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?**

Introduction

Mellahi & Wilkinson research provides a frame of reference to undertake a postmortem on the cause of Flow's financial distress and how the decline may have been avoided.

Prior to Mellahi & Wilkinson's 2004 research paper, two polarised perceptions had developed to explain organisational failure, namely the external / deterministic (IO/OE) theory and the internal / voluntarist (OS/OP) theory.

Mellahi & Wilkin research seeks to reconcile the two approaches and posits a new integrative framework (**MW Integrative Framework**) which cures some of the inherit limitations of the above mentioned theories when viewed in isolation.

Applying MW Integrative Framework to Flow's situation it is clear that a combination of internal and external factors have contributed to the financial distress of Flow. Although internal (specifically Management) is the primary cause of the company's decline and the exact nature of the external factors which have impacted Flow are obfuscated by poor information systems.

Applying external / deterministic (IO/OE) theory

Prior to 2012, Flow was a profitable company with a net profit of €9.4 in 2011.

The material[1] does not explicitly detail whether there were any significant changes to Flow's external environmental (technology, regulatory, demographic, economic). The material also doesn't specify Flow's position in its industry (the stage of the industry's cycle, the comparative age of the company and the comparative size of Flow). Nevertheless, there are two important data points in the material from which we can derive and infer details relating to Flow's external environment.

[1] It is assumed that the material is silent on these aspects because Flow's information systems have not captured this information.

Firstly, Flow operated in an unsaturated market. This inference is made based on Flow's ability to increase its prices[2] without this impacting demand for its product/ services. We can infer that there is little competition in Flow's industry given the market's (almost) indifference to the price increases.

Furthermore, an independent turnaround consultancy concluded that Flow is viable with view to the company's "market share".

These details suggest that external pressures are not a dominate factor contributing to Flow's financial distress and in fact Flow is failing to capitalise on certain favourable market conditions.

Applying to the internal / voluntarist (OS/OP) theory

Prior to the period of distress, Flow's CEO and CFO (**Management**) appear to be the principal decision makers of the company with little surveillance being conducted on their actions (for example the wrongful payment of significant bonuses to the CEO and CFO).

Management's unfettered control continues during the initial period of distress until at least late 2013. During this time Management makes some arguably hasty decisions including a decision to implement redundancies.

In short, Flow's distress has some of the earmarks of at least three of OS/OP five of the middle range theories

- Group Think Theory: Management demonstrates an ignorance of outside information[3]. The decision to implement redundancies is a good example as it was made in a vacuum of information. Indeed, there is clear evidence[4] that Flow's information systems were inadequate and unreliable at the time. In review, the decision did not resolve the company's underlying issues. Research supports the assertion that retrenchment activities done without a strategic focus, whilst beneficial in the short term, may hinder future restructuring activities[5].

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[2] Flow was able to increase its pricing structure with only "a few" negative responses received.
[3] Mellahi, K., & Wilkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews*, 5(1), p 28
[4] For example the numerous and significant "faults" in Flow's annual accounts.
[5] Schmitt, A., Raisch, S. (2013). 'Corporate Turnarounds: The Duality of Retrenchment and Recovery', *Journal of Management Studies*, 50(7) p 1218

- *Upper Echelon Theory*: Flow's Management team is homogenous. Homogeneous management teams have been found to be ineffective in being able to properly diagnose the cause of a company's failure[6]. This is seen to be the case as Management's two initial solutions, being redundancies and increases to customer pricing, did not resolve the company's financial distress.
- *Threat Rigidity Effect Theory:* This theory recognises that the ego of management can lead to a company's failure due to its influence on the processing and reporting of information[7]. Historically Flow was a profitable company, Management's ego could be a contributing reason as to why, despite Flow's decline, Management continues to provide overly optimistic forecasts.

By May 2016, Management has been replaced and improvements have been made to the management information systems, but despite all of this the "situation [remains] critical". This belies the conclusion that Management is the only cause of Flow's financial distress and instead indicates that there may be other external factors which may have caused the decline, preventing the successful restructure.

Conclusions

The financial distress of Flow was caused by internal factors which could have been prevented through the implementation of (1) good corporate governance policies and (2) reliable and robust management information systems. Regard also needs to be given to the fact that environmental and ecological factors appear to be at play with at least certain favourable market conditions having the effect of initially masking the negative internal issues. Arguably due to the poor management information systems Flow is unable to identify external pressure and so react to them appropriately.

