**CASE STUDY I**

**Adam Crane, 6 November 2023**

**Question 1**

Flow Management (also referred to generally as the **Company**) suffered from several issues which caused financial distress. It appears that a significant cause of the company’s distress is due to the management or mismanagement of the company (see Mellahi & Wilkinson, 2004, pgs. 27-28 for discussion on organisational failure from the OS/OP perspective). Mellahi & Wilkinson suggest that the OS/OP perspective argues that “*failure is linked to internal inadequacies in dealing with external threats*” and that causes of failure include “*impulsive decisions that overextended the organizations assets, not responding to change…*” Clear examples of this include the company’s wrongful payment of large management bonuses and the poor management information system which contributed to Flow Management’s failure to check real costs against their cost price calculations, leading to a loss resulting from poor pricing (see Adriaanse & Kuijl, 2006, pgs. 147-148).

As noted above, if the company had better management information systems in place, the company could have partially averted financial distress by adjusting pricing structures to ensure profitability. Perhaps the financial distress which occurred during the restructuring efforts could have been prevented or at the very least, reduced. Flow Management stated its intentions early to undertake a business/organisational restructure which included stabilisation efforts to increase cash flow such as reducing expenditures (e.g., staff cutbacks) and improving turnover (e.g., increasing prices), but failed to take these actions at an earlier stage or at all. Early stabilisation efforts could have given Flow Management “breathing space” (see Adriaanse & Kuijl, 2006). Throughout the restructuring process, the shareholder appeared to focus on financial/debt restructuring efforts, which have proven to have the least effect on the successful turnaround of a company compared to more favourable turnaround strategies which the company did not follow such as operational restructuring, capital expenditure, asset sales, etc. (see Sudarsanam & Lai, 2001, pg. 193).

**Question 2**

The general advantages of an out-of-court restructuring include flexibility, silence and control (see Adriaanse & Kuijl, 2006). An out-of-court restructuring provides parties with the flexibility of reaching “tailor-made” solutions without the rigidity of a Court guided process. Parties can agree on which restructuring methods will be implemented, including granting new-money creditors priority positions. As for silence, an out-of-court restructuring will likely prevent negative publicity (publication of financial distress and negative press coverage) which could harm a company’s image or lead creditors seeking repayment or commencing winding up/liquidation proceedings. Furthermore, out-of-court restructurings allow company management to retain control of the process and operations, rather than losing control to courts and insolvency practitioners. All of these factors can lead to cost and time savings compared to formal insolvency proceedings, and provide a better return for all stakeholders.

One of the main disadvantages of an out-of-court restructuring is that it will require a consensus/agreement among all of the stakeholders. A significant creditor’s (or a governing stakeholder as classified by Pajunen, 2006) refusal to participate in the informal restructuring process could undermine the restructuring. A formal insolvency proceeding could provide a company with the ability to “cram-down” a hold-out creditor.

In the Cayman Islands, the advantages of an out-of-court restructuring are generally the same as in other jurisdictions. Companies can undertake all sorts of business and financial restructuring efforts. Secured creditors have a right to enforce their security without reference to the court or liquidators/restructuring officers, so an out-of-court restructuring (with the benefit of a standstill agreement) will afford a company more breathing space from all creditors as compared to a formal insolvency process. Insolvency proceedings in the Cayman Islands can be costly, so an out-of-court restructuring will likely save a considerable amount of costs.

As for the disadvantages, again, the disadvantages are similar to other jurisdictions. A company can be at the mercy of a hold-out stakeholder who can frustrate the restructuring process. In a court restructuring (scheme of arrangement), a company would be able to cram-down the interests of a creditor(s) who holds 25% or less of the value of a company’s debt. A company will not receive the benefits of the statutory stay of proceedings on unsecured creditors in an out-of-court restructuring.

**Question 3**

Various turnaround/reorganisation approaches as presented in the reading material were applied (and presented) throughout the case. The company had clearly identified the most influential stakeholders to its survival (see Pajunen, 2006, pg. 1261). The consortium of banks were the company’s governing stakeholders as they had provided the company working capital and the company depended on them for survival. Whilst there were “hiccups” along the way, the company secured the continuing support of its governing stakeholders (see Pajunen, 2006, pg. 1279).

One of the most significant turnaround approaches taken by Flow Management was the replacement of the CEO of Flow Management Holding BV in April 2014 and the appointment of a Chief Restructuring Officer (**CRO**) (see Adriaanse & Kuijl, 2006, pg. 142). This created confidence in the company’s management among the consortium of banks and no doubt other stakeholders, despite poor or unreliable flow of information to the stakeholders. As noted by Sudarsanam & Lai (2006, pg. 184), a change in top management is “*widely quoted as a precondition for successful turnarounds”.* Whilst there were some communications issues, the company’s actions adhered to propositions 2 (frequent and open communication) and 4 (replacing management to improve brokerage position) in respect of stakeholder influence (see Pajunen, 2006, pgs. 1280-1281).

