Global Insolvency Practice Course 2023/2024
Case Study Module A - Amy Patterson

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?

1.1 Mellahi & Wilkinson[1] reference two schools of thought with regard to the causes of organisational failure:

(a) Industrial organisational and organisation ecology (IO/OE) being a deterministic school of thought in which organisational failure is caused by external factors and the role of managers are largely ignored on the basis that they are constrained by factors outside their control; and

(b) Organisation studies and organisational psychology (OS/OP) being a voluntaristic school of thought in which managers are considered to be the principal decision makers and therefore the primary cause of organisational failure.

1.2 It is noteworthy that management identify the causes of the losses within the Flow Management group as:

(a) incorrectly issued bonuses to management;

(b) incorrectly booked contingent gain requiring a €1.6m negative correction;

(c) a "paper gain" of €2.8m being included in the accounts that was neither realised in 2012 nor 2013; and

(d) a formula error in the cost price calculation and subsequent failure to check real costs against cost price calculation.

1.3 However, with the exception of the bonus payments, none of these appear to be **causes** of the worsening financial position at Flow Management. These may be reasons why the deterioration of the group's position was not identified sooner and which masked the financial distress, but they were not the reason for its deterioration.

1.4 That said, in my opinion, and based on the information provided, I would attribute the majority of the causes of financial distress at Flow Management to the OS/OP model.

IO/OE

1.5 As noted above, this school of thought considers that external factors are the driver of organisational failure.

1.6 Mellahi & Wilkinson note that the IO literature suggests a range of causes for organisational failure including turbulent demand structure due to brand switching my core customers, changes in customer taste, decline in demand, and strategic competition[2].

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[1] M Mellahi, K., & Wlkinson, A. (2004). Organizational failure: a critique of recent research and a proposed integrative framework. *International Journal of Management Reviews*, 5(1), 21 – 41
[2] *Ibid.* page 23

1.7 None of these appear to be apparent in the case study. Conversely, even when seeking to agree higher prices with customers, the majority of customers agree to such price increases indicating that customers remain loyal and the demand continues to exist.

1.8 While it could have been a difficult market in which Flow Management was operating, the information provided states that *"there is market demand and the forecast for so call "hiring and leasing days" are consistent with reality".* If that is correct, then external market conditions are not a key contributing factor to the group's declining financial position.

1.9 OE scholars focus on four factors which determine the chances of success or failure[3]:

(a) population density: the theory that the increase of the number of organisations in a given population initially increases legitimation but then, as that number continues to increase, creates higher levels of competition which, in turn, will result in organisational failure;

(b) industry life cycle: the theory that organisational failure is natural and objective and simply a part of a cyclical trend;

(c) organisation age: the theory that new companies experience a greater likelihood of failure than more mature ones (the "liability of newness");

(d) organisation size: the theory that "bigger is better" and that failure rates decline with increased organisational size.

1.10 When applied to the facts as presented in the case study, it appears for the first two of these there is insufficient information to draw any conclusion:

(a) with regard to population density it is not apparent where in the U shaped curve Flow Management would sit as between legitimacy and competition; and

(b) with regard to industry life cycle, it is not apparent where in the life cycle (or the "inexorable and irreversible movement towards the equilibrium of death") Flow Management current sits.

1.11 However, it is possible to make some comment in relation to organisation age and organisation size namely that, theoretically, both of these should be in Flow Management's favour:

(a) with regard to organisational size, to the extent that "bigger is better", the fact that Flow Management employs over 3,000 people, operates a fleet of 200,000 vehicles and operates out of numerous jurisdictions should lend itself to a lower likelihood of failure.

(b) while we do not know when Flow Management was founded, given its size, it is probably fair to assume that the group has been in existence for some time. Again, according to the OE school of thought, this should again lend itself to a lower likelihood of failure.

1.12 Clearly this is not the case in relation to Flow Management which perhaps indicates a slightly oversimplified view of factors such as size and age of a business and any correlation that may have on success or failure.

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[3] *Ibid* page 24

OS/OP theory

1.13 Mellahi & Wilkinson[4] explain in their paper how this theory suggests that:

(a) those who make decisions are more important than the external context within which decisions are made; and

(b) failure is linked to internal inadequacies in dealing with external threats.

1.14 There is clearly human error that has escalated within Flow Management. The financial data has been incorrectly prepared over an extended period of time including calculation errors (which were not identified due to a failure to cross check the data) and errors with regard to allocation of gains. This indicates ineffective review/interrogation/oversight of the financial information for the group which the appointment of the accounting firm should assist with.

1.15 One could perhaps assume, by the initial proposals from management to cut costs (in particular by way of redundancies) and increase prices, that some of the underlying issues were that the company's costs base was too high and their prices too low. This is borne out by the fact that the vast majority of customers subsequently agreed to the costs increases and it was possible to make 130 members of staff redundant.