[6] Mellahi, K., & Wilkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews*, 5(1), p 28
[7] Mellahi, K., & Wilkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews*, 5(1), p 30

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?

Introduction to the Cayman Islands regime

The Cayman Islands is regarded as a creditor friendly jurisdiction and arguably this is one of the contributing factors to its success as an international financial centre.

The Cayman Islands has no legal mechanism for facilitating out of court debt[8] restructuring, however, recently[9] laws have been enacted which have introduced a standalone court supervised restructuring regime. Prior to the introduction of the restructuring officer regime, the Cayman Islands courts had adapted the provisional liquidation provisions as a way of providing protection to a company while it restructures. The Cayman Islands corporate rescue procedures, relating to restructuring officer regime and the restructuring provisional liquidator provisions (together, the **Formal Restructuring Procedures**), are set out in the Companies Act.

Oftentimes, where a consensual agreement is not possible, a Cayman Islands restructuring is formalised and implemented by a scheme of arrangement[10]. A scheme of arrangement is a court approved compromise / arrangement as between the company and its creditors (or shareholders). A scheme of arrangement can also be promoted by a company outside of the Formal Restructuring Procedures.

Comparison

The below tables summarises the advantages and disadvantages of an informal and formal (court supervised) process from a general perspective with commentary as to the applicability of these generalisations to the Cayman Islands laws.

[8] For the purposes of answering this question it is assumed that restructuring is limited to financial restructuring and does not include operational restructuring.
[9] Effective 31 August 2022
[10] Section 86 of the Companies Act

Informal workouts - advantages

Generally accepted principles	Application to the Cayman Island legal framework
Privacy of the process[11]	Informal debt work outs are not provided for in the Cayman Islands legislation. In practice an informal financial restructuring would be implemented by way of contractual agreements which are capable of being kept confidential.
Flexibility (timing, structure)[12]	As compared to the formal restructuring options the informal route can be more flexible and is capable of being implemented swiftly ie is not bound by statutory timelines and court availability. Comparatively, in order to implement a Cayman Islands scheme of arrangement there are at least three steps to be observed (1) obtaining a convening court hearing to approve the administrative matters relating to the scheme, (2) holding a meeting for the relevant stakeholders to vote on the scheme (3) a subsequent court hearing for the court to consider whether to approve the scheme[13].
Control[14] remains with management which in turn can reduce the costs[15]	In the Cayman Islands during an informal process the directors will remain in control of the process. This is appropriate where there is functioning management and trust as between the company and its stakeholders. This can be the most cost-efficient means of restructuring without the need of additional costs relating to restructuring professionals and court related expenses.
Reduces the potential disruption to business. Many contracts include ipso facto clauses which will have the effect of automatically terminating contractual obligations in circumstances where one of the parties becomes insolvent (or there is deemed to be an event of insolvency)	The Formal Restructuring Procedures are deemed to be insolvency procedures on the basis that the threshold test (or a statutory pre-condition) is that the company is unable to pay its debts as they are due. Accordingly, if the company is a formal process the Cayman Islands law will allow contracting parties to enforce any ipso facto clauses as a matter of contract.

[11] Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions, Review of Central and East European Law p 146

[12] ibid p 146

[13] The Cayman Courts clarified the procure in Re In the Matter of E-House (China) Enterprise Holdings Limited, SD No 165 of 2022 (NSJ), unreported, 17 November 2022

[14] Ibid p 146

[15] The costs of formal insolvency proceedings are substantially higher. see Garrido, Jose "Out-of-Court Debt Restructuring" https://documents1.worldbank.org/curated/en/417551468159322109/pdf/662320PUB0EPI00turing09780821389836.pdf p 10

Informal workouts - disadvantages

Generally accepted principles	Application to the Cayman Island legal framework
There are limited situations where an informal workout will be a viable option	This disadvantage is particularly true in the context of the Cayman Islands legislative framework. As there is no informal mechanism to unilaterally vary a party's contractual rights, practically, a Cayman Island company will require the cooperation and support of its stakeholders and only through absolute consensus will a financial restructuring be binding on those stakeholders.
Lack of finality to the restructuring, as agreements are capable of being unwound should the company subsequently be liquidated	Creditors should be conscious that any payments made to creditors when a company is unable to pay debts as they are due, may be voidable if they were made within six months prior to the commencement of the liquidation[16]. This may also result in director liabilities as there are specific provisions whereby knowingly parties are liable where a company has "carried on with intent to defraud creditors of the company"[17].
The process can be controlled by relatively minor but dissenting stakeholders	Informal workouts are not provided for in the Cayman Islands legislation and there is no way to cram down or impose a restructuring on creditors. Predatory stakeholders may be able to leverage additional benefits or more favourable terms by threatening to petition for the company's liquidation.

