO were ultimately removed, and a new Chief Restructuring Officer was appointed to oversee the restructuring process. The business of Flow Management was repacked into a new company owned by the consortium of banks (i.e., Banks A, B, C and D) and a NewCo, Flow Management II BV, was incorporated, which is followed by the liquidation of Flow Management Holding BV.

In their article, Adriaanse and Kuijl contend that there are mostly two processes in a restructuring:

(a) business restructuring; and
(b) financial restructuring.

Regarding the first approach (i.e. business restructuring), which involves making changes to a company's business model, operations, and organisational structure to improve efficiency and competitiveness, this approach can help a company reduce costs, improve productivity, and better position itself in the market.

According to Adriaanse and Kuijl, business restructuring is often called "turnaround" and can be defined as:

> "*a comprehensive plan the aim of which is to restore the (operational) profitability of a company in financial difficulties. The main features of a restructuring process usually consists of … (i) stabilizing; (ii) analyzing; (iii) repositioning, and (iv) reinforcing.*" (See paragraph 3.1, *Business Restructuring*, Andriaanse and Kuijl, 2006)

In the Flow Management case study, the "stabilizing" approach is being implemented. This involves the company's strategy to improve its cash flow by raising the prices of its products and services. The company has communicated this intention to its end customers and sought their confirmation. Furthermore, the restructuring efforts at Flow Management include cost-cutting measures aimed at stabilising the company's financial position. These measures focus on reducing current expenses.

In their endeavour to enhance solvency, Flow Management's management has put forward a proposition to sell 350 cars. Nevertheless, the banks, who hold a differing perspective, have declined this proposal and instead favour a capital injection from the shareholder in the form of monetary funds. The banks perceive this direct capital infusion as a more favourable solution to meet the financial requirements of the company.

Regarding the "*Analyzing*" strategy, the Flow Management restructuring has implemented several strategies outlined in *Andriaanse and Kuijls's* "*Analysing*" framework. These "*Analyzing*" strategies include:

(a) Conducting a post-facto strategic and financial analysis to identify the root causes of the company's negative state of affairs.

(b) Assessing the current financial position to determine if the company still provides a sufficient foundation for recovery.

(c) Proposing specific measures and evaluating their impact on balance projections. Cash flow projections are also made for the short and long term, demonstrating the company's ability to fulfil its current and future obligations.

(d) Developing cash flow projections that indicate an improvement in the company's liquid assets over time.

(See paragraph 3.1.2 - *Phase II. Analyzing*, Adriannse and Kuijl, 2006)

By employing these *Analyzing* strategies, Flow Management aims to demonstrate to Banks A, B, C and D that it has gained a comprehensive understanding of its financial situation, identified areas for improvement, and created a roadmap for recovery.

In the context of "*Restoring Long-Term Profitability*", the following measures proposed by Adriaanse and Kuijl have been adopted by Flow Management:

(1) Adjusting strategy and marketing
(2) Cutting overhead costs
(3) Dismissing excessive personnel
(4) Rationalising the product assortment
(5) Improving management information systems
(6) Selling (profitable) operations which are not part of the core business

(see paragraph 3.1.2, *Table 3: Measures to Restore Long-Term Profitability*, *Adriaanse and Kuijl, 2006*)

As set out in *Adriaanse and Kuijl, 2006,* in order to rebuild business confidence, it is often crucial to enlist the expertise of specialised individuals such as interim managers, advisors, and accountants who are experienced in conducting turnaround processes. In the case of Flow Management, this approach has been implemented by engaging an independent accounting firm and consultancy firm. Their role is to examine Flow Management's financial system and assess the viability of its business as a going concern. By involving these external experts, the banks aim to gain recommendations to enhance Flow Management's financial stability and restore confidence in its operations.

Another turnaround approach which has been applied in this case is "*Repositioning*" in that the Flow Management's management seek to obtain consent from the existing clients on the increase of the prices, and supplying financial information and updates to the banks during the process (see paragraph 3.1.3, *Phase III. Repositioning*, Adriaanse and Kuijl, 2006). However, the results of repositioning by the management of Flow Management are not apparent, and the company continues to suffer financial losses.