1.16 Further, given that price increases were accepted by customers with very little resistance, that may indicate that management have a lack of understanding of the market or Flow Management's position within the market.

1.17 Staw et al[5] opine that in the face of internal or external threats, decision makers "stick to the knitting" and reinforce well-learned past routines and procedures.

1.18 Threat rigidity effect and in particular "cognitive inertia" may have played a role within Flow Management. Hodgkinson and Wright[6] note that cognitive inertia may result in management failing to notice changes in the conditions of their business environments until the changes have become so widespread that their organisation's capacity for successful adaptation has been seriously undermined.

1.19 Given that losses continue to be incurred despite the steps that are initially taken, it could be assumed that management are not acting decisively enough in altering the routines and procedures that have been in place to date.

Could it have been prevented?

1.20 Without having full clarity on the causes of the financial distress within Flow Management it is difficult to assess whether it could have been prevented. However, at the very least the issues could have been identified earlier if the accounting errors had been identified and rectified.

[4] *Ibid* page 28

[5] Staw, B. (1981) Threat-rigidity cycles in organizational behaviour: a multi-level analysis. *Administrative Science Quarterly,* 501 - 524

[6] Hodgkinson, P.G. and Wright, G. (2002). Confronting Strategic inertia in a top management team: learning from failure. *Organization Studies,* 949 - 977

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?

2.1 For the purpose of this question, the answer will differ in certain respects depending on whether reference to "formal bankruptcy procedure" means:

(a) only a bankruptcy procedure that involves the displacement of directors, a sale of the business and assets of the company and usually ends with the dissolution of the corporate entity such as, in England, administration or liquidation ("**Insolvency Procedure**"); or

(b) also encompasses formal insolvency procedures (set out within relevant legislation which, in England, would include the Insolvency Act 1986 and Companies Act 2006) but which do not involve the displacement of directors and can result in the ongoing survival of the corporate entity such as, in England, company voluntary arrangements and restructuring plans ("**Restructuring Procedure**").

2.2 Where that distinction is relevant, it is highlighted below.

Advantages

2.3 In my view[7], the advantages of out of court restructurings (including in England) are primarily:

(a) limited publicity;

(b) control on costs;

(c) flexibility;

(d) certainty (not absolute);

(e) continuation of company as a going concern.

Limited publicity

2.4 This is a significant advantage to out of court restructuring. Negotiations will be conducted on a private basis with limited scope for the "outside world" to find out details either of the financial distress of the company/group or of the nature and extent of the restructuring.

2.5 Conversely, in a court based restructuring, significant amounts of information will have to be made available to the court in the form of witness statements, exhibits and expert evidence. Much of that will be read and considered in open court such that the "outside world" will be aware of significant amounts of information regarding the business and its financial position.

2.6 Indeed in England, during the Covid-19 pandemic, the majority of court hearings were held on Microsoft Teams. While courts in England are open to the public (other than hearings in private), it is much less common for third parties or those not actively involved in the restructuring to attend an in person court hearing. During Covid-19, however, hundreds of lawyers, financial advisors, journalists etc were dialling in to hearings for the

[7] Flexibility, limited publicity (referred to as "silence") and control are also identified as advantages by Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganisation in The Netherlands as a Beacon for Policy Makes in the CIS and CEE/SEE Regions? *Review of Central and East European Law* 31, 135 – 154 at page 145

major restructurings such that the details of the financial position of these companies was widely known and discussed.

2.7 Even now that hearings are largely back to being in person, there is still considerable interest in court based restructurings and journalists focused on insolvency and restructuring (for example from Global Restructuring Review) will attend hearings and report comprehensively on the evidence and arguments being made by the company and supporting/opposing creditors.

Control on costs

2.8 While out of court restructurings can still be costly and time-consuming and the company will often have to bear the costs of the lenders incurred as part of the restructuring, the costs of a Restructuring Procedure or Insolvency Procedure will almost always be considerably higher.

2.9 Given the lack of publicity with regard to out of court restructurings it is difficult to obtain accurate information on their costs. However in England an interim report by the Insolvency Service estimated that costs for restructuring plans for larger corporates were between £2m and £10m and for mid-market companies were £1m - £2m[8]. It is fair to assume that, other than in the most complex case, costs for out of court restructurings would be (significantly) lower.

Flexibility

2.10 An out of court restructuring can, put simply, effect any restructuring agreed to by the parties. On the other hand, to effect a restructuring via a Restructuring Procedure or via an Insolvency Procedure, specific legal requirements (in England set out in the Insolvency Act, Insolvency Rules and Companies Act) must be complied with which provides the stakeholders with less flexibility to shape an entirely bespoke solution.