Formal Restructuring Procedures - Advantages

Generally accepted principles	Application to the Cayman Island legal framework
Funding advanced during a formal restructuring period will be afforded a priority status[18]	In Cayman there is no statutory protection or priority afforded to parties for financing advanced during the restructuring, however, if the company was to be later liquidated the funding provided during the restructuring period would be deemed to be an expense of the restructuring which would have priority above ordinary unsecured creditors[19].
A stay of proceedings	Pursuant to 91G of the Companies Act, upon the filing of the restructuring officer petition, and upon the restructuring officers' appointment, there is an automatic stay of proceedings with extraterritorial effect. In reality, whether or not this will be respected by other jurisdictions has yet to be fully tested. The stay will also have the effect of staying any winding up action even in circumstances where a petition to wind up the company was filed ahead of the petition to appoint the restructuring officer[20].
Cross border recognition of the restructuring	Shemes of arrangement promoted by a Cayman Islands restructuring provisional liquidator have been recognised by foreign jurisdictions. Whether or not a scheme of arrangement promoted by a restructuring officer will be afforded the same recognition and assistance is yet to be

[16] Section 145 of the Companies Act
[17] Section 135 of the Companies Act
[18] The Eighth Principle of the INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II
[19] O.20, r.1(1)(c) of the Companies Winding Up Rules
[20] This assumes that there is support of a large body of creditors to pursue the restructuring. Oriente Group Limited (FSD 231 of 2022)

	tested, however the new laws have been drafted in such a way as to be similar to the old laws (which were capable of recognition).
Ability to cram down dissenting stakeholders	In the Cayman Islands the threshold for approval of a scheme of arrangement is: - Creditors: majority in number representing 75% in value[21];and - Members: 75% (in value)[22], of creditors / members voting in person or by proxy at the scheme meeting(s). This means that dissenting stakeholders are capable of bring crammed down. As compared to other jurisdictions, cross class cram down is not available under the Cayman Islands restructuring regime.
Company led process that is supervised by the court	The application for the appointment of restructuring officers is company[23] led (and does not require approval of the shareholder(s)). Accordingly, directors are able to comply more effectively with their fiduciary duties to act in the best interest of the company during period(s) of the company's distress. The powers of restructuring officers, or restructuring provisional liquidators, is set out in the appointment order made by the Cayman Islands Court. If it is appropriate the directors may continue to manage the affairs of the company.
Overseen by experienced restructuring professional(s)	The proposed restructuring officer must be a qualified insolvency practitioner[24] who meets the requirements from a qualification, insurance and independence perspective. The involvement of an insolvency practitioner and advisors can improve the chance of success as it lessens the influence of the incumbent management's bias which could otherwise impede decisions and lead to the failure of the restructuring[25].

Formal Restructuring Procedures – disadvantages

Generally accepted principles	Application to the Cayman Island legal framework
The public nature of a formal restructuring process	It is the default position that a petition for the appointment of restructuring officers will be on notice to stakeholders *inter partes*[26].
The "taint" of the Formal Restructuring Proceedings	In relation to a restructuring provisional liquidator, a precondition to the filing, is the filing of winding up petition. The taint of liquidation can impact the restructuring and the value of a company's assets or cause reputational damage with customers. Importantly the precondition of filing a winding up petition is not required in order to file a restructuring officer petition.
N/A	As emphasised above, the Cayman Islands is a creditor friendly jurisdiction and there remains protections for secured creditors during the restructuring process, specifically that a secured creditor may

[21] 86(2) of the Companies Act
[22] 86(3) of the Companies Act
[23] 91B(1) of the Companies Act
[24] Section 91D(1) of the Companies Act.
[25] Mellahi, K., & Wilkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. International Journal of Management Reviews, 5(1), p 28
[26] Section 91C of the Companies Act also provides for the company to apply ex parte for the appointment of an interim

	enforces its rights over the assets which are the subject of the creditor's security interests[27].

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.**

I have used the restructuring phases identified in Adriaanse & Kuijl, 2006 work product to frame my critique of Flow's approaches to the reorganisation in the below table. Also, where appropriate, I have built on the critique with references to the findings from Pajunen, 2006, Sudarsanam, S, Lai, J., 2001, Schmitt, A., Raisch, S., 2013.

