CASE STUDY - 01

Response to Query 1:

Introduction: In the case study, Flow Management Holding BV ("**FMB**"), based in Netherlands, is the holding company of several subsidiaries which operate and lease trucks and private cars and are active in short leasing, real estate and truck repair. FMB is held by Lease Group Holding United Kingdom Ltd ("**Shareholder**"), which is ultimately held by the Johnson family, as well as two investment companies ("**Ultimate Shareholders**").

Key Causes of Financial Distress

Poor Management Information System: On various occasions, the management of FMB erred in withholding complete information from its lenders. New facts emerged from time to time and in absence of analysis of the entire factual matrix, the analysis of cause of losses and redressal measures proposed were inadequate. There were gross inadequacies in the management information systems within the group.

Poor Internal Management: A bare perusal of the causes of losses and negative corrections communicated by the board of FMB indicates that the management had failed to perform its duty of diligently ensuring that the accounts reflect a true and accurate position of the financial position. Moreover, the management had wrongly issued large bonuses to themselves. Being the principal decision makers of the company, the actions taken by the management highlight grave infirmities in the conduct of internal management.

Inadequate Corrective Measures: The causes of initial losses and negative corrections appeared to be internal factors related to management information systems and poor management (such as negligence in doing periodic checks and drawing excessive compensation). When necessary, price corrections / increases were undertaken with customers, the company did not face significant resistance.[1] Having noted the causes of losses, the board, instead of addressing the internal inadequacies attributable to management failure, only took retrenchment measures against labour and price corrections with customers. The management erred in not undertaking a holistic analysis of all causes of distress with fair corrective measures to address management misconduct. It is possible that the management's own deficiencies having been responsible for the distress, may have influenced the decision not to seek views of independent turnaround / restructuring expert on internal deficiencies.

Rigid Approach: The management's approach appeared to be rigid and inclined towards standardized solutions geared towards cost cutting and retrenchment solutions, as opposed to making any strategic changes to address the internal issues and the reasons for the reducing liquidity in the company, which may have been due to the same management (until the belated replacement of CEO and appointment of CRO) continuing to control FMB during the turnaround which had led the company to financial decline.

Inadequate steps from Shareholder and action of banks: Even though banks urged the board of the Shareholder to take measures with regard to the management (the CFO in particular), no immediate actions were taken. Paying off the equity capital and raising of amounts by the Shareholder as requested by the banks[2] would have not just helped in improving the solvency and equity capital position but inspired confidence in banks to support restructuring, but it was not done. The Shareholder also erred in taking adequate steps to make changes in the management of FMB in an organized manner, inspite of specific request by the banks in this regard.

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[1] Based on facts set out in Case Study-1 at page 2

[2] Banks sought for the shareholder to raise € 35 million to repay debts due on 31 December 2013 and € 12.5 to 15 million to strengthen the equity capital, in terms of facts at page 3 of Case Study-1.

The constant demands from the banks for settlement in money and charging of default interest, along with threat by banks C and D to cancel credit, created additional pressure on FMB, aggravating the existing financial distress and constraining FMB's ability to take bold strategic measures for long term positive effects.

Homogeneity of top management – While the homogeneity of the top management appears to have helped in certain decisions being taken fast, but absence of a heterogeneous group may have been a cause for the management following standardized solutions instead of taking strategic measures to address key concerns. Due to the homogeneity of the existing management, all solutions appeared to be inclined towards avoiding disruption of existing standard processes, without addressing the internal efficiencies. Heterogeneous groups appear to be more effective than homogeneous groups, especially in uncertain and turbulent environments.[3]

Summary: FMB suffered from financial distress pursuant to management misconduct and lack of diligence and poor management information systems, which was coupled with absence of undertaking a holistic analysis on causes of the financial distress and corresponding remedial measures. The psychological factor of the company management continuing to live in denial and not taking corrective measures (especially in respect of the internal issues) in a timely manner, led to the problems turning into a full-blown crisis.[4] The behaviour of the management appeared to be quite rigid and indicative of a series of defensive avoidance strategies (cognitive inertia).[5] Absence of a heterogeneous group in the management during turnaround may have led to further downward spiral after the early warning signals.

The prevention of the financial distress and further decline could have been possible, had the aforesaid causes of financial distress been arrested at an early stage by taking the following measures:

(a) **Better information management** – Poor information availability and management has not just impacted the ability of the management to assess the factual context in entirety, but it also affected the ability of banks to make an informed decision. FMB management should have prioritized fixing up of the management information system.
(b) **Fixing up of management responsibilities** – Further, the initial causes of loss point out to various indiscretions by the existing management. If suitable steps were taken to identify the inefficiencies by the management and address them through appointment of additional nominee directors or risk officers or setting out additional protocol to be followed to ensure adequate checks to avoid the recurrence of the identified causes of losses, it could have potentially helped the company in stemming the downward curve.
(c) **Seeking external views of a turnaround consultant** – The existing management may be faced with self-serving bias and conflict of interest in dealing with internal issues, and may not always be in the best position to be able to respond and take the desired actions to address the causes of losses. Often, they take measures which are in the nature of reinforcing past practices and end up being stuck to the knitting.[6] Existing management may lack competence to deal with turnaround strategy. Views from an independent turnaround consultant regarding internal inefficiencies would have provided an objective view on strategic measures which could address the real causes of losses.
(d) **Well thought out measures instead of ad hoc measures –** One of the aspects which is evident from the case study is that there has been no cohesive analysis undertaken regarding the causes of financial distress and the measures required to address those causes. Instead, at various points of time, ad-hoc measures were taken. A thorough

[3] Top Management Teams Demographic and Corporate Strategic Change - Wiersema, M.F. and Bantel, K.A. (1992)

[4] An Exploratory Study into Failure in Successful Organizations: The Case of Marks & Spencer -Mellahi and Jackson (2002)

[5] Confronting Strategic Inertia in a Top Management Team: Learning from Failure – Gerard P Hodgkinson and George Wright (2002)

[6] Threat-Rigidity Effects in Organizational Behavior: A Multilevel Analysis - Barry M. Staw, Lance E. Sandelands, and Jane E. Dutton (1981)

analysis and comprehensive plan for the business and financial restructuring should have been attempted instead of piecemeal measures at different points in time.

(e) **Contribution by shareholders to improve solvency –** The Shareholder was asked to pay off the equity capital, so the solvency rate returned to a minimum of 5%. However, they proposed to sell 350 cars instead, to improve the solvency rate, which would have further drained core business assets of the distressed FMB. The Shareholder should have taken requisite steps to pay off its equity capital and/or infuse risk bearing capital in FMB, which would not just have improved the solvency and liquidity position of FMB, but also inspired confidence among creditors.

(f) **Negotiation of a Standstill –** The management should have negotiated a standstill at an early stage of distress, by ensuring (i) full disclosure of information (ii) independent analysis by a turnaround consultant of all causes of concern, (iii) providing a timeline for the standstill.

Response to Query 2

An informal reorganization or out of court restructuring refers to a private restructuring or workout process effectuated outside the statutory framework with an ultimate objective of restoring the financial and operational health within the same entity and usually consists of business and financial restructuring.

Advantages of out of court restructuring:

Being an informal process in which the debtor continues to be in possession with no formal procedures such as approval of courts, workout has many advantages, including the following:

a) **Continuance of control:** One of the key components of workout is the continuance of control with existing management, who are usually in the best position to leverage on existing relationships with customers and creditors to find acceptable resolutions. No third party is required to be appointed to handle management in lieu of the existing board, which ensures that there is no disruption in business and the chances of a better recovery rate is high. The existing management, continuing to be in control, is incentivized to resolve the financial difficulty.

b) **Cost effective:** It is more cost effective as it does not involve litigation expenses and costs of liquidator / administrator, which are usually incurred in formal reorganization processes.

c) **Speedy resolution:** Workouts are usually speedier due to involvement of limited stakeholders without third parties such as administrators / liquidators and with no time lost in procedural formalities such as seeking the approval of courts and tribunals.

d) **Benefits of resolution in silence:** Being a reorganization which is undertaken in relative silence as compared to a formal reorganization process (usually public), it avoids reputational damage and stigma associated with formal insolvency processes. Also, in formal insolvency processes, the publicity of the distress could lead to customers, suppliers and creditors being more reserved about new contracts and renewals and continuing existing arrangements and competing to get paid in priority.

e) **Flexibility:** It is a flexible process which is light on procedural rules and is based on mutual agreement among key stakeholders (board, creditors, and shareholders) and allows ‘tailor made’ solutions, allowing flexibility on terms of reorganization and treatment to creditors. Flexibility facilitates ease of negotiation to arrive at mutually acceptable solutions.