Certainty

2.11 Once relevant stakeholders have agreed to an out of court restructuring, usually no additional consents/approvals are required. Therefore the parties can have a fairly high level of confidence that the restructuring will be brought into effect.

2.12 For a Restructuring Procedure that requires court sanction (such as, in England, a restructuring plan), there is no such certainty and the outcome of the proposed restructuring lies in the hands of a judge.

2.13 Likewise for a Restructuring Procedure that requires a certain level of creditor approval (such as, in England, a company voluntary arrangement), the outcome of the proposed restructuring lies in the hands of an often disparate and potentially unpredictable group of creditors.

Continuation of company as going concern

2.14 This is only a real advantage over an Insolvency Procedure. Whereas an Insolvency Procedure will usually lead to the business and/or assets being sold to a third party, the corporate entity itself will often, following any such sale (and following a distribution to creditors and completion of the remainder of the Insolvency Procedure) be dissolved. An out of court restructuring on the other hand ensures the survival and continuity of the corporate entity.

[8] Corporate Insolvency and Governance Act 2020 – Interim Report March 2022: Corporate Insolvency and Governance Act 2020 - Interim report March 2022 - GOV.UK (www.gov.uk)

Disadvantages

2.15 The disadvantages of out of court restructurings are:

(a) inability to cram down dissenting creditors (in some circumstances);

(b) lack of control of timings;

(c) lack of independent oversight;

(d) more limited ability to effect an operational restructuring.

Inability to cram down

2.16 In certain English Restructuring Procedures (in particular under the new restructuring plan regime), it is possible for an "in the money" class of creditor to cram down a dissenting class of creditor as long as certain criteria are met (such as the crammed down class being no worse off than they would be in the relevant alternative).

2.17 Unless there are intercreditor arrangements that allow decisions to be taken on the basis of majority consent / majority instruction, then an out of court restructuring requires consent of all impacted lenders. That can be a significant barrier to a successful out of court restructuring and is often one of the reasons why a court-based restructuring is required.

2.18 That said, there is some anecdotal evidence that the ability effect a cross class cram down (and therefore the threat of a court based restructuring) has been sufficient motivation for parties to reach a consensual outcome.

Lack of control of timings

2.19 Either a Restructuring Procedure or an Insolvency Procedure is driven by fairly clear timelines. In a court based restructuring, those timelines are set by court directions. In a formal insolvency process, the insolvency practitioners are required to conduct themselves expeditiously.

2.20 Conversely, in an out of court restructuring, the company is more exposed to the whim of the lenders/stakeholders and their level of engagement. Delay, prevarication and unreasonable behaviours are more difficult to control and manage because there is no public scrutiny of those behaviours or any real risk of ramifications.

Lack of independent oversight

2.21 Linked to the above, the company is effectively in the hands of its various stakeholders. While they may all be acting rationally and with a common purpose, they may equally be seeking to better their own commercial agenda. Stakeholders may be driven by factors outside of simply the position of the company (e.g. wider business pressures/objectives/personal feelings) without the risk of censure/criticism/control from the court or insolvency practitioner.

Limited ability to effect operational restructuring

2.22 The scope of an out of court restructuring is generally limited to a financial restructuring i.e. amendments to the debt/security position across the group. In the absence of a formal Insolvency Procedure, operational restructurings are far more difficult to achieve because it would require engagement with and buy in from a vast number of smaller creditors, each of which would need to agree with the proposals from the company.

2.23 Indeed many of the company voluntary arrangements in England which deal with the rationalising of leasehold portfolios started as an attempted out of court restructuring with its landlords which ultimately wasn't successful (and so the company had to revert to a Restructuring Procedure).

2.24 More recently this has been demonstrated with WeWork which made very public announcements around needing to reach a consensual position with its landlords in the US and elsewhere otherwise a formal bankruptcy process would be necessary. WeWork has now filed for Chapter 11 protection in the US indicating that the out of court operational restructuring was not successful.

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.

Adriaanse & Kuijl, 2006[9]

3.1 In this paper the authors identify four main phases[10] of a restructuring process, namely:

(a) stablising: identifying the critical problems – often with an emphasis on increasing cash flow;

(b) analysing: considering longer term prospects and drawing up a well founded reorganisation plan;

(c) repositioning: putting the reorganisation plan into effect and restoring confidence amongst stakeholders including supply of information; and

(d) reinforcing: both in relation to the management of the company as well as the company's balance sheet position.

