GIPC Case Study 1.

by

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Question 1

The causes of financial distress at Flow Management were:

1. **Poor business strategy**: A diverse portfolio of international subsidiaries, each operating in accordance with local laws, makes a clear and consistent business strategy difficult to devise and challenging to implement. Furthermore, each sub-market is subject not only to different laws regarding, for example, the treatment of employees, but also different market dynamics, which themselves evolve at different times and in different ways, bringing their own financial challenges in terms of budgeting, expansion, and capital expenditure.

2. **Excessive management remuneration:** Both the CEO and CFO have been issued with large management bonuses. Not only is this inappropriate given the company's operational performance, but also it appears to have been a basic mistake, suggesting poor financial controls at the company.

3. **Accounting errors**: A contingency gain relating to three years has been booked wrongfully in 2012. The company is not being prudent in its accounting, booking profits which have yet to materialise, and mistakes have been made in the company's cost price calculations, allegedly the result of a 'formula error' in an accounting spreadsheet. Each of these has added to the company's distress and is indicative of poor management systems and inadequate managerial oversight and care.

The above is not dissimilar to the findings of Mellahi and Wilkinson, 2004, in so far as their framework proposes significant differences in the outcomes of the same internal factors in different business environments.

This financial distress could have been avoided had there been better internal controls, a greater alignment of ownership interests, and lesser management greed.

Question 2

In England and Wales, the advantages of an out of court restructuring as opposed to a formal bankruptcy are less negative publicity, more control over the process for the company, and typically a saving of time and therefore of costs.

Question 3

The turnaround and reorganization approaches proposed by Adriaanse & Kuijl (2006), Pajunen (2006), Sudarsanam & Lai (2001), and Schmitt & Raisch (2013) were not explicitly applied. The absence of mention regarding informal reorganization, negotiation emphasis, and a comprehensive restructuring strategy implies a deviation from these theoretically sound approaches.

Incorporating elements of Adriaanse & Kuijl's focus on consensual solutions and Pajunen's stress on informal reorganization might have offered alternative avenues for the company's revival. Sudarsanam & Lai's restructuring typologies, if adopted, could have provided a structured framework for navigating the complexities of the financial distress. Furthermore, Schmitt & Raisch's integration of retrenchment and recovery as a duality could have positively influenced the turnaround performance.

A more proactive and diversified application of these theoretical frameworks could potentially have mitigated the challenges outlined in the case study.

Question 4

The reasons for banks C and D frustrating include their doubts about the feasibility of the restructuring plan, disagreements with other stakeholders, protection of their own interests, and aggressive opportunism.

As an adviser to the other two banks, I would have suggested restructuring to remove banks C and D, enabling the restructuring to continue without their interests frustrating the process.

Question 5

The 'Statement of Principles for a Global Approach to Multi-Creditor Workouts II' can be summarised as:

First Principle: Standstill Period - This entails that when a debtor is experiencing financial difficulty, creditors should cooperate with one another to provide the debtor with a fixed period during which they can gather information, assess the debtors financial state, and devise potential solutions.

Second Principle: Creditor Behaviour – This emphasizes that creditors should resist taking action to enforce their claims during the Standstill Period. It also acknowledges the need to maintain impartiality among creditors, and deal with conflicts of interest promptly and appropriately.

Third Principle: Debtor Behaviour - This specifies that the debtor should avoid making any moves during the Standstill Period that could potentially worsen the anticipated return for the creditors.

Fourth Principle: Coordination - This highlights the benefits of creditors coordinating their actions when dealing with a financially troubled debtor, often through representative committees and professional advisors.

Fifth Principle: Transparency - This Principle stresses that the debtor should make all relevant financial information accessible to creditors during the Standstill Period. This should help creditors better evaluate the debtor's financial position and assess any proposed solutions.

Sixth Principle: Legal Compliance and Reflective Arrangements - The solutions presented for resolving the debtor's financial difficulties and any arrangements made should comply with applicable laws and reflect the relative positions of the creditors at the commencement of the Standstill Period.

Seventh Principle: Information Confidentiality - Any information obtained about the debtor's finances, unless it is publicly available, should be made accessible to all relevant creditors and should be kept confidential.