Business Restructuring	Actions taken by Flow	Critique
Phase 1: Stabilising Focus is to increase cash flow in the short term	- Negotiated increases to client pricing structures - Redundancy of 130 workers (comprised of employees and contractors) - Sale of inventory (cars), although this was rejected by the financiers	Efforts were made by Flow to increase cash flow in the short term. Although, as detailed in my response to question 1, as a result of the poor information systems there is an open question as to whether these stabilising actions (particularly the implementation of redundancies) was appropriate notwithstanding the short term benefits. Further per the research of Sudarsanam, S, Lai, J., 2001, recovery firms have in common less of a firefighting approach and more than a strategic refocusing.
Phase 2: Analysing Formulation of a long term strategies to restore profitability (including drafting a reorganisation plan)	Flow implemented certain business restructuring activities which could all be classified as retrenchment activities (ie cutbacks, sale of shares etc).	It appears that the independent consultant's engagement was limited in scope, as it failed to consider the cause of the distress and it isn't clear whether the estimated projections (assumedly provided by management) were stress tested by the consultant.

[27] Section 91H of the Companies Act

		Accordingly the retrenchment activities have been implemented in a vacuum of information. Whilst Schmitt, A., Raisch, S., 2013 research shows that retrenchment activities can improve the recovery prospects of a firm, it was also shown that retrenchment activities needs to occur with the broader understanding of the recovery strategy[28].
Phase 3: Repositioning The reporting on and the implementation of the reorganisation plan	Flow provided monthly reporting to the financiers relating to turnover.	Regardless of the timeliness of the monthly turnover, through the whole restructuring process Flow failed to meet any of its forecasted projections.
Phase 4: Reinforcing This is characterised by changes to management and the balance sheet	The CEO and CFO of the company were replaced	The CEO and CFO were replaced at the insistence of the stakeholder group. A reinforcing approach would have been for this to have occurred without the need of interference by Flow's stakeholders.
Financial Restructuring	Actions taken by Flow	Critique
Summarised as the deferment or remission of current financial obligations as well as generating additional liquidity.	- Reduction in interest obligations (default interest waived on working capital and other loans - Deferring repayment of other loans - Repayment of working capital subject to liquidity - Securing funding from the shareholder (risk bearing) - Securing additional finance from the banks	The actions taken by Flow reflected Adriaanse & Kuijl, 2006 suggested approaches to Financial Restructuring.

[28] Schmitt, A., Raisch, S. (2013). 'Corporate Turnarounds: The Duality of Retrenchment and Recovery', *Journal of Management Studies*, 50(7) p 1218

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?**

In mid-February 2014, prior to execution of the standstill agreement, Banks C and D are no longer cooperating.

As reflected in Insol Principles, a standstill agreement is a key milestone in an informal workout, as it binds and halts creditor enforcement actions, for a period of time, which affords the restructuring company time during which it can explore and negotiate a restructuring.

The respite from the threat of enforcement is of value and ahead of signing the standstill agreement this presents an opportunity for the banks to improve their positions. Also, once the standstill agreement has been executed, until the expiry of standstill period, Banks C and D leverage will diminish (ie threat of enforcement) against the company, unless the company breaches its obligations under the agreement. Furthermore, a standstill agreement would also ordinarily fix the relative exposures of the signing creditors during the expiry of the standstill period.

Assuming that Banks A and B have already satisfied themselves of the feasibility of a potential workout[29], as an advisor to Banks A and B, I would advise them to intervene in the impasse with Banks C and D. This is important for a number of reasons, including ensuring that the workout is not derailed by Banks C and D, but it also to ensure that Flow does not capitulate to the Banks C and D's demands resulting in the preferential treatment of Banks C and D's debt; the idiom *squeaky wheel gets the grease* is often proven true in an informal restructuring.

Then as a priority, Banks A and B should propose, in accordance with INSOL's fourth principle, that a mutually agreed upon intermediary is engaged. This party should seek to facilitate open dialogue between the Banks so that their commercial drivers are understood, (it might be that Banks C and D are seeking a strategy to obtain repayment of the debts in full, or instead a strategy that results in an early exit/ reduction in exposure).

[29] A rescue or work out is not always feasible see INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II, page 14

Once this is determined the Banks could enter good faith negotiations to potentially arrive at a mutually agreeable solution. For example, should the negotiations reveal that Banks C and D do not have a long-term view of their relationship(s) with Flow, then Banks A and B could acquire Banks C and D's debts at a significant discount to the par value of the debts. Alternatively, if Banks C and D are pursuing a strategy to obtain repayment in full then steps could be taken to improve the chances of receiving such a return.