3.2 In the Flow Management case study, we see examples of each of these:

(a) stabilising: reducing costs by making redundancies and effecting other "large cutbacks" as well as consideration of sales of non-Benelux subsidiaries;

(b) analysing: proposing a wholesale evaluation and reassessment of the product range, albeit the details in this regard are fairly scant whereas the authors of the paper suggest that "*the more extensive (qualitatively) the better*"[11]. It is fair to say that the business restructuring (as opposed to the financial restructuring which is ultimately put in place with the Banks) is not particularly well developed or thought through by Flow Management;

(c) repositioning: information flow was present but much of the information was inaccurate which lead to frustrations with the Banks. Certain steps taken such as the introduction of a restructuring advisory firm would have assisted;

(d) reinforcing: replacement of both the CEO and the CFO and appointment of CRO to rebuild confidence in the management team. The ownership of the group was

[9] Adriaanse, J.A.A., & Kuijl, J.G. (2006). Resolving Financial Distress: Informal Reorganisation in The Netherlands as a Beacon for Policy Makes in the CIS and CEE/SEE Regions? *Review of Central and East European Law* 31, 135 – 154

[10] *Ibid. p*age 140

[11] *Ibid. page* 141

also transferred to the Banks and the financial restructuring effected thus "reinforcing" the group's balance sheet.

Pajunen[12]

3.3 This paper explores stakeholders' influence on an organisation's survival and identifies those stakeholders as either minor stakeholders, potential stakeholders or governing stakeholders.

3.4 According to Pajunen's model, stakeholder influence is comprised of[13]:

(a) resource dependency based influence (the idea that power is organised around crucial resources); and

(b) network position based influence (the idea of betweenness centrality or structure based influence).

3.5 Pajunen then considers how such stakeholders can be managed during any turnaround process and considers in detail a case analysis of the corporate turnaround of the Kymi group (a Finnish pulp and paper group).

3.6 The paper concludes by putting forward a number of propositions regarding stakeholder management including the importance of: (i) ongoing support of governing stakeholders; (ii) frequent and open communication with governing stakeholders; (iii) personal relationships between management and governing stakeholders; (iv) the brokerage function of management; and (v) consensus on long-term goals.

3.7 In relation to Flow Management, the Banks would be considered governing stakeholders. They have considerable resource dependence based power throughout the restructuring process given that they provided the vast majority of the funding for the Flow Management business and without their ongoing support and forbearance, the group would have failed.

3.8 In that regard, while there was an information flow with the Banks and ultimately consensus was achieved with regard to long term goals and support of the Banks was secured, it is likely that this stakeholder could have been managed more effectively had the information been accurate and provided on a more timely basis. References are made throughout the case study to the Banks' lack of satisfaction with, amongst other things, information provided by the group.

Sudarsanam[14]

3.9 The study outlined in this paper considers various turnaround and restructuring strategies (as outlined below) and, in particular, focuses on the frequency, timing and intensity of those strategies.

3.10 However, according to the hypothesis set forth by Sudarsanam based on the findings in the study, the choice of restructuring strategy is not the cause of non-recovery but rather the ineffectiveness of restructuring in the early years and the lack of forward looking at market focused strategies.[15]

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[12] Pajunen, K. (2006). Stakeholder Influences in Organizational Survival. *Journal of Management Studies,* 43(6), 1261 - 1288

[13] *Ibid.* page 1263

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

[15] *Ibid.* page 197

3.11 The results of the study as set out in this paper indicate that:

(a) recovery and non-recovery firms adopt very similar sets of strategies to deal with financial distress;

(b) recovery firms choose investment and acquisition to lead them out of that distress;

(c) non-recovery firms are more internally focused on operational and financial restructuring.[16]

3.12 Set out below are the various turnaround strategies discussed and commentary on whether these are demonstrated with the Flow Management case study:

(a) Managerial restructuring:

(i) This is said to be widely quoted as a precondition for successful turnaround (Bibeault, 1982, Slatter, 1984) although Sudarsanam notes that the effectiveness of managerial restructuring is yet to be conclusively established.[17]

(ii) In Flow Management, the CFO and CEO are both removed and replaced and a CRO is appointed, all of which is required to seek to restore the confidence of the Banks in the management team.

(b) Operational restructuring:

(i) This is said to comprise cost reduction, revenue generation and operating asset reduction strategies.

(ii) Flow Management implemented (or proposed to implement) each of these. Cost reduction in redundancies and other "large cutbacks" (the details on which were not specified), revenue generation in price increases and reassessing product lines and asset reduction in a sale of non-Benelux subsidiaries and proposed sale of 350 vehicles.

(c) Asset restructuring:

(i) This is said to comprise both asset divestment and asset investment in order to effect a corporate turnaround.

(ii) Flow Management implemented asset reduction as noted above. It did not, however, engage in asset investment, albeit there was a proposal to evaluate and asset the entire business mix which may well have included asset or corporate acquisitions.

(d) Financial restructuring:

(i) This is said to involve the restructuring of a firm's capital structure to relieve the strain of interest and debt repayments and involves both equity and debt based strategies.