The company’s restructuring plan involved the use of a debt for equity swap, with the consortium of the banks waiving/writing off significant portions of the debt to receive equity interests in the newly formed entity, Flow Management II BV (see: Sudarsanam & Lai, 2001, pg. 187).

There were a number of turnaround/reorganisation procedures outlined in the reading materials which were not applied by the company. In the early stages, the company proposed certain stability improving measures such as increasing pricing, reducing staff and selling off assets (see Adriaanse & Kuijl, 2006, pg. 140). The company delayed taking the necessary steps to improve cash flow by undertaking these efforts. Further, the consortium of banks opposed the company’s suggestions that the company sell off 350 cars, and advocated for a money settlement instead. If the company immediately took these steps, it would have helped resolve (at least in part) the company’s cash flow issues. Thus, the company failed to take the necessary retrenchment (asset or cost retrenchment) activities outlined by Schmitt and Raisch (2013).

The company also did not appear to undergo any recovery activities in order to reposition to the company for sustained growth and profitability (see Schmitt & Raisch, 2013, pg. 1218). The company’s restructuring plan did not include any analysis or plans for structural change (beyond consolidating the operating entities into a new corporate shell), acquisitions, product launches, etc. The company did not reposition itself in the market, and the operational losses and lack of interest from takeover candidates suggest that the company may not be viable going forward.

If the company undertook early/swift retrenchment activities coupled with an analysis of recovery activities (and eventual action on suitable recovery activities), the company might have been able to avoid undertaking the debt-equity swap and also continue as a going concern without having to seek takeover candidates.

**Question 4**

The rational reasons for banks C and D to frustrate the restructuring process could be that they had a general lack of confidence in the management of the Flow Management company and because the company failed to take early steps to improve cash flow (cutbacks and the increase in prices). Banks C and D (together with banks A and B) were unhappy with the constantly changing information provided by the company.

The opportunistic reasons for banks C and D to frustrate the restructuring process include their threat to cancel credit to force the company to hurry up with its restructuring efforts. Banks C and D were governing creditors (see Pajunen, 2006) and had significant influence over the viability of a turnaround.

As the advisor of banks A and B, I would have encouraged banks C and D to subscribe to the INSOL Statement of Principles at an earlier stage and that the consortium of banks were stronger with a co-ordinated effort. I would have also encouraged them that they would see better results in an informal out-of-court restructuring compared to a liquidation.

**Question 5**

The workout process for Flow Management used principles 1-7 of the “Statement of Principles for a Global Approach to Multi-Creditor Workouts III”.

First principle: Although it took a considerable time to get to the point, the company and its relevant creditors entered into a standstill agreement which gave the company breathing room and soon after led to the four proposals that were to be analysed by the relevant creditors. The company and its relevant creditors were ultimately able to agree a restructuring plan during the standstill period.

Second principle: It can be implicitly assumed that the relevant creditors agreed to avoid seeking to enforce their debt because they agreed to the standstill, and appeared to co-operate with the company to consider the four proposals first put forward and eventually agreed to the restructuring plan. The threat to cancel credit by banks C and D occurred before the standstill period.

Third principle: The company did not appear to take steps to adversely affect the prospective return to relevant creditors. The €10 million loan from the shareholder to Flow Management Holding BV occurred before the start of the standstill period and the loan did not necessarily adversely affect to prospective return of the consortium of banks as the relevant creditors because it was an unsecured loan.

Fourth principle: The consortium of banks co-ordinated their response to the company from a very early stage. Whilst banks C and D waivered in the joint efforts/support, there was sufficient co-operation and co-ordination among the consortium of banks. The banks advocated for the use of professional advisors including an accounting firm. It is noted that it appears that only bank A pushed for the appointment of a CRO, but the other banks were supportive of the appointment because of their concerns over the management of the company.

Fifth principle: It is debatable whether the company provided the relevant creditors with reasonable and timely access to all the relevant information. It appears that the consortium of banks was unhappy with the constantly changing information given by the company. This suggests that the information provided by the company did not provide the relevant creditors with sufficient information in a reasonable and timely manner.

Sixth principle: It can be implicitly assumed that the restructuring proposals reflect the applicable law and relevant positions of the relevant creditors. The consortium of banks was aware of the issues with their security which could have caused them to receive substantially lower or zero proceeds in the event of a liquidation. It can be assumed that the consortium of banks took this into account when agreeing to the debt-equity swap.