Regardless of how Banks C and D are dealt with, I would also advise Banks A and B to take reasonable steps to improve and protect their position ahead of the signing the standstill agreement, for example

- As a precondition, or prior to execution of the standstill agreement, the company must cure any of the legal issues with loan agreements;
- Include provisions in standstill agreement to install a mutually agreeable party to oversee the performance of any milestones and to co-ordinate the creditor group[30]; and
- Ensure that reporting requirements are detailed in the standstill agreement[31].

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)?

First principle – adhered

A standstill agreement was executed in mid August 2014 with Flow's key stakeholder group the Secured Financiers (Banks A, B, C and D).

Notably the commentary to INSOL's first principle in its Statement of Principles for a Global Approach to Multi-Creditor Workouts II, caveats that a standstill agreement may not always be appropriate in a particular case. In Flow's restructuring, prior to the resolution of the following matters, it was arguably inappropriate to pursue a standstill agreement:

- Reconstitution of Flow's management team. Flow's management team was shown to be, at the very least, incompetent and ill equipped to lead and administer the workout process. However, this was resolved ahead of the standstill agreement by the removal of

[30] Fourth Principle of INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II.
[31] Fifth Principle of INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II.

the CEO and CFO and the installation a CRO (by Bank A). It would have been inadvisable for the Secured Financiers to enter into a standstill agreement prior to changes to the management team.

- The solvency of Flow was such that any workout was likely untenable without the injection of additional capital by Flow's shareholder. The Secured Financiers made it a pre-condition of the standstill agreement that the shareholder provides this risk bearing capital.

Third principle - breached

The Secured Financiers agreed to a standstill for the period 15 August to 15 December 2014 (the **Standstill Period**). The third principle was not adhered to by the Secured Creditors as during the standstill period Flow provided the Secured Financiers with €10 million of tax refunds as additional security. This is in contravention of the third principle as the result of providing the additional security would prejudice the Flow's other creditors. Assuming there is not floating charges, in the event of a liquidation, these funds would have otherwise been available to meet unsecured creditor claims.

Fifth Principle – adhered

It is implied that during the Standstill Period, that Flow will continue to report to the Secured Financiers on the company's "actual costs and turnover each month".

It is also implied that the public announcements reported in October 2014 were of a timely nature.

Eighth principle – adhered

It is explicitly confirmed in the material that the providers of the working capital will obtain pledges on the assets of Flow Management Work and will receive part of their claim on liquidation ahead of other creditor claims.

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?**

Soft law, developed by standard setting bodies, is prescriptive text of a legally non-binding nature[32]. The use of soft law instruments can be a helpful to fill the void of absent laws and statue. In the context of an informal workout in the Cayman Islands, given that there is no legal mechanism for facilitating out of court debt[33] restructuring, it presents a good use case for at least considering soft law instruments.

Examples (non-exhaustive) of relevant standard setting bodies from restructuring and insolvency practice perspective are the United Nations Commission on International Trade Law Working Group, The World Bank and INSOL International.

The UNCITRAL's Model Law is credited as being the lynchpin to the rise of "soft law" in insolvency and restructuring matters[34] upon which many jurisdictions have based their legislative frameworks[35]. The Cayman Islands has not adopted the UNCITRAL Model Law, regardless, many of the objectives of the Model Law can be achieved through a Cayman Islands process as a result of common law (judge made law)[36].

The Cayman Islands judiciary has also shown support for soft law instruments. An example is this are the practice directions[37] issued by the Chief Juice of the Cayman Islands in 2018 directed that Cayman Islands officeholders, when entering into a cross-border insolvency protocols, should have regard to two soft law texts namely the ALI and International Insolvency Institute Global Guidelines for Court-to-Court Communications in International Insolvency Cases (2012) and the Judicial Insolvency Network Guidelines for Communication and Cooperation between Courts in Cross-Border Matters (2016)[38] (the **Cross Border Protocols Guidelines**).

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[32] Prof. em. B. Wessels en mr. drs. J.M.G.J. Boon "Soft law instruments in restructuring and insolvency law: exploring its rise and impact" at https://scholarlypublications.universiteitleiden.nl/access/item%3A2910366/view

[33] For the purposes of answering this question it is assumed that restructuring is limited to financial restructuring and does not include operational restructuring.