In terms of "*Reinforcing*", the shareholder of Flow Management has provided some funding, however, not as much as the banks wish the shareholder to provide. Thus, reinforcing the balance sheet is not adequately applied in the Flow Management restructuring.

Regarding financial restructuring, which involves negotiating with creditors to reduce debt and modify payment terms. This approach certainly can help a company reduce its financial obligations and free up resources to invest in growth and improvement initiatives. This is definitely applied in the Flow Management restructuring. In the Restructuring Agreement, various terms of payments and loans are either varied,

postponed or written off, and these are all part of the financial restructuring strategy mentioned in *Adriaanse and Kuijl*.

According to Pajunen, K. (2006), "*Stakeholder Influences in Organizational Survival*", it appears that the six (6) propositions for restructuring a company in financial distress were not fully applied in the case of Flow Management case study.

1. Secure continuing support from governing stakeholders:

In the case study, Flow Management has placed significant importance on garnering ongoing support from its key stakeholders, including clients, the board of directors, shareholder, and major financiers such as Banks A, B, C, and D.

2. Frequent and open communication with governing stakeholders:

In the case study, Flow Management does establish a regular communication schedule with their governing stakeholders, including regular updates on their financial performance and progress, as well as any challenges they have been facing.

3. Personal relationships with governing stakeholders: Flow Management should cultivate personal relationships with their governing stakeholders, including building rapport and trust with individual stakeholders. This can be achieved through regular meetings, social events, and other opportunities for interaction. By building personal relationships, the company can better understand the needs and expectations of their stakeholders and tailor their communication and engagement strategies accordingly.

However, in the case study, it does not appear that Flow Management has cultivated personal relationships with their governing stakeholders.

4. Unlocked brokerage position: Flow Management should aim to establish an unlocked brokerage position between their governing stakeholders, which means they should seek to maintain a balance between the interests of all stakeholders, while also ensuring that the company's long-term goals and objectives remain the top priority.

In the case study, it is unclear whether the management of Flow Management has achieved this.

5. Consensus on long-term goals: Flow Management should work to establish a consensus among their governing stakeholders on the company's long-term goals and objectives. This can be achieved through a collaborative process of setting goals and strategies, and regular monitoring and evaluation of progress. By achieving consensus on long-term goals, the company can better align the interests of all stakeholders and ensure that everyone is working towards the same objectives.

In the case study, Flow Management seems to have reached some consensus with the banks on the company's long-term goals.

6. Continuous stakeholder engagement: Flow Management should achieve good firm performance in order to receive continuous stakeholder engagement.

In the case study, Flow Management experienced a decline in financial performance, leading to reduced stakeholder engagement and a lack of consensus among them. This situation persisted until the signing of the restructuring agreement in 2015.

Pursuant to *Sudarsanam, S, Lai, J., (2001), "Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis"*, the turnaround/reorganization approaches

applied in Flow Management can be classified into four categories: (1) managerial restructuring, (2) operational restructuring, (3) asset restructuring, and (4) financial restructuring.

1. Managerial Restructuring (Top management change): The company's management was restructured by appointing a new CRO, who had been recommended by the banks and had experience in turning around distressed companies. This move aimed to bring in fresh perspectives and expertise to lead the company's turnaround efforts and rebuild the trust that is needed for the continued support of the creditors (i.e., Banks A, B, C and D).

2. Operational Restructuring: The company's operations were restructured (slightly) by increasing prices of products and services, reducing costs by terminating redundant personnel, slimming overheads, and evaluating and reassessing the entire business mix (product-range), and improving efficiency. These measures aimed to improve the company's profitability and competitiveness.

3. Asset Restructuring: The company's asset structure was restructured by divesting non-core assets and businesses, such as the sale of its subsidiary, Flow Management Services, streamlining operations by selling off the shares of the companies outside the Benelux-countries as well as some foreign branches. These measures aimed to reduce the company's debt burden and focus on its core operations.