The key disadvantages of informal organizations are mentioned below:

(a) **Issues with existing management in control:** Continuation of existing management could be a disadvantage especially in cases where there are concerns about management conduct such as management being responsible for the decline or being accused of fraud or criminal conduct. Also, if the management has a passive attitude and does not undertake adequate strategic, operational, and financial measures, then it may not aid in realizing the benefit of the workout.

(b) **Unanimity requirement:** Workouts can be quite flexible regarding the contents of the restructuring, but they are extremely rigid in their approval procedure, as they require unanimity of creditors due to their contractual nature. Unanimity among creditors may be hard to achieve, especially where the debtor has significant public debt securities.

(c) **Absence of statutory moratorium:** A workout is based on contractual forbearance and in absence of a statutory moratorium framework, there is no universal protection against recovery / enforcement action for the company.

(d) **Requirement of debtor's consent:** The requirement of debtor's consent is a prerequisite for the workout to take effect. Such approval may not be forthcoming if it requires the approval of shareholders, and they are not agreeable to dilute their interests.

(e) **Limitation of remedies:** In a workout, it is not possible to use some extraordinary remedies, like lifting the veil of incorporation or subordinating the claims of insiders.

(f) **Lack of recognition by foreign courts:** Foreign courts are more likely to recognize formal insolvency resolution or liquidation proceedings and not out of court restructurings, thus limiting feasibility of workouts in cases with significant cross-border activities/assets.

(g) **Higher chances of lender liability actions:** Since lenders are the key decision makers, they run the risk of liabilities associated with concessions granted and any credit decisions being deemed to be abusive or extortionate, in absence of court approvals on the scheme.

(h) **Difficulties of multi-party negotiations:** It is practically very difficult to deal with a large number of creditors in an out of court restructuring, whereas formal insolvency proceedings provide a forum capable of accommodating large number of creditors.

(i) **Directors' liability:** If the law contains a duty for directors to file for insolvency, directors may take a less risky route if they use formal insolvency procedures, rather than trying to reach an agreement while the company slides into insolvency.

Regulatory Framework in India

In India, a restructuring process can be consummated through one of the following routes:

(a) a court-monitored route under the legislative framework of Insolvency and Bankruptcy Code, 2016 ("**Code**"), reorganisation under a scheme of compromise or arrangement under the Companies Act, 2013[7] or a pre-pack under the provisions of the Code (only in case of micro and small enterprises),[8] all of which require the approval of the National Company Law Tribunal ("**NCLT**");

(b) restructuring under Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 ("**RBI Directions**"), which does not require NCLT approval.

Advantages of out-of-court restructuring in India

In India, the Code is the first comprehensive insolvency framework and prescribes a creditor-in-control model and has been a preferred choice of creditors to resolve complex insolvencies. However, creditors prefer an out-of-court restructuring in certain matters due to its advantages:

(a) **Support from Promoters/ shareholders:** Unlike a formal insolvency proceeding under the Code in which a resolution professional ("**RP**") takes over the management of affairs of the company and is vested with powers of the board of directors of the company, with the powers of the existing board of directors being suspended,[9] the management/ promoters/ shareholders stay in control. This ensures continued support of management during the insolvency resolution process. In processes under the Code, on account of ineligibilities set out in Section 29A, several shareholders/management are barred from submitting a resolution and thus disincentivized from participation in the process. This is

[7] Section 230 to 232 of the Companies Act, 2013.

[8] Sections 54A to 54P of the Code.

[9] Section 17(1) of the Code.

evident from the fact that in number of cases, the RP is constrained to seek directions from the adjudicating authority for cooperation by the erstwhile management.[10]

(b) **Benefit of Confidential process:** Out-of-court workout is a private transaction and less susceptible to public attention and consequent value erosion due to reputational harm, as compared to the process under the Code which is a proceeding 'in rem', with public announcement apprising creditors about the admission. The stigma associated with the insolvency process dissuades certain existing suppliers and customers from further business. Further, in concession-based contracts, concessionaires often seek to terminate existing arrangements.[11]

(c) **Reduces uncertainties and closing risks:** Since out-of-court restructurings involve a consensual arrangement between the existing management (who have full knowledge of the company's financial position) and the creditors, the likelihood of withdrawal and closing risks on account of information asymmetry is low.

(d) **Faster and Inexpensive Resolution:** Out-of-court restructuring is a relatively shorter process as it does not require any judicial approvals. The RBI Directions prescribe a period of 180 days from the review period for implementation of the resolution plan. It is also inexpensive as workouts under the RBI Directions do not involve fees of the RP or litigation costs pertaining to the NCLT.

Disadvantages of out-of-court restructuring in India

(a) **Unanimity of creditors**: Out of court restructurings are dependent on inter-creditor agreements for the binding effect on other creditors and require unanimity among creditors. Unlike formal insolvency process under the Code, there is no mandatory cram down based on majority voting on dissenting creditors and non-lender creditors,[12] thus requiring the company to separately resolve their dues consensually.

(b) **No blanket stay on liabilities:** In an out of court restructuring, there is no calm period of statutory moratorium leading to a halt of existing liabilities.[13]

(c) **Investigation of antecedent transactions:** In case of formal insolvency under the Code, the RP is required to investigate antecedent transactions such as undervalued, preferential, fraudulent, and extortionate transactions[14] and avoid them; however, there is no similar provision in out of court restructuring. If creditors are apprehensive about the past corporate governance, formal insolvency under an RP is usually preferred by creditors over out of court restructuring.

(d) **No concrete enforcement mechanisms other than breach of contract:** Out of court restructurings are contract-based and hence, failure on the part of the company in meeting its commitments only has the consequence of breach of contracts. In formal restructuring under the Code, there is a statutory prescription to comply and all parties including the management need to comply, with penal consequences for non-compliance.[15]

Response to Query 3

A. **Adriaanse & Kuijl, 2006**

Informal reorganization takes place outside the statutory framework with the objective of restoring the health of a company within the framework of the existing legal entity through business and financial restructuring.

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[10] Section 19 of the Code seeks to create an obligation on erstwhile management and other personnel of the company to cooperate and support the RP, upon failure of which RP can seek specific directions from the NCLT.

[11] Courts have come to the rescue of companies against coercive actions seeking termination of contracts due to insolvency. In Gujarat *Urja Vikas Nigam Limited v Amit Gupta* (Civil Appeal No 9241 of 2019), the Supreme Court provided protection against termination of power purchase contracts during moratorium period.

[12] Section 31 of the Code creates a binding effect of the resolution plan approved by 66% majority of the committee of creditors, upon its approval by NCLT, on all creditors including financial, operational as well as statutory creditors.

[13] Section 14 of the Code provides for a statutory moratorium on all legal proceedings against the company and all actions to recover or enforce security interest against the company.

[14] Sections 43, 45, 49, 50 and 66 of the Code provide for transactions to be reported for avoidance by RP.

[15] Section 74 of the Code provides for penal consequences on failure to comply with approved resolution plan.

Observations on application of informal reorganization concepts in the Case Study:

(a) **Stabilizing –** The management of FMB undertook immediate steps for stabilizing upon observing early warning signals:
   (i) cost-cutting measures of cutbacks in expenditure with regard to labour costs by making 130 staff members redundant;
   (ii) savings on account of improved loss recovery, higher excess premiums and savings on car repairs;
   (iii) Shareholder offered to sell 350 cars to improve solvency rate.