[34] Jown A.E Pottow 2020 Cross-Border Corporate Insolvency in the Era of Soft(ish) Law. https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1363&context=book_chapters

[35] The Model Law on Cross Border Insolvency has been adopted in 59 States in a total of 62 jurisdictions: see UNCITRAL https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency/status

[36] The Cayman Court has granted assistance to foreign officeholders China Agrotech Holdings Ltd (FSD 157 of 2017 (NSJ))

[37] Practice directions reflect the judiciary's view as to the approach to a particular matter. The directions are an example of soft law.

[38] Practice Direction No1 of 2018 Court to Court Communications and Cooperation in Cross Border Insolvency and Restructuring Cases

The Cayman Courts have also clarified in a later decision In the Matter of LATAM Finance Limited et.al that the Cross Border Protocols Guidelines "most directly provide a jurisdictional basis" for approving the requested protocol.

Given the absence of statute concerning informal workouts in the Cayman Islands, and the judiciary's support of soft law instruments, Flow should consider, ahead of implementing the standstill agreement, what soft law instruments might be applicable.

I would suggest that on such option is a "Letter Agreement Concerning the Adoption of Workout Guidelines". This letter is a standard template developed by the World Bank and it essentially is an agreement by the executing parties to observe the INSOL International Statement of Principles for a Global Approach to Multi Creditor Workouts II[39].

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

In essence the July 2015 restructuring agreement is a preferential deal that prefers Banks A, B, C and D (the **Secured Financiers**).

As a result of the restructuring agreement, the assets of Flow Management Holding BV (**FMH BV**), being its interests in operating foreign subsidiaries, will be transferred to new entity Flow Management II. Then shares in this newly formed company are granted to Banks A, B, C and D (the **Secured Financiers**).

It is contemplated that FMH BV will then be liquidated. In accordance with the agreement, the shareholder and the Secured Financiers will cancel their debts against FMH BV, however, it is understood that there are other debts owed by FMH BV outside of the amounts owed to the Secured Financiers/ the Shareholder.

Importantly, once appointed the liquidator of FMH BV will conduct investigations concerning the period leading to the insolvency of the company. As part of these investigations the liquidator will consider transfers of assets for a certain period before the liquidation (the period will be dependent on the applicable laws) and whether they were made at under value in a deliberate action to defeat the claims of creditors.

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[39] INSOL "A Toolkit for Corporate Workouts" documents1.worldbank.org/curated/en/982181642007438817/pdf/A-Toolkit-for-Corporate-Workouts.pdf

An assessment of whether this transfer would constitute a preference will be complex as the Secured Financiers would enjoy a priority in the liquidation and the Secured Financiers have provided value in exchange for the shares (ie extending additional financing and cancelling debts) regardless of these facts there remains a chance[40] that the unsecured creditors would have received a distribution in a liquidation.

The unsecured creditor position should be fully thought out as failing to do so could open the transfer to legal challenge on the basis of preference and in some jurisdictions, it would be available to liquidator to effect the reversal of the transfer.

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

Insolvent trading

Throughout the restructuring of Flow the solvency of the company was marginally solvent and by June 2014 the company was insolvent. Some jurisdictions can impose penalties on directors found to be engaging in trading whilst insolvent.

In the Cayman Islands directors have a fiduciary to act in good faith and in the best interests of the Company. A decision by the UK Supreme court, which would be persuasive precedent in the Cayman Islands, recently clarified that when a company enters a period of distress the directors need to have regard to the interest of creditors[41].

Employee claims

In the first year of Flow's distress, 130 workers (comprising of employees and independent contractors) were made redundant. It is not known which of the entities is the employing entity nor where the employing entity is domiciled but there could be cross border employment issues. It is likely that the employees will have statutory remedies available to them in seeking redress. For example, Flow is a Dutch company and, in the Netherlands,

[40] The fact pattern notes that "most probably" [unsecured creditors] would receive nothing from their claims on liquidation.
[41] BTI 2014 LLC v Sequana SA and others [2022 UKSC 25]

former employees are often awarded payments either through court rulings or employers associations[42].

Bank liability issues

Bank A instigated the appointment of a Chief Restructuring Officer (**CRO**). Bank A will need to ensure that the CRO remains independent and is not, in proxy, exercising control over the company. If not, there could be cross border actions / liability issues for Bank A if it could be said it is acting as a shadow director.

Challenge to the restructuring

As detailed in my response to question 7 there could be a challenge by unsecured creditors of Flow Management on the basis of preference / defrauding creditors in respect of the transfer of its assets to a new vehicle.