4. Financial Restructuring: The company's financial restructuring was implemented through the writing off of the debts of Flow Management Holding BV and the incorporation of the NewCo, Flow Management II BV.

In *Schmitt, A., Raisch, S.* (2013). "*Corporate Turnarounds: The Duality of Retrenchment and Recovery*", the turnaround approaches applied in the Flow Management case study can be related to the duality perspective of corporate turnarounds.

The duality perspective of corporate turnarounds suggests that turnaround processes involve both retrenchment and recovery activities, which are often seen as conflicting or opposing forces (Lim et al., 2013). Retrenchment activities aim to reduce costs, improve efficiency, and refocus the organization's resources, while recovery activities aim to restore growth, improve performance, and reposition the organization for long-term success (Arogyaswamy et al., 1995).

In the case of Flow Management, the management's turnaround strategies encompassed both retrenchment and recovery approaches. On one hand, the company implemented cost-cutting measures and restructuring initiatives to minimise expenses and divest its subsidiaries, which can be classified as retrenchment activities. On the other hand, the shareholder made investments through new capital and loans, and the company engaged in financial restructuring with banks. Additionally, efforts were made to enhance profitability by raising the prices of products and services. These actions can be categorised as recovery activities, with the objective of revitalising growth and enhancing overall performance.

In conclusion, in my view, although the restructuring efforts undertaken by Flow Management have incorporated various strategies, their implementation does not seem to be yielding the desired results. A more suitable approach would have been to adopt a comprehensive turnaround plan for the Flow Management restructuring, one that addresses not only the financial aspects but also the operational and strategic challenges faced by the company. Specifically, the Flow Management restructuring has neglected the operational restructuring component by failing to implement effective measures such as: (i) developing new market focuses, (ii) divesting unpromising business lines or

products, (iii) acquiring companies or businesses that complement and strengthen the core operations, and (iv) establishing strategic alliances, joint ventures, and licensing agreements with other firms (S. Sudarsanam and J. Lai, 2001).

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?

Banks C and D may have had rational and/or opportunistic reasons for frustrating the process at a certain point. Here are some possible reasons:

1. Rational reasons:

a. Banks C and D may have had concerns about the viability of the restructuring plan and the ability of the other two banks (i.e. Banks A and B) to successfully restructure the debt, together with the shareholder and the current management of the company. They may have believed that their interests would be better protected by delaying the process and forcing a more thorough robust change of the management of the company and the additional injection of fund by the shareholder of the company.

b. Banks C and D may have had conflicting interests or priorities that made it difficult for them to agree with the other two banks on the terms of the restructuring. For example, they may have had exposure to other borrowers in the same industry and were concerned about setting a precedent for debt restructuring that could impact their other loans.

c. In order to decrease their exposure, Banks C and D could consider selling their loans to Banks A and B. To accomplish this, they may need to adopt a more independent stance in the restructuring process.

d. Banks C and D may have had concerns about the potential impact of the restructuring on their own balance sheets and capital ratios. They may have believed that a more conservative approach was necessary to protect their own interests and maintain their regulatory capital requirements.

2. Opportunistic reasons:

a. Banks C and D may have seen an opportunity to gain a strategic advantage over the other two banks by delaying the restructuring process. By dragging out the negotiations, they may have hoped to extract more favourable terms or gain greater control over the outcome.

b. Banks C and D may have been motivated by a desire to protect their own market share and customer relationships. By slowing down the restructuring process, they may have hoped to create uncertainty and instability that could lead to a greater share of the market for themselves.

c. Additionally, they might desire to negotiate a distinct settlement agreement with the company, seeking terms that are more advantageous than the ones currently being proposed.

If I were an advisor to Banks A and B, I would have tried to understand the motivations behind Banks C and D's behaviour and would have attempted to address their concerns through diplomatic means. Here are some steps I would have taken:

1. Communication: As the representative of Banks A and B, my approach would involve establishing clear and transparent lines of communication with Banks C and D. This would allow me to fully comprehend their concerns and priorities. Furthermore, I would make it a priority to understand the key priorities of the team representing Banks C and D. Additionally, I would ensure that Banks C and D have access to all pertinent

information regarding the company and the proposed restructuring plan. The objective is to provide all banks with the necessary information to enable them to make informed decisions under the prevailing circumstances, thereby preventing irrational behaviour resulting from a lack of information.