   But the stabilizing steps were inadequate with the Shareholder not paying off the equity capital, information system failure as evidenced by new information emerging of further losses in foreign subsidiaries and lenders charging default interest.

(b) **Analysing** – Instead of drawing up an extensive reorganization plan after detailed, strategic and financial analysis tracing the causes of the negative state of affairs and long-term prospects of FMB which would have inspired confidence among interested parties, the management of FMB took ad-hoc measures without adequate analysis. Key issues which were responsible for the financial decline were not identified for resolution, as clearly evidenced by inadequate remedial measures. No restructuring expert was appointed to analyse the viability of the internal processes, management conduct and the internal reorganisation required in the group. With the existing management under pressure due to declining state of affairs, a restructuring expert would have helped, in addition to the consultant who advised on viability of business projections. A comprehensive analysis of the causes of distress by a restructuring expert and detailed measures to address them would be essential. The careful consideration of such analysis by the board, Shareholder and banks, would have led to a well thought out restructuring plan addressing inefficiencies / challenges in a holistic and viable manner and focused on long term goals.

(c) **Repositioning** – After the above stages of stabilizing and analysing, the management of the company is required to initiate the reorganization. Plans were drawn up in respect of FMB focusing on increasing turnover by itself in combination with large cutbacks, evaluation and reassessment of the entire business mix (product range) and the plan to sell off shares of the non-Benelux foreign branches controlled by Flow Management Work BV ("**FMW**").

(d) **Reinforcing** – During the period of business reorganization, the company often also needs to be reinforced in the field of management as well as in the company's balance sheet. The steps taken towards reinforcing included replacement of CEO and appointment of CXO by the banks. Pertinently, while banks sought a change of CFO, the same was not undertaken (despite past accounting issues highlighted in causes of decline). The steps of reinforcement were undertaken with delay and may have been inadequate.

   Reinforcement of the balance sheet is interconnected with **financial restructuring**. Financial restructuring was undertaken with the Shareholder infusing risk bearing capital (and committing to infuse further amounts), execution of restructuring agreement dated 04 July 2015 ("**Restructuring Agreement**") restricting the recourse of lenders to operating subsidiaries under Flow Management Holding II BV ("**FM II BV**") with haircuts and payment of additional working capital facilities due in December 2013, in January 2015.

Some of the key shortcomings observed in FMB, which should have been addressed are:

(a) Inactive attitude of management and shareholders to detect early warning signals and to make thorough analysis to identify the causes and redress them;
(b) Lack of transparency with regard to the actual financial situation of FMB, with the emergence of constant changes to the financial position and inaccuracy of projections;
(c) Inadequate and slow reorganization of the business operations (with limited involvement of third parties) with inadequate strategic, financial and operational measures; and
(d) Delay in injection of risk bearing capital by the Shareholder, which further stretched the liquidity position of the company.

B. Pajunen, 2006

The paper relates specific types of behaviour of influential stakeholders to the probability of organizational survival and develops propositions on how stakeholder management can be operationalized in an organizational turnaround.

The key propositions of stakeholders' management in organizational survival in the research paper and related observations in the case study are set out below:

(a) The more secure the continuing support of governing stakeholders in an existence-threatening crisis, the more probable is organizational survival – The key governing stakeholders (banks and Shareholder) initially did not provide continuing support.[16] However, the Shareholder did subsequently infuse an amount of €10 million as unsecured loan, followed by assurances to infuse further funds. Banks A and B provided constant support to FMB. Upon changes made in management (with replacement of CEO and CXO being appointed as recommended by banks), banks provided continuing support resulting in Restructuring Agreement and improvements in results.

(b) In an existence-threatening crisis, frequent and open communication between managers and governing stakeholders will tend to enhance the continuing support of those stakeholders and increase the probability of organizational survival - Continual communication with powerful stakeholders is important during an organizational decline and turnaround.[17] In FMB, the management failed to have adequate communication with the governing stakeholders and there were several instances of entire information not being provided to governing stakeholders.[18] This created a lack of confidence among the governing stakeholders such as banks. Banks C and D declined to support standstill in view of the constantly changing information landscape.

As information disclosure improved, banks were more supportive to defer payments and more open to a workout agreement. The Shareholder also contributed risk bearing capital.

(c) In an existence-threatening crisis, personal relationships between managers and governing stakeholders will tend to enhance the continuing support of those stakeholders and increase the probability of organizational survival – Strong and fair relationships with key stakeholders is likely to generate positive impact on the performance of a company, especially in a crisis. Initially, the management of FMB did not have the confidence of the governing stakeholders. But upon replacement of CEO and appointment of the CRO, banks became more supportive, which is likely to have been due to positive inter-personal relationship between the CRO and the banks.[19]

(d) In an existence threatening crisis, management's unlocked brokerage position between governing stakeholders will tend to enhance the continuing support of those stakeholders and increase the probability of organizational survival – The manner in which the brokerage function of management is used by the board and perceived by the stakeholders is an important factor in a crisis-struck company, with the management being expected to be facilitator of communication between different stakeholders. FMB management failed to provide holistic information to the key governing stakeholders such as the banks and Shareholder, creating a trust deficit. However, with the replacement of the CEO and the inclusion of the CRO, information flow improved, and banks as well as the Shareholder were notably more supportive towards the restructuring efforts, which is likely to have been due to the unlocked brokerage position of the new management.

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[16] (i) The Shareholder did not initially pay off the equity capital and contribute money as risk bearing capital into FMB; (ii) The banks C and D sought settlement of their dues, did not agree to standstill and even threatened to cancel credit at one stage; (iii) Banks started charging default interest and did not agree to standstill.

[17] Firm Turnarounds: An Integrative Two-Stage Model – K Arogyaswamy (1995)

[18] Failure to provide information pertaining to losses in foreign subsidiaries and holding company and repeated failure of results meeting projections.

[19] In early August 2014, even though the banks as a group continued to be unhappy about the constantly changing information given by FMB, banks were happy with new management and improving results.

(e) In an existence-threatening crisis, consensus on long-term goals among governing stakeholders will tend to enhance the continuing support of those stakeholders and increase the probability of organizational survival – It is important that there is consensus among the key stakeholders in respect of the long-term goals, otherwise the company runs the risk of governing stakeholders not being aligned. FMB's management focused on certain ad-hoc cost cutting measures initially, which did not favour with banks.[20] Later in the process, post changes in management and when a long-term plan was provided to group operating subsidiaries separately, with a going concern solution having been chosen as the best route, banks and Shareholder both were agreeable, which finally culminated with the Restructuring Agreement being signed in July 2015.

(f) In an existence-threatening crisis, governing stakeholders' association of management with good firm performance is positively related to the continuing support of those stakeholders and will tend to increase the probability of organizational survival - The existing management was perceived negatively by the governing stakeholders due to the constantly changing information landscape, the company failing to meet projections and being unwilling to make changes in the management inspite of the banks having sought for a change in the CFO.

The new management after the replacement of the CEO and appointment of the CXO was perceived positively with improved information flow and improvement in the results due to reorganization. Even though additional losses were announced in June 2014 due to delay in reorganization with a liquidity issue imminent, banks were more supportive towards the changed management, ultimately leading to signing of the Restructuring Agreement.

C. Achim Schmitt and Sebastian Raisch (2013)

Introduction: Retrenchment and recovery measures play a key role in turnaround performance. The purpose of retrenchment measures is to reduce assets or costs and improve operational efficiencies and profitability, while recovery activities refer to strategic changes aimed at repositioning the firm for long-term growth and profitability. While several turnaround studies describe retrenchment and recovery as contradictory forces (dualism perspective)[21] and discourage pursuing them concurrently instead of sequentially, later turnaround stage models suggest that turnarounds involve integration of retrenchment and recovery (duality).[22] Although it appears to be contradictory, but long-term plans for turnaround can also help in convincing external stakeholders to extend support for short term retrenchment measures. Thus, such duality in the form of interaction between retrenchment and recovery is often positively associated with successful turnarounds.