(ii) In the Flow Management case study, while it took time to reach consensus, a financial restructuring was at the core of the turnaround, culminating with the agreement signed in July 2015 that effected a

[16] *Ibid.* page 184
[17] *Ibid.* page 185

significant reduction in debt levels and extension to maturity within the group (together with a change of ownership). While the shareholder proposed to advance capital by way of equity financing, that did not in fact take place and rather the shareholder put in additional capital by way of unsecured loan.

Schmitt & Raisch[18]

3.13 This paper considers the concepts of retrenchment and recovery as turnaround tools. As further described in the Schmitt & Raisch paper:

(a) retrenchment focuses on increasing efficiency through cost and asset reductions; and

(b) recovery focuses on improving market position through strategic change.

3.14 Their study suggests that, despite the commonly held view within corporate turnaround scholars that retrenchment and recovery are contradictory forces that should be addressed separately (Bruton et al, 2003), in fact they are interrelated and their integration is beneficial.

3.15 The case study provides information reflecting both. In terms of retrenchment, in December 2013, the Flow Management group:

(a) made 130 staff members redundant;

(b) realised additional savings through loss recovery, higher excess premiums and savings on car repairs.

3.16 In terms of both retrenchment and recovery, in March/April 2014, proposals were made to:

(a) focus the group's strategy on increasing turnover by itself, together with large cutbacks;

(b) evaluate and reassess the entire product range;

(c) sell off shares in companies outside the Benelux countries.

3.17 The proposals to focus strategy on increasing turnover and evaluating and assessing the product range both appear to be more focused on recovery while the consideration of "large cutbacks" and sales of shares in subsidiaries outside the Benelux region are more focused on retrenchment.

3.18 While it appears that Flow Management is accepting the dualism of retrenchment and recovery and implementing both approaches simultaneously (rather than sequentially), it does not appear from the information that this is a conscious turnaround decision. It is not obvious, for example, whether the decisions on the significant redundancies have been shaped by which staff will be required following the review of the group's product range or any revision to the group's strategy. Consequently, there remains a risk of "impaired decision making" within the turnaround process (Hambrick and D'Aveni, 1988).

3.19 That said, the paper notes that future research would be beneficial in relation to the question of whether "firms experiencing particularly severe decline are better off by

[18] Schmitt, A,. Raisch, S (2013) Corporate Turnarounds: The Duality of Retrenchment and Recovery, *Journal of Management Studies,* 50(7), 1216 - 1244

initially opting for a one-sided attention to retrenchment to stop the bleeding" (Bibeault, 1982).

3.20 In Flow Management's case, its losses were continuing to increase at quite an alarming rate (from net profit of €9.4m in 2011, to losses of €6.1m in 2012, losses of €36.4m in 2013 and losses of €39m in 2014). Consequently, in this instance, a primary focus on retrenchment may well have been a prudent approach to take.

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?

Rational

4.1 Banks C and D may have had internal dynamics to contend with:

(a) It may be that they had multiple distressed borrowers at that time which were taking up significant time and requiring fairly involved levels of oversight/management such that Flow Management was deprioritised. In such circumstances it wouldn't be that they were deliberately frustrating the process but rather they simply didn't have the bandwidth/manpower to deal at the speed needed.

(b) Alternatively, Banks C and D may have had significant internal procedures/processes to follow (internal reports, Investment Committees, internal legal sign off etc)

(c) They may also have needed to obtain independent legal advice in respect of their defective pledges and whether (and what) steps could be taken in that regard.

4.2 Either way, what may have appeared to be lack of cooperation may simply have been matters outside the control of the representatives of Banks C and D who were leading on the discussions/negotiations.

Opportunistic

4.3 Alternatively, Banks B and C may have been permitting the position of the Flow Management group to worsen such that they were able to secure a better position either:

(a) by Banks A and B buying their debt;

(b) by Flow Management seeking to refinance Banks C and D (because they were concerned about their ability to derail the restructuring);

(c) by being able to demand more favourable terms because the Flow Management group's negotiating position was weakening as their financial position was worsening; or

(d) by positioning themselves to buy the business out of a formal insolvency process (either with or without a credit bid mechanism).

4.4 They may also have been taking separate legal advice on any enforcement/restructuring options available to them unilaterally that may have improved their position to a greater extent than a fully consensual restructuring – for example using a WHOA to effect a cross class cram down.

Advisor to other Banks

4.5 In the first instance, I would advise Banks A and B to seek to increase dialogue with a view to understanding what the reasons for delay/reluctance to engage are and how they could be unlocked.

4.6 In parallel I would suggest that Banks A and B:

(a) Consider buying out of their interest so can act quickly and decisively (either consensually or under the terms of intercreditor arrangements if such buy out rights exist).

(b) Establish whether there any rights under the contractual documentation to force the issue. For example, is there an intercreditor arrangement which permits Banks A and B to act in certain circumstances (e.g. by issuing notice and triggering standstill / consultation period/where interests are prejudiced)

(c) Understand their security rights by undertaking a full security review. Do Banks A and B benefit from the apparently defective pledges or do they have separate security?