2. Education: In the event that the representatives of Banks C and D lack the necessary knowledge and experience in restructuring, I would have educated the teams representing Banks C and D about the benefits of the restructuring plan and the potential risks and consequences of delaying the process. I would have provided them with analysis to support the viability of the restructuring plan and the ability of the stakeholders, including the Banks, to successfully restructure the debt.

3. Collaboration: I would have worked closely with Banks C and D to identify potential solutions that could address their concerns and priorities. I would have encouraged them to collaborate with Banks A and B to find a mutually beneficial solution that would support the success of the restructuring of the company.

4. Mediation: If necessary, I would have facilitated mediation sessions between the four banks to help resolve any disputes and reach a consensus on the terms of the restructuring. I would have worked closely with a neutral third-party mediator to ensure that the process was fair and transparent.

5. Which of the eight principles of the '*Statement of Principles for a Global Approach to Multi-Creditor Workouts II*' can be found in the workout process of Flow Management (explicit or implicit)?

The eight principles of the '*Statement of Principles for a Global Approach to Multi-Creditor Workouts II*' are:

"***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.*

SECOND PRINCIPLE: *During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims agains 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.*

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.*

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.*

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.*

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.*

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.*

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.*"
(see *INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II.)*

In my opinion, most of these principles can be found in the workout process of Flow Management, either explicitly or implicitly. For example:

1. **FIRST PRINCIPLE***:* The principle of co-operation among all creditors to give the debtor sufficient time for evaluation and proposal formulation is evident in the case of Flow Management restructuring. In the Flow Management case study, it is stated that on 16 November 2013, Banks A, B, C and D agreed to meet the board of Flow Management to discuss the financial position of the company and that Banks A, B, C, and D (the creditors) agreed to discuss the company's situation again on 1 December 2013. Additionally, Banks A, B, C and D agreed that legal action will not be taken yet against the company, pending the final report from the consultancy agency. Moreover, it is stated that it is concluded by the bankers "*not to panic*" and that action "*must be taken jointly and in a controlled manner"*.

This indicates a willingness to cooperate and provide the debtor with an opportunity to gather information and develop solutions for its financial difficulties. Although not explicitly mentioned, Banks A, B, C and D have provided a Standstill Period for the company to formulate and provide a realistic restructuring plan and to achieve the restructuring as proposed.

Furthermore, while no standstill agreement is formally signed until the middle of August 2014 and even then, the standstill agreement is a short 120-day standstill agreement, there has been no enforcement or other legal action commenced by the banks against the company allowing a de facto standstill period for the purpose of restructuring.

2. **SECOND PRINCIPLE**: Although not explicitly documented until mid-August 2014 through a 120-day standstill agreement, the principle of refraining from enforcing claims or reducing exposure to the debtor during the Standstill Period is evident in the Flow Management case study. This can be observed as the Banks agreed not to take any enforcement actions while awaiting the report from the consultancy agency. As mentioned earlier, the banks also agreed to discuss the company's situation on specific dates, indicating a temporary suspension of immediate enforcement actions. Furthermore, despite having sufficient legal grounds to terminate the credit agreements, the banks chose not to do so. They collectively decided to take joint action in a controlled manner.

3 **THIRD PRINCIPLE**: The principle that the debtor should not take any action which will disadvantage relevant creditors during the Standstill Period, apart from paying employees and trade creditors in the ordinary house of business is evident in the Flow Management case study. In particular, the following measures have been taken / plans have been drawn up which are clearly for the purposes of protecting the interests of the creditors during the Standstill Period :

1. *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;*

2. *130 staff members - employees and independent contractors - will be made redundant. This will yield an annual saving of € 3.3 million;*

3. *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.*

There is no evidence to suggest that the company's management has engaged in transferring company assets to related parties at undervalued prices or entering into favourable settlement agreements with select creditors while excluding others. There are no indications of the company offering security, such as charges, mortgages, liens, or other forms of collateral, to non-participating creditors or depleting the value of its business in a manner that would diminish repayment prospects for relevant creditors.