Dualism: Usually, it is observed that external stakeholders such as shareholders and banks seek short-term improvements to protect their investments,[23] internal stakeholders such as employees prefer a recovery plan that details the strategic changes required to ensure the firm's long-term survival.[24] In the present case study, dualism is observed to have been followed with the focus initially being only on retrenchment measures[25] towards savings of assets and costs aimed at stemming the losses in the short-term and to stabilize FMB, which

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[20] Banks charged default interest, banks C and D sought to cancel the credit, the Shareholder did not infuse funds and no standstill was agreed to.

[21] Strategic Transformation as the Essential Last Step in the Process of Business Turnaround. Business Horizons - John & Robbins, D. (2008)

[22] Firm Turnarounds: An Integrative Two-Stage Model – K Arogyaswamy (1995)

[23] The PI Style of Management – Pradip N Khandwalla, 1983

[24] Firm Turnarounds: An Integrative Two-Stage Model – K Arogyaswamy (1995)

[25] The key measures initiated in December 2013 included increase in prices, creating redundancies of employees and independent contractors and other savings through improved loss recovery, higher excess premiums and savings on car repairs.

was sequentially followed by recovery measures later during the reorganization. However, later in the process, FMB was more proactive in taking strategic recovery measures.[26]

Preferred approach: The board of FMB failed to address the key causes of decline and to take the recovery measures to address the issues with the top management and the internal processes within FMB to improve the management information system. Sequentially dealing with retrenchment measures followed by recovery measures led to low support from lenders and prolonged the financial decline of FMB. If FMB's board had adopted an integrated strategy towards the retrenchment and recovery measures, by undertaking key recovery measures, such as necessary change of managerial persons (including in the board), fixing up of internal processes such as management information system early in the decline, re-assessed key markets to develop strategy to sell off non-profitable subsidiaries, it would have inspired confidence of banks.

D. Sudi Sudarsanam and Jim Lai (2001)

The research paper examined the effectiveness of different strategies for turnaround and concluded that while similar turnaround strategies may be adopted by different firms, but the firms which manage to turnaround are those which are more effective in strategy implementation. The research paper highlights that key causes of organizational failure include managerial inaction, poor timing, lack of intensity and poor implementation of turnaround strategies. The success of managerial responses to performance decline is conditioned by their timing, intensity, and effective implementation.

Managerial Restructuring: Top management change is widely quoted as a precondition for successful turnarounds.[27] Often, key stakeholders such as financiers will only extend support if they are confident about the management team being able to handle the crisis. In the case study, it is observed that the managerial inaction in respect of key causes of losses[28] was one of the most critical factors which led to FMB's losses further spiraling down instead of showing improvements. Once the managerial restructuring was undertaken with the replacement of the CEO and appointment of the CXO recommended by the banks, the banks were more supportive in the efforts towards restructuring and the information flow also improved.

Operational Restructuring: The operating turnaround stage aims to stabilize the operations and restore profitability by pursuing strict cost and operating asset reductions. Operational restructuring measures were undertaken in the initial stages.[29] FMB also later proposed large cutbacks, re-evaluation, and re-assessment of the product range, thus indicating that the operational restructuring continued for a prolonged period of time.

Asset Restructuring: Asset restructuring refers to major reconfiguration of the company's assets and covers asset divestment and investment. In the case study, it is noted that FMB drew up plans for asset divestment by way of sale of the shares of non-Benelux subsidiaries (along with some non-Benelux foreign branches). No asset investment measures are observed to have been undertaken by FMB.

Financial Restructuring: Financial restructuring is the reworking of a company's capital structure to relieve the strain of interest and debt repayments and is separated into two strategies: equity based and debt-based strategies. In the case study, it is observed that in June 2014, the shareholder had proposed financial restructuring in the form of re-working of

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[26] Drawing up plans to evaluate and re-assessment of the entire business mix (product range), exploring sale of the shares of the companies outside the Benelux countries, which could have significant long-term effects, and drawing up plans for financial restructuring (ultimately culminating in Restructuring Agreement).

[27] Bibeault, 1982; Hofer, 1980; Schendel, Patton and Riggs, 1976; Slatter, 1984

[28] Large management bonuses wrongfully issued, failure in carrying out periodic check on the real costs against results of cost price escalation and poor management information systems.

[29] Spending cuts on labour costs with 130 staff members made redundant, extra savings through loss recovery and higher excess premium and savings on car repairs.

terms of the existing working capital financing and other loans, which was to be coupled with the infusion of additional contributions by the Shareholder (€35 million). Ultimately, the banks agreed to restructuring terms in terms of the Restructuring Agreement signed on 04 July 2015.

Effectiveness of Turnaround strategy implementation

Several factors such as severity of decline, economic and industry conditions and size of the firm are determinants of the pace of restructuring and effectiveness of the measures undertaken aimed at turnaround. In FMB, initially a few operational restructuring measures were undertaken, but the desired outcome was not achieved, and banks kept insisting on steps to be undertaken towards managerial restructuring and funds infusion by the Shareholder. Delay in managerial restructuring inspite of several early warning signals pointing towards inefficiencies in management, is likely to have been one of the key factors responsible for operational restructuring measures not having been as successful, which constrained FMB to adopt further operational restructuring measures later in the process. Given the slow progress in intensively tackling the key causes of decline in the initial phase of restructuring, the concentration of restructuring measures was much higher later. Further, only after the managerial restructuring by way of replacement of CEO and appointment of a new CXO, the banks favourably considered the financial restructuring proposal. But due to delay in the financial restructuring and low intensity of restructuring measures initially, the operational position of FMB had weakened further leading to a prolonged period for the turnaround.

Response to Query 4

Behaviour of Banks C & D: Lenders to the same borrower are usually not in a contractual relationship with each other but are in a relationship of financial interdependence once the borrower is in a position where it lacks the resources to honour its contractual commitments to creditors. Self-serving behaviour by any lender in isolation could injure the borrower as well as the interests of other creditors. Banks C and D seemed to frustrate the process which threatened to derail the restructuring efforts – (a) when they did not support in entering into a standstill agreement in February-March 2014 and (b) when they threatened to cancel the credit (to give FMB a signal to hurry up with the restructuring) at the end of June 2014.

Reasons for Banks C and D behaviour

Low confidence in existing management: Banks C and D lacked confidence in FMB's management in view of the poor management information systems and the issues of management failures which had emerged since November 2013. As the key remedial measures proposed by the management also did not address the key causes of concern, with new facts constantly emerging regarding further decline, it eroded confidence in the erstwhile management for banks C and D.

Banks C and D additional working capital facilities already overdue: Banks C and D appear to have also lent partly additional working capital facilities to FMB which were due for repayment in 2013. As FMB sought further time for this payment, reschedulement of due date without any clarity on restructuring made banks C and D impatient.

Effort towards making quick recovery: Considering the behaviour pattern of banks C and D, and the effort of banks A and B to acquire the loans of banks C and D with a discount of 15-20%,[30] it also appears that banks C and D may have relatively lower exposure to FMB. It looks likely that banks C and D were opportunistically exerting pressure to explore if the larger creditors and/or borrower would feel pressurised to facilitate a quick exit for banks C and D.

Fear of further value deterioration due to delay: Banks C and D were likely to have been frustrated with the delay in finalization of the restructuring. With the Shareholder delaying

[30] Page 4 of the Case Study

infusion of amounts into FMB, banks C and D may have been concerned about the impact of the delay on the overall valuation of FMB and FMB not meeting forecasted projections.
Pressure on Shareholder to expedite funding: Given the delay in the Shareholder infusing funds into FMB, the threat to cancel credit was aimed at exerting pressure for expediting the infusion, while also nudging the management of FMB to expedite the pace of restructuring.