Seventh principle: It can also be implicitly assumed that all the information made available by the company was made available to all four of the banks. But the case study does not suggest that the relevant creditors were supposed to ensure the information shared remained confidential. It could, however, be assumed that the stakeholders kept the information confidential.

Eighth principle: The consortium of banks did not advance any funding to the company during the standstill period. So the eighth principle cannot be found in the workout process.

**Question 6**

In the Cayman Islands, standstill agreements are commonly used during the out-of-court restructurings. If a debtor cannot convince all of its relevant creditors to adopt the Statement of Principles, the company’s options for an out-of-court restructuring may be limited.

The company could try to persuade its relevant creditors that they would be better off working with the company in an out-of-court restructuring compared to a formal insolvency proceeding. Having practiced in both Canada and the Cayman Islands, my personal experience suggests that lenders are more willing to work with a company in an out-of-court restructuring. For example, if the company can demonstrate that the lender will only twenty cents on the dollar or some amount lower in the liquidation/bankruptcy proceedings than they would get otherwise, the lender would rather work on a resolution.

The Cayman Islands has recently introduced a Practice Direction on judicial mediation. It is not publicly known whether anyone has benefited from this mediation for insolvency purposes, but it remains a potential option. But the relevant stakeholders would all have to agree to the process. Mediation in insolvency is becoming a more viable option and is used often in the United States. Columbia has recently adopted a mediation process through its Chamber of Commerce where a company can undertake an out-of-court restructuring. This requires a “buy-in” from all the relevant stakeholders and that the resulting agreement from the mediation can be incorporated into a court order.

**Question 7**

The essence of the restructuring agreement signed on the 4th of July 2015 (**Restructuring Agreement**) is that the company underwent solely a financial restructuring. The creation of Flow Management II BV and the transfer of the operating companies under Flow Management II BV would not necessarily qualify as an asset restructuring as it did not comprise a major reconfiguration of the company’s assets (see Sudarsanam & Lai, 2001, pg. 186). Rather, this ought to be considered more of a financial restructuring utilised to cancel claims against Flow Management Work BV.

As for the financial restructuring, the company engaged in a debt-equity swap with the consortium of banks collectively cancelling/writing off over €100 million in debt in exchange for shares in the new Flow Management II BV entity (see Sudarsanam & Lai, 2001, pg. 187). The cancellation of debt and consolidation of the subsidiaries under Flow Management II BV will hopefully make a takeover more viable.

**Question 8**

Since the company has operations in multiple jurisdictions and that the corporate group comprises several entities facing insolvency situations, there are a variety of legal and non-legal cross-border issues to consider.

If formal insolvency proceedings were required (liquidation, etc.), the different entities would likely be subject to insolvency proceedings in the jurisdictions in which they are incorporated. This can add significant costs and create uncertainty among the approaches to be taken within each jurisdiction. This kind of scenario would benefit from cross-border protocols and court-to-court communication protocols to ensure a coordinated approach. The liquidation scenario may become more likely if the company cannot find a takeover candidate willing to takeover the company without the company being run through a liquidation.

It is assumed that the out-of-court restructuring activities that were undertaken were done so in accordance with the relevant laws within the jurisdiction.

One of the potential cross-border concerns could be the enforceability of the restructuring in other jurisdictions. On an out-of-court restructuring, enforceability should not be problematic. But there could be potential issues if the contractual arrangements in an out-of-court restructuring are not recognised by courts if formal proceedings are commenced.

**Question 9**

Calling for a moratorium was not a good option given the situation faced by the company at that time. As set out at principle two of the INSOL “Statement of Principles”, it is often more advantageous for parties to take an informal or contract based approach and to avoid statutory moratoriums (pre-insolvency or within insolvency to avoid costs and publicity of a formal process. A more informal arrangement will provide the debtor company and its relevant creditors with the confidence that they are working on a co-ordinated basis. A formal moratorium could undermine this confidence and co-ordination.

The consortium of banks had agreed to a 120-day standstill agreement in August 2014 (showing their willingness to give breathing space and to work with the company) and were agreeable to a further 180-day standstill. As such, a moratorium was unnecessary and ill-advised.

In the Cayman Islands, there is no informal or pre-insolvency moratorium. In order to obtain a statutory moratorium, a company would have to be placed into formal restructuring proceedings under section 91G of the Companies Act (2023 Revision) (automatic on the petition for the appointment of a restructuring officer) or the company would have to be placed into official liquidation proceedings (moratorium commences on the making of a winding up order under section 97 of the Companies Act). Formal insolvency proceedings will attract publicity and can be costly.

Furthermore, the commencement of formal insolvency proceedings could cause a company to breach its contracts with its creditors.