Additionally, there is no indication of the company incurring new borrowings or obtaining credit from individuals or entities unrelated to the relevant creditors.

4. **FOURTH PRINCIPLE**: The Flow Management case study highlights the principle that the interests of relevant creditors are best served through coordination. While there is no formal coordination committee representing all creditors of the company, Banks A and B have actively taken steps to coordinate with each other and with Banks C and D.

In most instances, the Banks opt for joint and controlled action by collectively discussing the company's situation. Furthermore, the shareholder company of Flow Management has requested that the Banks act collectively, emphasising that without such unity, they will not commit to injecting the required new capital for the company's operations.

Considering the practicality of the situation and the limited number of four banks as creditors, the need for appointing a formal coordination committee to facilitate communication among various financiers does not appear to be essential in the Flow Management case study.

5. **FIFTH PRINCIPLE**: The Flow Management case study indirectly recognises the principle that, during the Standstill Period, the debtor should provide creditors with reasonable and timely access to all pertinent information. Throughout the process, the company consistently offers Banks with regular updates on information in both 2013 and 2014. The appointment of the Chief Restructuring Officer to Flow Management's board of directors further facilitates the provision of comprehensive and detailed financial and operational information to the creditors.

6. **SIXTH PRINCIPLE**: The sixth principle emphasises that proposals for addressing the debtor's financial difficulties and any arrangements made between relevant creditors during a standstill period should align with applicable law and consider the relative positions of the creditors at the beginning of the standstill. Although the case study does not explicitly mention this principle, the appointments of an accounting firm to investigate the company's procedures and an independent turnaround consultancy agency to assess its viability indicate that the banks are cognizant of the importance of adhering to relevant laws and ensuring fairness to all participating creditors in the restructuring of Flow Management.

7. **SEVENTH PRINCIPLE**: The Flow Management case study does not explicitly address the principle of confidentiality regarding the information obtained during the process. However, considering that Banks A, B, C, and D are creditors of the company and have been provided with its business and financial information, it is reasonable to assume that these banks may have a legitimate entitlement to access such confidential information. This entitlement could arise from the terms outlined in their respective loan agreements, security agreements, or their decision not to enforce the loans against the company.

Nevertheless, in practice, it would be advisable and relevant for the company to establish formal confidential and non-disclosure agreements with each of the creditors before disclosing any price-sensitive or confidential information. This step would further safeguard the confidentiality of the shared information and ensure that all parties involved understand their obligations and responsibilities in maintaining its confidentiality.

8.**EIGHTH PRINCIPLE**: The principle that the repayment of additional funding, or New Money, should, so far as practicable, be accorded priority status is indirectly inferred in the Flow Management case study. It is stated that in January 2015, a total of 25 million is paid back to the providers of the (additional) working capital. It does seem that this principle is thus applied in this case.

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?

If it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, there may still other possibilities for "soft law" to use.

Here are some examples of "soft law" that could be used in Hong Kong:

1. Industry standards and guidelines: Industry associations and organizations may have their own standards and guidelines that can provide guidance for creditors in a restructuring or insolvency situation. For example, Hong Kong Monetary Authority (HKMA) has issued guidelines on debt restructuring and insolvency for banks and other financial institutions in Hong Kong, and there used to be the Guidelines on Corporate Difficulties issued by the Hong Kong Association of Banks in April 1998. These are generally known as the "HKAB Guidelines". The Guidelines are non-statutory, but they are supported by both HKAB and the HKMA and all banks in Hong Kong are expected to use their best endeavours to comply. The underlying principles of the HKAB Guidelines are as follows:

- *When it becomes public knowledge that a debtor company may be experiencing financial problems and the borrower has approached its banks, banks' initial attitude should be one of support. They should not withdraw facilities or hastily put the company into receivership, or issue writs demanding repayment.*
- *Further decisions should only be based on information that is reliable and shared fully with all the creditor banks (after obtaining the debtor's permission).*
- *The decision to offer the company financial assistance - or not - should be a collective one by creditor banks.*

(see: https://www.hkab.org.hk/en/industry-guidelines/code-of-bank)

2. Market practices and customs: Market practices and customs can also provide guidance for creditors in a given situation. For example, it is common practice in Hong Kong for creditors to engage in negotiations and discussions with debtors before pursuing legal action. Legal advisers and financial consultants are regularly engaged to assist the creditors to negotiate with the debtors prior to commencing formal legal proceedings.