Role as Advisor to Banks A and B

As an advisor to banks A and B, I would have taken the following key measures:

(a) **Better inter-creditor coordination:** As a first step, I would have persuaded all the banks to have a joint meeting for better inter-creditor understanding, to be able to act in a joint manner. Appointment of a coordinator institution would have further enhanced the coordination. If banks act together, it also provides confidence for the Shareholder to provide the additional financial support to the company for the restructuring.
(b) **Execution of an inter creditor agreement:** I would have advised banks to execute an inter-creditor agreement among all the banks laying down the ground rules for coordination among the banks, which would among others, lay down the key principles to be followed during the restructuring, manner of decision making, principles to be followed to ensure the maintenance of relative priority of securities of the creditors,[31] period for which standstill may be agreed, restrictions on banks to offer a first right to the existing lenders to acquire the loans to avoid the introduction of a new assignee lender.
(c) **Appointment of an observer on the board of FMB:** Considering the significant discomfort of banks C and D (which are also echoed by the other banks) with the conduct of the existing management, I would seek to persuade banks A and B to deliberate with banks C and D and to collectively appoint an observer on the board of FMB.
(d) **Appointment of a restructuring expert:** I would also have sought for the restructuring / turnaround expert to be engaged to assess and present the comparison of out of court workout against a formal insolvency / liquidation (relevant comparator). A favourable view of the restructuring expert regarding informal restructuring after due analysis would have instilled confidence among banks.
(e) **Appointment of a concurrent auditor and structured payments / tagging:** As an additional measure of comfort to banks C and D, I would have advised to also appoint a concurrent auditor / cash flow monitoring agent in FMB. Further, to keep lenders regularly incentivised, a tagged amount may be fixed for remittance by FMB regularly out of its revenues for creation of a corpus, to be utilised by lenders for their repayment.

Response to Query 5

<u>First Principle:</u>

No Standstill: In case of FMB, the level of cooperation among the banks was inadequate, as banks C and D were not aligned with banks A and B on signing standstill agreement (resulting in delaying standstill agreement and not providing the comfort required by the Shareholder to infuse funds) and seeking to cancel the credit in June 2014, thus creating further uncertainty. Delay in signing standstill agreement stretched the resources of FMB and eroded confidence of the shareholder to contribute any amount into FMB. Ultimately, a time bound standstill agreement was signed later, but the delay led to further losses.

Relevant Creditors: Further, the case study is silent on the other potentially relevant creditors and whether they were taken into confidence regarding the restructuring contemplated. Considering the nature of the business of FMB, it is likely that there must have been several trade creditors, however they were not involved in the workout process, which could potentially impact the effectiveness of the final restructuring agreed to between FMB and its bankers.

[31] To contractually create acknowledgement of acceptable principles to be followed, similar to those set out, for instance, in the INSOL Statement of Principles for a Global Approach to Multi-Creditor Workouts II.

Second Principle:

Conflict of Interest: The relevant creditors could not come to an agreement in respect of a standstill. During this time, in June 2014, banks C and D even threatened to cancel the credit. The conflicts of interest among the banks should have been identified and resolved earlier in the process.

Recovery and Enforcement Actions: The banks were charging default interest which was further stretching resources of FMB. Additional working capital facilities of € 25 million were repaid prior to the Restructuring Agreement being signed. While such loans may have been repaid due to the scheduled repayment date being prior in time (December 31, 2013), but it led to change of relative position among creditors.[32]

Transfer of loan exposures: Given the conflicting position among banks leading to delay in standstill agreement being signed, banks A and B explored buying out loans of banks C and D with a 15-20% discount.

Third Principle:

During the standstill period, the debtor should not take any action which could potentially adversely affect the interests of the relevant creditors. While this principle appears to be broadly complied with, but the repayment of additional working capital of € 25 million made in priority to the other lenders adversely affects the prospective return to other relevant creditors (especially when the proposed haircuts under the Restructuring Agreement is considered).

Fourth Principle:

Lack of Coordination: There was a significant lack of coordination among the banks, specifically between A and B as opposed to C and D, leading to a delay in standstill arrangement. The Shareholder's key expectation prior to infusing funds was a standstill arrangement to assure of the continuing support of banks, but the banks could not come to an agreement amongst each other for a significant period. Banks C and D even sought to cancel their credit to FMB at a particular instance. However, subsequently the banks did manage to coordinate better and arrive at agreed restructuring terms.

No Coordinator: No coordinator was appointed to facilitate coordination among banks. A coordinator could have facilitated better coordination among banks and mitigated conflicts among banks. Lastly, no committee or advisor was appointed by banks for assistance in coordination.[33]

Fifth Principle:

Failure to provide timely access to all relevant information: FMB board did not ensure timely access to all relevant information relating to its business and prospects. The initial causes of losses reflected poor information management systems in the company, which was followed by repeated instances of new information emerging (such as losses in foreign subsidiaries and holding company in December 2013) which impacted ability of the financers to be able to properly evaluate the financial position of the company. On several occasions, the forecast made by FMB board proved to be inaccurate and banks were faced with changed scenario when results were declared. Because of the constantly changing information, FMB initially could not inspire confidence of banks to support in restructuring. Thus, in the initial stages of the workout, the aforesaid principle does not appear to have been complied with.

Improvement in Access to Information: As the information flow improved, even though FMB continued to suffer losses, when the financial workout proposal was given by the Shareholder,

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[32] It is assumed that additional working capital lenders did not have preferential right of payment.

[33] An accounting firm was however appointed to investigate the procedures within FMB and a turnaround consultancy agency was appointed to examine viability of the company with a view to market share and to achieve estimated turnovers.

banks could evaluate the same better due to improved information access and were supportive, finally culminating in the signing of the Restructuring Agreement.

Sixth Principle:

While largely the aforesaid principle appears to have been complied with, with none of the banks having undertaken any actions which would alter the relative positions of relevant creditors as on standstill commencement date, however, a few key exceptions are noted in the Restructuring Agreement. Firstly, the bankers C and D appear to be absorbing disproportionate haircuts compared to the other creditors. Further, the repayment of additional working capital of € 25 million prior to the execution of the Restructuring Agreement also alters the relative positions of creditors.

Seventh Principle:

It is important that during the stage of evaluation of the proposals, confidentiality is duly maintained in respect of the financial position of the debtor and all connected information is made available to all relevant creditors, which should be maintained with confidentiality. There are no facts in the case to indicate there has been any breach of this principle.

Eighth Principle:

No additional funding has been availed from third parties (other than Shareholder). Loans were however taken from the Shareholder as unsecured loan (€10 million), and a subsequent €30 million was proposed to be given subject to banks transferring security rights of € 45 million to the Shareholder. No priority is usually given to the shareholder's subordinated / unsecured loans granted during the standstill period, but in this case, the Shareholder is further hard done as it is constrained to cancel all its claims on FM II BV, thus amounts infused even during the workout are not recognized to be paid back.

Response to Query 6

Soft law

The term 'soft law' generally denotes agreements, principles, and normative statements in non-binding political instruments such as declarations, resolutions, and programs of action that are not legally binding. While such soft law instruments have a persuasive value, but their compliance is not legally binding and enforceable. They are especially useful to provide guidance in areas where the legal framework is not yet codified. In the area of international financial law, soft law has become the most frequently adopted form of law.[34] In terms of their effect, soft law rules can vary from simple professional practices (such as best practices or gentlemen agreements) to uniform rules, codes, and guidelines.[35]

Soft law instruments have been observed to be increasingly prevalent in restructuring and insolvency law. Soft law instruments usually originate from standard-setting organisations such as the United Nations Commission on International Trade Law (UNCITRAL) Working Group V (Insolvency), the World Bank, Asian Development Bank, as well as insolvency practitioners' organisations, such as INSOL International and International Insolvency Institute. The INSOL Principles of 'Statement of Principles for a Global Approach to Multi Creditor Workouts II' ("**INSOL Principles**") are a soft law instrument which has been endorsed by the World Bank, the Bank of England, many international commercial banks and consultancy agencies, as well as the British Bankers' Association.