(d) Consider whether there are options for a formal route to compel action by C and D such as, in England, the use of a restructuring plan which can cram down dissenting lenders (including secured lenders) but only when specific criteria are met.

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: agreement of a standstill

5.1 A formal standstill was ultimately agreed to and implemented by the Banks but not for a considerable period of time and not without difficulty between the Banks. The Banks accepted that a standstill was needed in January 2014 but the standstill agreement was not signed until mid August 2014 i.e. 7 months later.

5.2 While there was a de facto standstill (in that the Banks did not, in fact, take any action against the Flow Management group), this delay lead to uncertainty including, for example, the delay in the shareholder putting in additional €35m by way of equity/debt capital.

Second principle: creditors agree to refrain from taking steps to enforce security

5.3 This was demonstrated in the workout process and in December 2013 (before the formal standstill), while the Banks had sufficient grounds to terminate the facility agreements (which, it is assumed, would be coupled with a right to enforce security), they refrained from doing so and agreed that "legal action will not yet be taken"..

5.4 This was likely both because liquidation would have resulted in a lower return but also, in part, because of weaknesses in the existing security.

Third principle: debtor should not take action which might adversely affect the prospective return to creditors

5.5 It is implicit that this was the case but is not entirely clear. There were no obvious steps taken which were deliberately designed to adversely affect returns to creditors. That

said, the Flow Management group appeared unable to rectify the operational issues within the business given that there was continued, and worsening, financial performance throughout 2013 and 2014.

Fourth principle: co-ordination of response and formation of a Coordination Committee.

5.6 This does not appear to have been followed in the work out scenario. That may well because, with four banks, they considered that a coordination committee was not necessary and the Banks were able to appropriately manage the process without the need for a formal coordination committee.

5.7 Further, it appears that the Banks were not necessarily all viewing the process in the same way in which case there may have needed to be two coordination committees (one for banks A and B and one for banks C and D) which would have created additional cost and process potentially without the upsides of a coordination committee (given each would only be coordinating with two banks).

Fifth principle: debtor to provide reasonable and timely access to relevant information including assets, liabilities, business and prospects

5.8 It appears from the material provided that Flow Management did provide information to its Banks. From as early as December 2013, an accounting firm was sent in by the Banks to investigate procedures (which would have required access to information). In addition, Flow Management Holding was required to report to the Banks in relation to actual costs and turnover each month.

5.9 While it does not appear that costs and turnover would cover all of the information listed in the Fifth Principle (for example it is unlikely to include details on longer term liabilities or prospects), it must be assumed that the information was considered adequate for the Banks at that time.

5.10 That information also appears to have been provided to all Banks equally.

5.11 That said, the information produced by the group and provided to the Banks clearly had material inaccuracies because the reforecast financial position for the group continued to deteriorate. It is also noted that there were misgivings on the Banks' behalf in relation to the information provided (see page 5: *"Although the Banks as a group as not happy with the constantly changing information given by the company…."*).

Sixth principle: arrangement to reflect applicable law and relative positions of creditors.

5.12 The information provided indicates that the restructuring *did* reflect the relative positions of creditors and it is implicit that applicable law is also reflected. Ownership of the Flow Management group was transferred to the Banks, reflecting the fact that the shareholders retained no economic interest in the group (because on any insolvency funds would not be sufficient to repay creditors).

5.13 Of the Banks, those which provided the original working capital and had the benefit of pledges over group assets retained the majority of their secured debt.

5.14 The other lenders – being both Banks and the shareholder either did not have security or had subordinated security and therefore their debt was released/waived as part of the restructuring agreement.

Seventh principle: information made available to all creditors and treated as confidential.

5.15 As noted above, this is implicit in the case study. No Bank raised any concern with an inequality of disclosure and appeared able to form views and engage in the restructuring process adequately.

5.16 It is not clear whether a formal confidentiality agreement was entered into between the Banks and Flow Management but it may be assumed that this would have been the case to the extent that confidential and price sensitive information was being made available.

Eighth principle: additional funding accorded priority status.

5.17 According to the information in the case study, in January 2015, €25m is paid back to the providers of the additional working capital indicating that those Banks who had provided the additional funding were being repaid as a priority. That said, as part of the July 2015 restructuring, Banks C and D which had previously provided additional working capital waived the entirety of that debt.

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?

6.1 During the Covid-19 pandemic, guidance was issued by the Prudential Regulatory Authority (part of the Bank of England and regulator to banks/lenders) with regard to the approach regulated lenders should take towards borrowers experiencing financial distress as a result of the pandemic. However, that guidance now no longer applies.