3. Informal networks and relationships: Based on my experience, informal networks and relationships among creditors, debtors, and other stakeholders can contribute significantly to resolving disputes and achieving successful restructuring or insolvency outcomes. These connections can facilitate communication and cooperation in various ways. For instance, certain creditors may have existing relationships with debtors or other stakeholders that can aid in fostering dialogue and collaboration during the restructuring process.

Furthermore, independent financial consultancy firms often play a crucial role in introducing distressed funds to debtor companies. These firms assist both creditors and debtors by exploring potential restructuring options and facilitating the introduction of new investors, "white knight." By leveraging their expertise and connections, these consultancies can help create opportunities for the parties involved to find mutually beneficial solutions and navigate through challenging financial situations.

In summary, while the Statement of Principles may not be binding in Hong Kong, there are still a number of other soft law options that can provide guidance and influence the behaviour of creditors in a restructuring situation. These include industry standards and guidelines, market practices and customs, informal networks and relationships.

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

Flow Management Restructuring Agreement (or "RA") signed on 4 July 2015

The signing of the RA in July 2015 was a significant milestone for Flow Management and its stakeholders.

The restructuring plan involves several key elements:

1. *All operating companies under Flow Management Holding BV will be consolidated into a shell subsidiary called Flow Management II BV.*

2. *The shares of Flow Management II BV will be transferred to a consortium of banks (i.e. Banks A, B, C and D) that originally provided working capital to Flow Management Work BV, as well as certain board members including the CRO.*

3. *Flow Management Holding BV will be liquidated in a confidential manner, and all claims against this entity will be canceled by the banks and the shareholder of Flow Management Holding BV.*

4. *Flow Management Holding BV and its shareholder will waive all claims against Flow Management II BV and its subsidiaries.*

5. *Banks C and D, who previously provided additional working capital to Flow Management Work BV, will waive an amount of €32.5 million, effectively writing off the entire debt.*

6. *The consortium of financiers will waive an amount of €97.5 million, while retaining a remaining claim of €240 million against Flow Management Work BV.*

7. *The €55 million loan in Flow Management Work BV will be fully canceled.*

Therefore, the essence of the restructuring terms provided in the RA can be summarised as follows:

(a) Setup a NewCo and Consolidation of operating subsidiaries: All operating companies under Flow Management Holding BV will be brought together into a new subsidiary called Flow Management II BV.

(b) Debt to Equity Swap: The shares of Flow Management II BV will be held by a consortium of banks (namely, Banks A, B, C and D) and certain board members, including the CRO. This allows the creditors and key stakeholders to have a direct interest in the newly formed entity.

(c) Liquidation: Flow Management Holding BV, the original holding company, will be liquidated in a confidential manner. As part of this process, all claims against Flow Management Holding BV will be canceled by the banks and the shareholder.

(d) Debt Cancellation: Flow Management Holding BV and its shareholder will waive all claims against Flow Management II BV and its subsidiaries. This cancellation clears any outstanding debt obligations between these entities.

(e) Debt Write-Off: Banks C and D, who provided additional working capital to Flow Management Work BV in the past, will waive €32.5 million, effectively writing off the entire debt. The consortium of financiers will also waive €97.5 million, while retaining a remaining claim of €240 million against Flow Management Work BV.

(f) Loan Cancellation: The €55 million loan in Flow Management Work BV will be fully canceled, relieving the company of this debt obligation.