[34] Chris Brummer, 'Soft law and the global financial system', 2nd edn (Cambridge: CUP, 2015) 120

[35] Rosa M. Lastra, 'International financial and monetary law', 2nd edn (Oxford: OUP, 2015) 511

Soft law options with specific emphasis on India

While the INSOL Principles provide for a globally well recognized set of principles which aid in guiding parties in their conduct in multi-creditor workout processes, if parties are not convinced to adopt them, other soft law options which may provide useful guidance in respect of conduct of parties in an informal restructuring / workout include the World Bank Principles for Effective Insolvency and Creditor Rights Systems,[36] UNCITRAL Alternative approaches to out-of-court insolvency processes and the European Commission's 'Helping businesses overcome financial difficulties: a guide on good practices and principles on restructuring, bankruptcy and a fresh start', Asian Development Bank's Good Standard Practice, etc.[37]

Recently, an attempt has been made to create a comprehensive Asia specific workout philosophy with the ultimate vision of producing a set of Asian Principles of Business Restructuring ("**Asian Principles**"), based on study of several jurisdictions within Asia (including India) under the auspices of the Asian Principles of Business Restructuring Project jointly undertaken by the Asian Business Law Institute (ABLI) and the International Insolvency Institute (III). It sets out a model of best practices, in the form of both principles and practice tips, for workouts of corporate debtors in Asia, taking into consideration unique challenges of workouts (which is still in infancy) in developing jurisdictions in Asia and which may not have been considered by other soft law instruments.

Being a region-specific workout philosophy, in a workout being considered in my region, i.e., Asia and India, placing reliance on these set of 'soft law' principles is likely to find more acceptability among creditors, as it is based on practical experiences within this region and takes into account the unique challenges of the region, while laying down both principles and guidance for best practices. Considering the absence of any universally accepted directives in Asia, such as European Directive on Preventive Restructuring Frameworks adopted by European Union as a part of broader program to create Capital Markets Union in Europe, Asian jurisdictions will be well served in cross border restructurings if broad rules of restructuring such as those laid down in Asian Principles are followed.

Informal possibilities in India

In India, resolution of distress is undertaken usually through formal legislative or regulatory frameworks. Formal restructuring is provided under the Code (through resolution plan in the corporate insolvency resolution process ("**CIRP**") pursuant to a moratorium period with the creditor in control) or through a scheme of arrangement under the Companies Act, 2013 for corporate and/or debt restructuring with the debtor in possession, both of which require the approval of NCLT. Schemes under the Companies Act, 2013 and resolution plans under the Code once approved by the NCLT provide for cross-class cramdown.

The only informal possibility under Indian law for restructuring is under the framework prescribed under RBI Directions, which provides an out-of-court restructuring option with the consent of the lenders. The informal reorganization under the RBI Directions does not have the benefit of cramdown on the other creditors. It however prescribes for execution of an inter-creditor agreement between the lenders, for agreeing on principles of standstill and decision-making based on majority[38] being binding upon all the lenders. However, in view of foreign lenders not being regulated by the Reserve Bank of India ("**RBI**"), informal reorganizations under the RBI Directions face practical challenges if foreign lenders are not agreeable to the resolution plan.

In recent times, hybrid process of pre-packs with debtor in possession have been introduced under the Code for micro and small enterprises, however, the experience in the Indian context

[36] Principle 25 and 26.

[37] In Asia, there have been several localized iterations of workout philosophy such as in the form of Bangkok Rules, the Jakarta Initiative and the Hong Kong Approach to Corporate Difficulties.

[38] Lenders representing 75% by value of total outstanding credit facilities (fund based as well non-fund based) and 60% of lenders by number.

has been muted on pre-packs so far. While pre-packs within the framework of the Code (requiring final approval of the NCLT) is yet to see significant success, however, considering the judicial delays in the formal insolvency framework, increasingly lenders are keen to explore informal reorganizations and pre-packs as a viable alternative to formal insolvency resolution.

Response to Query 7

Essence of the Restructuring Agreement: After a significant delay since the early warning signals were observed in November 2013, FMB signed the Restructuring Agreement in July 2015. The Restructuring Agreement is preceded by several steps aimed at business restructuring including retrenchment measures and changes in the management (as already indicated in previous responses) and infusion of funds by the Shareholder, followed by repayment of €25 million to the additional working capital lenders. The essential elements of restructuring under the Restructuring Agreement[39] are as set out below:

(a) **Transfer of all operating companies of FMB to a shell subsidiary:** All the operating companies held by FMB were required to be transferred to a shell subsidiary entity FM II BV, whose shareholding was to be transferred by FMB to all the banks who have financed original working capital of FMW and certain board members (including the CRO). FMB and its Shareholder would cancel all claims against FM II BV and its subsidiaries. Thus, the ownership and control structure of the group consisting of the operating companies stood changed from the existing Ultimate Shareholders to banks and certain board members. The operating subsidiaries could continue to operate under the new ownership structure without facing imminent pressure of default, bankruptcy, or enforcement.

(b) **Non-operating companies to continue with shareholder:** Reflecting the relative position of the shareholders being lower in priority to the creditors in a situation of insolvency / liquidation, the Shareholder ceased to have any shareholding in FM II BV (and the operating subsidiaries) and was vested with the responsibility of handling and monetizing the non-operating subsidiaries continuing in FMB. Inspite of the contributions made by the Shareholder during the financial difficulties, the Shareholder was not allotted any equity in FM II BV, nor did the debt survive with recourse to the assets.

(c) **Liquidation of FMB and extinguishment of claims against FMB:** FMB was required to be liquidated in an undisclosed manner and it has been clarified that banks would waive all their claims against FMB. Similarly, even the Shareholder was to cancel its claims against FMB. This effectively means that the exposure of the banks was restricted only to FM II BV where the operating subsidiaries were housed. Extinguishment of all claims against FMB would pave the way for a solvent liquidation of FMB and its post-reorganisation subsidiaries.

(d) **Re-working of the loan obligations:** The debt obligations of FMW were re-worked in the following manner:

Exiting Creditors and Shareholder: The restructuring contemplated that as banks C and D were repaid part of the additional working capital facilities, the balance amounts payable to them were waived. Further, loans of € 55 million in FMW were also cancelled in full. All claims of the Shareholder on FM II BV and its subsidiaries were cancelled.

Restructured Lenders: The working capital consortium lenders were required to waive an amount of € 97.5 million (with €240 million continuing), but they received equity shares of FM II BV in lieu thereof. The security over the FMW assets of the working capital lenders is recognized and it is proposed that they will receive part of their claims on liquidation. With the haircut, it is expected that FM II BV will be able to service its dues to the continuing lenders. The Restructuring Agreement however does not delve into the manner of mitigating / dealing with the losses in foreign subsidiaries of FMB.

[39] It is noteworthy to highlight that since the Dutch statute of Wet Homologatie Onderhands Akkoord (WHOA) came into force on 01 January 2021 (much after the date of Restructuring Agreement), the implications of the same has not been considered in the responses.

Key Results of the Restructuring Agreement

New Group under lenders and board members: A new group under FM II BV is created which is ring-fenced from the other liabilities in the residual entities retained in FMB. FM II BV is a more solvent entity with its net profit positive and equity capital strengthened and is expected to have a larger role for banks in the overall strategy and management. With the banks also acting as shareholders and claims of Shareholder already cancelled, FM II BV and the operating subsidiaries has the benefit of protection from any coercive action from them.

Upside on Shareholding in FM II BV for banks**:** Once FM II BV is revived, its valuation will increase and banks will realize an upside on account of the shareholding held by them, resulting in better realization than liquidation.

Foreign Subsidiaries Vulnerable**:** Considering the losses in the foreign subsidiaries, the restructuring fails to address one of the key causes of distress, being the losses at the foreign subsidiaries, which would certainly adversely impact ability to sell FM II BV as a going concern.

Solvent Liquidation of FMB: Upon the transfer of the operating subsidiaries to FM II BV and the extinguishment of claims by the banks and Shareholder against FMB, the residual entity of FMB with the non-operating subsidiaries has the benefit of being debt free. This should help in proceeding with the solvent liquidation of FMB and its non-operating subsidiaries in an orderly fashion to enable the Shareholder to have its investment returned (if any) in a tax efficient manner.