Enforcement risk

Flow is a multinational company and assumedly has intercompany positions. At all times there was a real threat to the group's successful workout of enforcement actions been brought against Flow Management's subsidiaries.

9. In October 2014 four scenarios have been drawn up. Why was or wasn't calling for a moratorium (see scenario 4) a good option given the situation at that time? [you are allowed to give your opinion based on your own countries' Bankruptcy Act; be as detailed as possible]

Introduction

In October 2014 obtaining a moratorium would not have improved Flow's position and in contrast may have been harmful to the success of the any workout.

[42] Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganization in The Netherlands as a Beacon for Policy Makers in the CIS and CEE/SEE Regions?, Review of Central and East European Law, 31(2), p 144

To support this conclusion first it is imperative to identify the classes of stakeholders to be included in the process, which is a dynamic exercise which can change over time[43]. Thereafter, an assessment will be made concerning the appropriateness of a moratorium with regard to the governing stakeholders in the context of the Cayman Islands restructuring legislative framework.

Stakeholder Influence Identification

Kalle Pajunen constructed a model for stakeholder influence identification. The process is biphasic and requires an assessment to be made as to the stakeholders' (1) Resource Dependence Based Influence; and (2) Network Position Based Influence.

Resource Dependence Based Influence

Applying the resource dependence based influence principles, as at October 2014, the stakeholder classes are considered:

- *Flow's board members and management primarily Flow's CEO and CFO (**Management**)* Prior to the period of distress, Flow's Management had significant influence on the affairs of the company (ie wrongfully issuing bonuses). Their influence was a dominating factor initially during the workout periodas Management retained influence and autonomy (ie implementing redundancies and their involvement client contract negotiations). This can be seen until January 2014 and April 2014 when the CFO and CEO were replaced respectively. Management's influence further deteriorated once the CRO was installed by Bank A. Notwithstanding the declining influence, Management retains a moderate standing due to the CEO's relationship with Flow's clients and workers.
- *Flow's Shareholder Lease Group Holding United Kingdom Ltd (**Shareholder**)* In contrast to Management's declining influence, conversely the Shareholder's governing influence increases. By 2014 the financiers trust in Management has deteriorated and as a consequence the Shareholder becomes the governing mind behind the rescue. Despite the Shareholder's improved influence, the Secured Financiers (discussed below) are still able to exert pressure on the Shareholder to raise additional capital.
- *The Secured Financiers (Banks A, B C and D)* From December 2013, the Secured Financiers are driving the rescue process. Banks C and D (the **Dissenting Secured**

[43] INSOL International. (2017), Statement of Principles for a Global Approach to Multi-Creditor Workouts II. p 6

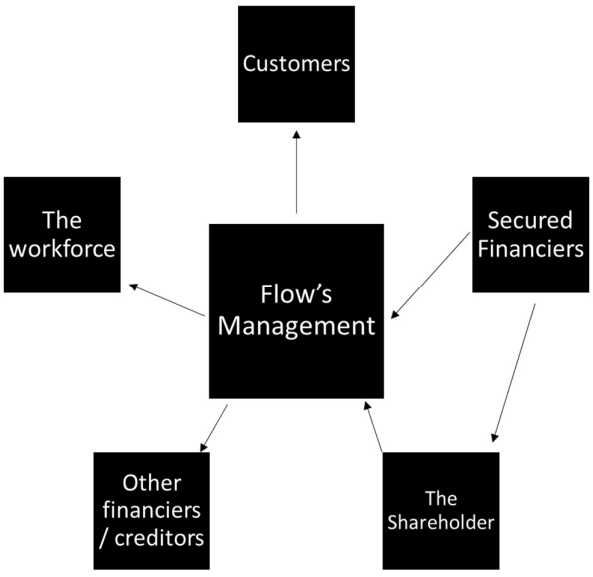
Financers) are increasingly influential as key agitators. From a resourcing perspective, Flow's capital structure relies on a combination of secured loans (in respect of its assets, assumedly its fleet) and working capital facilities. As a result, the Secured Financiers have been able to influence (1) Flow's board (particularly Bank A which instigated the appointment of a CRO), and (2) the Shareholder (requiring the Shareholder to provide additional capital). As at October 2014, the Shareholder had successfully negotiated a standstill agreement, however this will expire in the short term (mid December).