The key results of this restructuring arrangement are:

NewCo Structure and debt relief: The restructuring consolidates the operating companies under a single subsidiary, simplifying the corporate structure. The debt write-offs and cancellations significantly reduce the financial burden on Flow Management Work BV, improving its financial position. The liquidation of Flow Management Holding BV allows for a clean resolution of claims against the company, benefiting both the banks and the shareholder.

Potential Sale of Business (NewCo): The restructuring sets the foundation for a potential sale of Flow Management II, now operating as a going concern, providing opportunities for future investors or buyers.

Overall, the restructuring terms aim to address the financial challenges faced by Flow Management Work BV and create a more commercially and legally viable entity, potentially leading to improved prospects for the company's business to be sold as a going concern.

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

In the Flow Management restructuring process, there are several potential legal and non-legal cross-border issues that may arise, including:

1. Conflicts of law and jurisdictional issues: The Flow Management restructuring process can give rise to conflicts of law, particularly when Flow Management operates or has creditors in multiple jurisdictions. These conflicts can arise due to differences between the laws of the jurisdiction where Flow Management is incorporated, such as The Netherlands, and the laws of the jurisdictions where its assets are located, such as Spain, France, Australia, South Africa, and the USA, or where its creditors are based.

As a result, when determining the applicable law for aspects like loan terminations, business transfers from current operating subsidiaries to Flow Management II BV, or the compromise of debt obligations, the restructuring process may encounter jurisdictional challenges. These challenges may involve determining which law governs the relevant share transfer, the resolution of debt obligations, or the establishment or release of security interests and pledges.

In cases of dispute, questions may arise regarding which court has the authority to hear the case and whether that court has jurisdiction over Flow Management's assets. Additionally, there may be considerations regarding the recognition and enforcement of court decisions across multiple jurisdictions.

Overall, the complexities of navigating these jurisdictional issues can arise during the restructuring process, requiring careful analysis and consideration of the applicable laws and jurisdictions involved.

2. Potential Moratorium and Recognition and enforcement of foreign judgments: In October 2014, four scenarios were formulated, and one of them involved a moratorium or restart following liquidation. If a moratorium is to be implemented, it typically requires statutory provisions to grant it both local and extraterritorial effects. However, it remains unclear which law governs the loans between Flow Management and the banks (i.e., Banks A, B, C, and D) and whether a formal moratorium needs to be established in one or more jurisdictions.

The Flow Management restructuring process may entail the recognition and enforcement of foreign judgments, such as the appointment of a restructuring officer under the local law, which may have the statutory power to extend the moratorium's effects beyond its territorial boundaries. The local restructuring regime may be recognised in the United States, Spain, Australia, South Africa and France. Nevertheless, the recognition of foreign court judgments can be a complex matter, especially when the judgments originate from jurisdictions that adopt a territorial approach rather than a universal one.

3. Cross-border insolvency: The Flow Management restructuring process can give rise to complex cross-border insolvency issues, including the need to coordinate proceedings in multiple jurisdictions, recognise foreign insolvency proceedings, and allocate assets and liabilities across different jurisdictions. In particular, certain jurisdictions follow a universal approach that aims to facilitate foreign liquidation proceedings and certain jurisdictions do not.

In the event that Flow Management Holding BV undergoes liquidation, creditors, including all creditors within and outside of The Netherlands and in other jurisdictions, will be required to participate in the liquidation process and provide the necessary documentation to the liquidators of Flow Management Holding BV. Depending on Flow

Management Holding BV's financial position at the start of the liquidation, court supervision may be necessary if the company is not solvent.

Moreover, if there are small creditors who oppose the overall restructuring terms, they may choose to initiate winding-up applications in jurisdictions where such proceedings can proceed under the relevant loan agreements or contracts. This is especially likely if these creditors believe that the establishment of NewCo (Flow Management II BV) and the liquidation of Flow Management Holding BV will directly harm their interests without their agreement.

Additionally, if the shareholder of Flow Management Holding BV has a change of heart regarding the restructuring plan, they may initiate legal proceedings challenging the implementation of the restructuring in one or more jurisdictions, depending on the grounds of their opposition.