Negative Impact on Shareholder and their shareholders: The UK based Shareholder and the Ultimate Shareholders lose their entire investment value, both in terms of the equity capital contribution as well as the loans and other investments made in FMB, including during standstill period, and only have the benefit of realizing out of liquidation of FM II BV. The Ultimate Shareholders in USA and UK could have raised issues in absence of any cross-class cramdown provisions applicable to the Restructuring Agreement on the ground of receiving disproportionate value allocation in the restructuring, however, being lower in priority as compared to the banks in payment waterfall, they may have been inclined to support the restructuring.

Response to Query 8

Problems in preservation of the foreign subsidiaries

As a general principle, one of the key objectives of an efficient and effective insolvency law is the preservation of insolvency estate to allow equitable distribution to creditors, including *inter alia* through stay of creditor action to allow breathing space to the debtor.[40] The main (and perhaps, the only) assets of FMB are its investments/shareholding in its subsidiaries, including those in certain foreign subsidiaries in Spain, France, Australia, South Africa, and USA under their respective local company laws.[41] In a group scenario, the preservation of assets is complicated since the preservation of financial condition (and assets) of group/subsidiary companies through 'automatic stay of creditor actions' may not be possible on account of being separate legal entities. In the same jurisdiction, the problem may be mitigated through coordinated or consolidated approaches of group insolvency – which is dependent on the degree of financial and decision-making autonomy in enterprise groups.[42]

In the present case, while the Restructuring Agreement involves the banks ultimately becoming the shareholders of FM II BV, which holds among others several foreign subsidiaries and will

[40] UNCITRAL Legislative Guide on Insolvency Law - Part 1, Para 10 of Chapter I.

[41] Case Study, Pg 1.

[42] UNCITRAL Legislative Guide on Insolvency Law - Part 3, Para 10 of Chapter I.

be sold as a going concern ultimately,[43] however, until such sale is completed, any realizations by the creditors are dependent on, *inter alia*, the underlying value of the assets of the foreign subsidiaries. Therefore, preservation of assets of the foreign subsidiaries in the interim period until the going concern sale of FM II BV is imperative for the successful implementation of the restructuring process. However, since the Restructuring Agreement is an informal workout, it may not be recognized as a 'foreign proceeding'[44] under the UNCITRAL Model Law on Cross Border Insolvency ("**MLCBI**"). Even in case the informal workout is ultimately sanctioned in Dutch court monitored insolvency proceedings (if possible) for it to qualify as a 'foreign proceeding' under MLCBI, the recognition of such Dutch Proceedings in any foreign jurisdiction will depend upon multiple factors including: (i) whether the concerned jurisdictions are signatories to MLCBI or any similar treaty for cross-border insolvency co-operation[45] or apply the rule of comity;[46] (ii) the presence of an 'establishment'[47] of FMB in such jurisdiction; (iii) the reliefs available upon recognition of a foreign main proceeding in that jurisdiction; (iv) interest of creditors of FMB in that jurisdiction; and (v) public policy of such jurisdiction. Further, even if such Dutch Proceedings are recognized in these foreign jurisdictions, the reliefs available upon recognition (including automatic stay on creditor actions), will only be available towards the assets, rights, and obligations of FMB and not extend to its subsidiaries (or their assets).[48]

Therefore, if the financial condition of the foreign subsidiaries deteriorates before the Restructuring Agreement is implemented, it leaves such subsidiaries potentially amenable to creditor action in their respective jurisdiction, which may include initiation of insolvency, winding-up, liquidation, receivership, enforcement actions or any similar proceedings and consequent change in control of such foreign subsidiary or alienation of assets in those subsidiaries. While the Restructuring Agreement deals with the debts owed by FMB and FMW, however, it does not seek to provide any resolution for the continuing losses and accumulating debt obligations at the foreign subsidiaries.

Proposed Solution 1

One solution might be to achieve a workable informal arrangement with the creditors and stakeholders of such foreign subsidiaries in the interim period, which may provide for a standstill on enforcement of their rights against such foreign subsidiaries. If such an informal arrangement upholds the pre-insolvency entitlements of the creditors in the jurisdictions where such subsidiary is incorporated, it would be easier to facilitate a concurrence from such creditors, as they would not be 'worse-off' upon agreeing to such arrangement as compared to the uncertainties and costs associated with a formal insolvency or enforcement action against the subsidiary.

Proposed Solution 2

Alternatively, considering that FMB acts as the centre of main interests ("**COMI**") for its foreign subsidiaries, which indicates a closely linked and intricately connected operational and

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[43] Case Study, Pg 7.

[44] Article 2(a) of MLCBI defines "**Foreign proceeding**" as collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

[45] While the recognition of Dutch Proceedings in Spain and France will be governed through EU Recast Regulations, recognition in Australia, USA, and South Africa (all of them being signatories to MLCBI) may be difficult on account of The Netherlands not being a signatory to the MLCBI.

[46] UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, Chapter III defines "**Comity**" as, in the legal sense, neither a matter of absolute obligation, nor of mere courtesy and good will, but recognition that one State accords within its territory to the legislative, executive or judicial acts of another State, having due regard both to international duty and convenience and to the rights of its own citizens or of other persons who are under the protection of its law.

[47] Article 2(f) of MLCBI defines "**establishment**" as any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.

[48] An assumption has been made that there is no cross-border group insolvency framework governing enterprise groups to which the concerned jurisdictions have acceded.

financial structure of the group,[49] voluntary insolvency proceedings may be initiated against FMB and subsidiaries in Netherlands, with such proceeding being the 'foreign main proceeding' for the foreign subsidiaries as well (if possible, under the local laws). Such centralization of insolvency proceedings gains greater impetus and yields better results where the solution envisaged is a going concern sale of the integrated group.[50] Once the main proceedings have been initiated in the Netherlands against FMB and its subsidiaries, one of the two following methods may be adopted:

(a) contractual assurances or assurances basis judicial orders[51] may be obtained to the effect that if there were no secondary proceedings in the relevant local jurisdictions, then their respective financial positions as creditors under their relevant local law would as far as possible, be respected in the Dutch Proceedings; or

(b) the Dutch proceedings may be sought to be recognized in the local jurisdictions as the 'foreign main proceedings'. However, this may be more complicated on account of the problems highlighted above (*refer paragraph (d), specifically (i), (iii), (iv), and (v)*). Further, an additional complication may arise on account of the relevant jurisdiction's treatment of the concept of COMI; i.e., whether the jurisdiction recognizes group-wide COMI or only individual entity basis. In EU, for example, the concept of COMI would generally apply to each entity separately,[52] however, in practice, there have been examples of group insolvency cases where the group headquarters have been recognized as the COMI for all group entities.[53]

<u>Problems associated with probable shareholders' objection.</u>

The Restructuring Agreement substantially impairs rights of the Ultimate Shareholders and Shareholder, as the Shareholder is required to cancel all claims against FM II BV and will (most probably) receive nothing from claims on liquidation of FMB.[54] The Ultimate Shareholders and Shareholder could have challenged the Restructuring Agreement as being 'unfair' and 'unreasonable', in view of the distribution of value to them.[55] The jurisdiction of objection would have been either at the place of restructuring (*lex fori concursus*), the place where the shareholder is based/registered, and/or the place where ancillary proceedings are conducted (including recognition proceedings) and would depend upon the formalized insolvency proceeding (if any) for the execution and implementation of Restructuring Agreement.

Proposed Solution

If such a challenge is foreseeable from a foreign shareholder, a proposed solution which may mitigate the risk of challenge by a foreign shareholder, would be to implement the Restructuring Agreement through a formalized proceeding(s) (if any) in a jurisdiction and through an insolvency proceeding which allows cross-class cramdown of impaired shareholders.

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[49] Case Study, Pg 1.

[50] Irit Mevorach, *Cross-Border Insolvency of Enterprise Groups: The Choice of Law Challenge*, 9(1) Brooklyn Journal of Corporate, Financial, and Commercial Law (2014) 226, 235.