6.2 Covid guidance aside, there is no "soft law" (either guidance or other principles) issued on a general basis by Regulators or other industry bodies in England relating to borrowers in financial distress other than as relates to individuals/consumers.

6.3 In a financial restructuring context the other primary source of "soft law" would therefore likely be individual lenders' Codes of Ethics or Statements/Standards of Lending Practice. Most regulated lenders will make public the relevant Codes or Standards by which they conduct business.

6.4 Certain government bodies such as HMRC (the English tax authority) and FCA has issued guidance on how *they* will approach any given restructuring situation. But there is nothing issued on a more wholistic basis.

6.5 That said, despite the lack of broad "soft law", many regulated lenders are still concerned around issues of reputation. In the aftermath of the Global Financial Crisis, a number of lenders in England were criticised for the approaches they had taken to their distressed borrowers. For some lenders, the wider concerns around perception and reputation in the market will drive their decision making process in a restructuring context.

6.6 The threat of a formal restructuring process may also assist from a negotiating perspective. While there is no empirical research that has been carried out, anecdotally, the market view is that the threat of a restructuring plan (which can cram down interests of a dissenting creditor) is a powerful lever in stakeholder negotiations.

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

7.1 Despite various suggestions during the time preceding the restructuring agreement that the shareholder would inject significant additional capital into the Flow Management group, this did **not** take place as part of the final restructuring.

7.2 As a result, it appears that there was an agreement between all parties that, going forward, the former shareholders (the Johnson family and the two institutional investors) would have no economic interest in the group. Instead, ownership of the group would transfer to the Banks plus a number of the board members (to incentivise them going forward).

7.3 To effect the shift in economic ownership, a newly incorporated entity is set up (Flow Management II BV), presumable as a wholly owned subsidiary of Flow Management Holding BV and the shares in the operational subsidiaries are transferred to Flow Management II BV.

7.4 The shares in Flow Management II BV are then transferred to the Banks and board members.

7.5 It is not clear if the transfer of the shares in Flow Management II BV to the Banks was for any cash consideration or just in consideration of the debt write off within Flow Management Holding BV. I assume it was the latter.

7.6 The former shareholders have released all claims against Flow Management Holding BV, Flow Management II BV and all of the operating subsidiaries. The Banks have also released all claims against Flow Management Holding BV.

7.7 Flow Management Holding BV is to be liquidated. Assuming there are no other liabilities in that entity (following the release by the former shareholders and the Banks) and also no other assets (because, given this was a holding vehicle, that any value would have sat within the subsidiaries which have transferred to Flow Management II BV), there will be no value to return to Lease Group Holding United Kingdom Ltd as shareholder.

7.8 The Banks have restructured their debt in the ongoing business as follows:

(a) The additional working capital facility to Flow Management Work BV is released by Banks C and D;

(b) The "main" working capital facility provided to Flow Management Work BV written down to €240m by Banks A, B, C and D;

(c) The €55m loan in Flow Management Work BV is released.

7.9 Leasing Group Holding United Kingdom Limited (and ultimately the former shareholders) would therefore be left with a much smaller group of companies consisting of Lease Cayman Real Estate Limited and Lease and Truck Repair Sweden Holding Ltd which were not transferred to Flow Management II BV as part of the restructuring agreement.

7.10 Following the restructuring, the operating subsidiaries of the Flow Management group remain in their current form under new ownership (the Banks and management) and with a significantly reduced secured debt burden.

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

8.1 In terms of the restructuring agreement entered into on 4 July 2015, cross border issues would likely have included:

(a) Transfer of the shares in each of the operating subsidiaries: This process would have required local counsel advice on the documentation and legal requirements for transferring shares of the subsidiaries in their relevant jurisdiction.

(b) Release of claims: the shareholder has agreed, as part of the restructuring, to release all claims against the trading subsidiaries. The mechanism by which claims can be released and, in particular, the tax implications of such release (and any possible tax mitigation steps) would vary as between the trading subsidiaries and should be considered on a jurisdiction by jurisdiction basis.

(c) Liquidation of Flow Management Holding: it is not clear whether any assets or liabilities of Flow Management Holding will remain after the implementation of the restructuring agreement. However, to the extent that any assets are located outside of the Netherlands, the liquidators would require recognition and assistance of the courts in the relevant jurisdictions. Assets within the jurisdiction of the Member States of the European Union should be recoverable in a straightforward and predicable manner as the Recast Insolvency Regulation 2015/848 will apply. For any other jurisdiction, domestic rules on recognition and assistance would need to be considered.

(d) Impact of change of control and liquidation of Flow Management Holding: either of these events could give rise to termination rights or other contractual rights. Whether termination rights as a result of insolvency of a group company are enforceable will need to be considered.