Overall, the cross-border nature of the restructuring process introduces complexities, including potential disputes and legal actions, as stakeholders navigate the various jurisdictions involved and seek to protect their interests.

4. Tax implications and cross-border payments: The restructuring process may have tax implications, particularly as Flow Management Holding BV has operations and/or assets in multiple jurisdictions. For example, there may be issues related to the taxation of profits, the allocation of tax liabilities, and the impact of tax laws on the restructuring process under the laws of EU and the United States.

5. Labor and employment laws issues: The Flow Management restructuring process has the potential to be affected under the local labor and employment laws, especially when Flow Management Holding BV intends to make 130 staff members, including both employees and independent contractors, redundant. While the specific locations of these employees and contractors are unclear, considering the diverse nature of the Flow Management group's operations, it is likely that they are situated in multiple jurisdictions. As a result, several issues may arise concerning the transfer of employees, the termination of employment and service contracts, and the application of various labor and employment laws within the respective local jurisdictions.

6. Potential regulatory compliance issues: The restructuring process of Flow Management may give rise to regulatory compliance issues, particularly concerning the ownership and leasing of trucks in the United States and the European Union (EU). In the United States, for instance, the Federal Motor Carrier Safety Administration (FMCSA) has established the Truck Leasing Task Force (TLTF) to address potential safety and financial concerns related to lease agreements for owner-operators. See FMCSA website at: *https://www.fmcsa.dot.gov/newsroom/fmcsa-forms-new-task-force-combat-predatory-leasing-practices*.

During the establishment of Flow Management II BV and the liquidation of Flow Management Holding BV, it is crucial to ensure full compliance with all relevant regulations and requirements. This includes adhering to any applicable laws, rules, and guidelines pertaining to truck ownership, leasing, and related obligations in the United States, the EU, Spain, France, The Netherlands, South Africa and Australia.

7. Political and social issues: The Flow Management restructuring process may further raise regional political and social issues, particularly given Flow Management has operations or assets in multiple jurisdictions. For example, there may be issues related to the impact of the restructuring process on local communities, the protection of employees rights, and the engagement with local stakeholders.

In summary, the Flow Management restructuring process may involve a range of legal and non-legal cross-border issues, and it is important to consider these issues carefully to ensure a successful restructuring outcome.

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?

In October 2014, scenario 4, which involved calling for a moratorium, might not be considered as a good option given the situation of Flow Management for several reasons:

1. Lack of change of management and ultimate ownership: Flow Management and its management have previously undergone multiple restructuring attempts in 2013 and 2014, which did not yield any visible success. During this time, creditors, including Banks A, B, C and D did not have full access to information and were limited in their understanding of Flow Management's business operations due to the management and shareholder remaining in place. Implementing a moratorium could have provided the existing management and shareholder with additional time to continue their restructuring efforts. However, there is no indication that maintaining the same management and shareholder team and granting them a "breathing space" through a moratorium would be in the best interest of the creditors. The extended delay in achieving a successful restructuring could further diminish Flow Management's credibility with stakeholders, including customers, suppliers, and employees. Considering these factors, it appears that pursuing a moratorium is not a viable option for Flow Management, as it could hinder progress and exacerbate the erosion of trust and confidence from various stakeholders.

2. Inevitable liquidation: Given Flow Management's dire financial situation, it was unlikely that a moratorium would have led to a successful turnaround. Instead, it would have only delayed the inevitable liquidation of the company.

On the other hand, a moratorium, might be a option give the lack of alternatives.

Lack of Alternatives: At the time, there were no other viable alternatives to a moratorium. The company's financial situation was too precarious to consider other options, such as obtaining additional funding or selling off assets. Furthermore, a moratorium would have had less negative impact on the company's reputation and its employees, who would have faced uncertainty and potential job losses. Finally, in light of the time pressure of immediate liquidity issues which Flow Management was facing and a severe liquidity crisis must be dealt with to meet its short-term financial obligations, a moratorium would have bought some time, pending the change of the economic environments.

In light of these factors, the option of implementing a moratorium for the Flow Management restructuring in October 2014 has both advantages and disadvantages.