- *Flow's workforce* It can be reasoned that Flow's workforce did not possess critical resources as it was comprised of employees and independent contractors some of which were made redundant in the first year of Flow's distress, with apparently no regulatory or legal consequences.
- *Other Financiers and Creditors* Apart from the Secured Financiers there are other non secured financiers and creditors, however, these stakeholders do not appear to be engaged in the process and it is implicit therefore that they are minor stakeholders.
- *Clients* Flow's clients were not price sensitive to the increases to the prices negotiated in December 2013. Although it does not seem that Flow is operating in an unsaturated market. Accordingly, the customers are deemed to be a moderate influence.

Network Position Based Influence

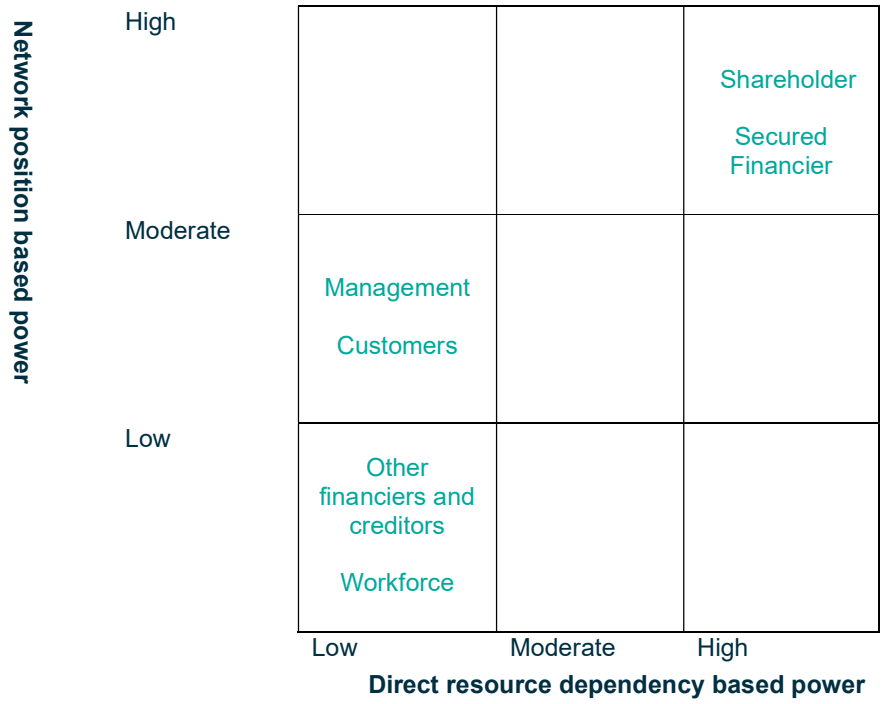
The following figure details the network position of the above identified classes of stakeholders.

Figure 1: Flow's stakeholder network



Based on the above assessment the below figure details the Flow's stakeholder influence as at October 2014:

Figure 2: Stakeholder Influence



As reflected above, the governing stakeholder classes of Flow as at October 2014 are the Secured Financiers and the Shareholder.

Impact of the moratorium (Cayman Islands perspective)

The proposed moratorium is considered within the context of the Cayman Islands legislative framework.

In the Cayman Islands, a binding moratorium is only available through a formal (court driven) process[44]. Accordingly, it can deduced that this option would not be the preferred option by

[44] Namely during a provisional liquidation, official liquidation and restructuring officer led restructuring. For current purposes the moratorium is considered in the context of a restructuring officer led restructuring.

the Shareholder, as shareholders inherently prefer informal alternatives since these procedures (at least) generate significantly higher share returns[45].

A moratorium (court driven process) could potentially cause further friction with the Secured Financiers, particularly the Dissenting Financiers, who already consider there have been unacceptable delays. The moratorium would also not prevent the Secured Financiers from enforcing their security interests without leave of the Court and without reference of the restructuring officer. Whilst the fact pattern mentions there may be legal issues with the Secured Financiers security, notably these “issues” may not be an issue for the purposes of Cayman Islands law. The Cayman Islands does not have a legislative framework that governs the perfection of the security interests. The Secured Financiers would therefore be entitled to enforce their security so long as the contract is valid.

It is concluded that the two governing stakeholders the Shareholder and the Secured Financers would not be in support of a moratorium, and in the case of the Secured Financiers the moratorium would not prevent them from enforcing their rights against the assets of Flow.

[45] See Stuart C. Gilson et al., “Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default”, in Altmann, op.cit. note 20, 77-124, at p 109.