[51] Re Collins & Aikman Europe SA, [2006] EWHC 1343 (Ch), in which the Hon'ble High Court of England and Wales directed that English administrators should distribute assets to foreign creditors, in so far as possible, in accordance with their putative rights under their respective local laws in the event that secondary proceedings had been opened in those countries.

[52] Miguel Virgós & Etienne Schmit, Report on the Convention of Insolvency Proceedings, 03 May 1996, Para 76.

[53] In the matter of Daisytek-ISA Limited, [2003] BCC 562.

[54] Case Study, Pg 6-7.

[55] For example, the decisions of the English court and Dutch court in the restructuring of Vroon group (In the matter of Lamo Holding B.V., [2023] EWHC 1558 (Ch)), wherein the restructuring plan was implemented through two interconnected and conditional schemes, one in the UK (Scheme of Arrangement) and the other in the Netherlands (Dutch Scheme/WHOA). The shareholders had challenged the restructuring plan before the English court as well as the Dutch court, adducing valuation evidence and alleging misallocation of value of the restructured group.

Response to Query 9

Suspension of Payments: One of the insolvency regimes under Dutch law is the suspension of payments[56] which provides for grant of temporary relief to a debtor from payment obligations and may be used to facilitate the reorganisation of a company's obligations to enable it to continue its business as a going concern. If a debtor satisfies the liquidity test,[57] it may file a petition seeking suspension of payment, which the court may grant and appoint an administrator to act alongside the directors of the company. During the suspension of payment, the directors and the administrator jointly represent the company, save for a few exceptions.

During the suspension of payments procedure, the unsecured and non-preferred creditors are barred from recovering their claims against the debtor's assets, and enforcement measures already taken are suspended by operation of law, providing some breathing space to the company, for preparation of a composition plan for approval of its unsecured and non-preferred creditors followed by the court's approval. However, secured creditors and preferred creditors (such as tax and social security authorities) are excluded from the operation of suspension of payments as well as the composition plan. Secured creditors and preferred creditors can continue to take recourse against the company's assets during the suspension of payments and cannot be impaired or crammed down under the composition plan.

Suspension of Payments not advisable for FMB: In case of FMB, its key creditors were banks A, B, C and D, who were secured financial creditors. Until October 2014 when the four scenarios were prepared, no financial restructuring had taken place. The suspension of payments would not apply against banks A, B, C and D and the threat of insolvency, recovery or enforcement actions by the banks loomed large, threatening to jeopardise all efforts towards composition. Further, any composition plan under the suspension of payments procedure, would be of limited benefit in absence of cram down of restructuring terms on secured creditors. Lastly, any suspension of payments only at the holding company FMB would not have yielded much positive results, unless there were similar standstill / suspension orders in each of the subsidiaries (including foreign subsidiaries) which were facing financial difficulty. Accordingly, seeking a moratorium by way of a suspension of payments procedure was not an advisable option at that stage in case of FMB.

Moratorium in Indian context: In India, the primary formal process for seeking suspension of payments / moratorium is by way of an initiation of a CIRP under the provisions of the Code. A CIRP can be initiated, upon an admission of an application filed by an operational creditor, financial creditor, or the company itself with the NCLT.[58] Once the CIRP is admitted, the NCLT immediately directs a detailed order of moratorium providing protection against any coercive actions against the company including recovery and enforcement measures by creditors,[59] which applies against all creditors of the company and continues during the entire CIRP.[60] An RP is appointed by the NCLT who is vested with the management of affairs of the company and the powers of the board of directors of the company, while the powers of the existing board of directors stands suspended[61] during CIRP.

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[56] The two primary insolvency regimes under Dutch law are suspension of payment ("surseance van betaling") and bankruptcy ("faillissement").

[57] Liquidity test is if the company foresees that it will not be able to pay its debts as they fall due.

[58] Section 7 (application by financial creditor), Section 9 (application by operational creditor) and Section 10 (application by the corporate debtor)

[59] Section 14 of the Code *inter alia* prohibits any (a) institution of suits or continuation of pending suits or proceedings against the company including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority; (b) transferring, encumbering, alienating or disposing off by the company of any of its assets or any legal right or beneficial interest in it; (c) any action to foreclose, recover or enforce any security interest created by the company in respect of its property; and (d) recovery of any property by an owner or lessor where such property is occupied by or in the possession of the company.

[60] Section 31(4) of the Code

[61] Section 17(1)(a) and (b) of the Code

Section 29A of the Code, a unique provision in the Indian context, classifies certain persons as ineligible to submit a resolution plan which includes all connected persons[62] of debtors classified as non-performing assets (as prescribed by RBI) for a period of a year, thus limiting the participation of existing promoters / management of several distressed debtors. The objective of the CIRP is to find a resolution plan for the company, by inviting resolution plans from prospective resolution applicants. Unlike the Dutch suspension of payments procedure, the resolution plan once approved by the committee of creditors (which constitutes of all financial (secured and unsecured) creditors of the company) and the NCLT, has a binding effect on all stakeholders, including all creditors of the company (financial, operational and other creditors and includes all government bodies as the creditors) as well as shareholders, employees and guarantors.

Moratorium process under Indian law not feasible for FMB: Given the status of FMB in October 2014 when the 4 options including moratorium were drawn up, it would not have been a feasible option (viewed from perspective of moratorium process under Indian laws if FMB was incorporated in India) because of the following key reasons:

(a) **Management loses control:** In terms of the Code, once the moratorium process commences, the management ceases to have control and the entire CIRP is managed by the RP with decision making with committee of creditors on critical matters such as approval of the resolution plan. FMB's shareholder and management will lose the control of the company and will not have any ability to protect their own interests in the resolution plan for the company and all progress made towards arriving at a restructuring plan up to the moratorium, would be lost.

(b) **Potential ineligibility of Shareholder and management:** In view of Section 29A of the Code, the existing management and Shareholder run the risk of being unable to participate in the CIRP as a prospective resolution applicant, if they are classified as ineligible under the Code, thus adversely impacting not just their interests, but also making ineligible the persons with best knowledge of the company, which is likely to drive down the value offered in the resolution plan to creditors. While the existing management may seek withdrawal from CIRP,[63] it requires approval of a high threshold of 90% of the committee of creditors and any settlement proposal in connection with such withdrawal does not have the benefit of cross-class cramdown and other benefits available to a 'resolution plan' under the Code.

(c) **NCLT monitored process without benefit of closed-door proceedings**: In view of the CIRP being a process run in the public glare, the debtor suffers reputational harm due to the stigma of being admitted into CIRP. India does not have any formal insolvency process for a closed-door proceeding. Publicity of the financial distress could create apprehension among FMB's suppliers and creditors in continuing on existing terms with FMB. While moratorium does provide protection against certain actions and Indian courts have interpreted it liberally to protect the company during CIRP, but the risks of lack of cooperation from certain suppliers and customers is still likely.

(d) **Absence of Group and Cross Border Insolvency Framework**–The Code does not prescribe any framework for group insolvency, though the NCLT in exercise of inherent powers has directed for substantive and procedural consolidation in several cases.[64] The Code also does not comprehensive framework for cross-border insolvency yet.[65] FMB being a holding company with several subsidiaries including foreign subsidiaries, its insolvency requires resolution at a group level by inclusion of all subsidiaries, for which group insolvency and cross-border insolvency framework would be critical.

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[62] Connected persons has been defined widely in the Code to include the promoter and persons in management or control of the resolution applicant, promoter and persons in management or control of the business of the company during the implementation of the resolution plan and their holding company, subsidiary company, associate company, or related party.

[63] Section 12A of the Code

[64] For example, group insolvencies in the cases of Srei Group, Lavasa Group, Vidoecon Group etc.

[65] While a set of draft provisions were formulated by the Insolvency Law Committee constituted by the Ministry of Corporate Affairs, Government of India, for adoption of the UNCITRAL Model Law on Cross Border Insolvency with some alterations, however the same is yet to be introduced into the Code.