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]

Moratorium in England

9.1 Prior to June 2020, a moratorium only came into effect in England in the following limited circumstances:

(a) as an automatic consequence of the commencement of an administration

(b) as an automatic consequence of the commencement of a compulsory liquidation

(c) if applied for and granted by the court in a voluntary liquidation

(d) if applied for an granted by the court in a small company voluntary arrangement.

9.2 In June 2020 the Corporate Insolvency and Governance Act 2020 ("**CIGA**") came into force in England and Wales. CIGA introduced both temporary measures to address the economic impact of Covid-19 as well as permanent measures that had been under consultation since 2018 and were fast tracked as part of the CIGA legislative process.

9.3 One of those permanent measures involved the introduction of what is referred to as a "standalone moratorium" or a "Part A1 moratorium" which was designed to assist with corporate rescue outside of a formal insolvency process.

9.4 It is designed to be a straightforward process to commence and, assuming no winding up petition has been presented, directors of a company incorporated in England simply need to file certain prescribed documents at court to obtain the benefit of the moratorium.

9.5 The Part A1 moratorium involves the appointment of a licenced insolvency practitioner to act as "monitor" in respect of the moratorium. As part of the suite of documents filed at court, the monitor has to provide a statement that it is "likely that a moratorium for the company would result in the rescue of the company as a going concern".

9.6 The monitor does not replace the directors, who remain in control of the company. Rather, the monitor ensures compliance with the moratorium requirements and acts in the interest of creditors. The monitor's consent will be required for transactions which are not in the ordinary course of business.

9.7 Companies which are or are likely to become unable to pay their debts are eligible for a 20 business day[19] moratorium protecting the company from secured and unsecured creditor action[20] including:

(a) enforcement of security (other than financial collateral arrangements);

(b) commencement or continuation of legal process against the company or its property;

(c) repossession of goods;

(d) exercise of forfeiture rights;

(e) commencement of administration or presentation of winding up petition (except by directors).

9.8 On any Part A1 moratorium taking effect, a "payment holiday" is granted to the company in respect of pre-moratorium debts meaning a company does not have to pay those debts. Exceptions include:

(a) amounts falling due under a contract involving financial services (e.g. interest under a loan agreement);

(b) the monitor's remuneration;

(c) goods and services supplied during the moratorium;

(d) rent for the period of the moratorium;

(e) wages, salary and redundancy payments.

9.9 If the above amounts are not paid, the monitor is required to bring the moratorium to an end.

9.10 While secured lenders are unable to enforce their security during a Part A1 moratorium, they are still able to accelerate their debt, should an Event of Default occur. In such circumstances a monitor would need to bring the moratorium to an end because the company will no longer be able to pay amounts falling due during the moratorium (i.e. the full amount advanced under the loan agreement).

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[19] Which is capable of extension by creditors and the court

[20] Except with permission of the court

Was a moratorium a good option given the situation at the time?

9.11 On balance I do not consider that a moratorium would have assisted Flow Management.

9.12 Firstly, there is a high threshold requirement, in that it would require a monitor to confirm that it is likely that the moratorium **would** result in the rescue of the company as a going concern (rather than "might" or "is likely to"). This is said to be one of the reasons why the Part A1 moratorium has not received widespread use in England. Based on the information provided, including the continual deterioration of the position of the company and the lack of a definite plan with regard to its rescue, it is not clear that this threshold would have been met.

9.13 Secondly, a Part A1 moratorium isn't a restructuring option in and of itself. In effect it provides a breathing space to enable a wider restructuring to be implemented. It would therefore have needed to have been paired with something else (such as the proposed sale in a "controlled" manner) which could have been achieved within the 40 business day period (assuming the directors sought the initial extension which does not require creditors consent). While that period could be extended once by the directors for a further 20 business days without creditor consent, that is still a relatively short period of time to achieve a rescue of the company.

9.14 Thirdly, it is not clear whether the Banks would have provided the bridging loan which was required for the moratorium and sale process. As noted above, any amounts falling due during a moratorium would need to be paid otherwise the monitor would be required to bring the moratorium to an end. If the bridging loan wasn't forthcoming, it appears that Flow Management may not have had the financial means to trade through the period and the directors would have needed to consider the financial position carefully.

9.15 Finally, as noted above, a Flow Management would need consent/co-operation of Banks A, B, C and D as secured lender for any Part A1 moratorium otherwise (assuming there is an event of default) they could elect to accelerate their debt and bring the moratorium to an end. Consequently, the real benefit of the Part A1 moratorium is: (a) the ability to restrain actions of unsecured creditors from taking action against the company and (b) the "payment holiday" that Flow Management would obtain in respect of (most) pre-moratorium debts.

9.16 However, it is not obvious from the case study that the position of unsecured creditors is a concern for Flow Management in the short term – indeed there is discussion of it being able to pay debts as and when they fall due. Consequently, the main advantage of a Part A1 moratorium would be largely irrelevant on this fact pattern.