Eighth Principle: Priority to Additional Funding - If any additional funding is provided during the Standstill Period or under any restructuring proposal, repayment of such funding should ideally be given priority compared to other debts or claims of creditors.

In this case, co-operation of creditors is being facilitated, this being an approach supported in the UK by the Bank of England, as per Mark Carney's letter to Mark Robinson, President of INSOL, dated 16th November 2016. This is consistent with the Fourth Principle. In addition, sufficient time has been given for information to be disclosed, which is consistent with the Standstill Period of the First Principle.

Question 6

In the event it is not possible to convince other creditors to adopt the Statement of Principles in a given situation, "soft law" may come into use in the courts of England and Wales.

Despite not being legally binding, soft law can have a significant impact. It often serves to interpret the hard law, to develop new laws, or to provide a basis for negotiations. Soft law can be important for establishing norms and providing flexibility in areas where hard law might be ineffective or inappropriate.

An as example, the UNCITRAL Model Law on Cross-Border Insolvency, can help to shape practices, guide negotiations, and bridge gaps between varying national laws, because it offers a globally recognized set of principles which may be applied in insolvency cases.

Question 7

The essence of the restructuring agreement, signed 4th July 2016, is as follows:

1. all operating companies of Flow Management Holding BV are to be accommodated in a shell subsidiary, called Flow Management II BV;
2. the shares in Flow Management II BV are to be transferred to the consortium of banks (A, B, C, D) which has financed the original working capital of Flow Management Work BV, as well as to a number of board members (including the CRO);
3. Flow Management Holding BV will be liquidated in an undisclosed manner. All claims against this BV will be cancelled by the banks and the shareholder of Flow Management Holding BV;
4. Flow Management Holding BV and its shareholder will cancel all claims against Flow Management II BV and its subsidiaries;
5. the banks (C and D) which in the past provided Flow Management Work BV with additional working capital, will waiver an amount of € 32.5 million, taking a haircut (writing off) the entire debt;
6. the consortium which in the past provided Flow Management Work BV with working capital will waiver an amount of € 97.5 million. A € 240 million claim against Flow Management Work BV remains; and
7. the €55 million loan in Flow Management Work BV is to be cancelled in full.

The contents of the financial restructuring agreement reflect the relative positions of the financiers involved. The providers of the original working capital possess pledges on most assets of Flow Management Work BV (the main partner in the group) and will receive part of

their claim on liquidation. The other financiers (both banks and shareholders) are subordinated.

Question 8

The Flow Management restructuring process may give rise to several legal and non-legal issues of a cross-border nature. These can be classified under six broad categories:

1. **Regulatory Compliance**: Each country has its own set of laws and regulations that govern corporate restructuring. This includes tax laws, labor regulations, antitrust laws, and securities laws. Non-compliance can result in penalty or even prosecution.

2. **Tax Implications:** Tax laws differ from country to country. Taxation issues such as double taxation or tax evasion could arise. Misunderstanding or neglecting transfer pricing rules can also have significant consequences.

3. **Labor and Employment Laws:** In many jurisdictions, restructuring processes that involve layoffs or furloughs require consultation with employees/workers' representatives or certain procedures to be followed. Also, employee rights, benefits and pensions should be properly managed with the legal considerations in each country.

4. **Intellectual Property Transfer:** If Intellectual Property rights need to be transferred as a part of the restructuring, this could raise cross-border legal issues. National IP laws can vary significantly, and inadvertent infringement is a serious risk.

5. **Data Privacy and Security:** European GDPR must be taken into consideration during restructuring, especially if the process involves the transfer of data across borders.

6. **Contracts and Agreements:** Existing agreements with suppliers, customers, or other business partners may contain provisions that are triggered by restructuring. Potential matters could include termination rights, change of control provisions, and consent requirements.

In terms of non-legal issues, there may be cross-border language and cultural differences, which can affect communication, employee morale, and the general execution of the restructuring process. Currency risks, political instability, and reputational risks can also be a concern, along with differences in business customs and ethics.

However, these potential issues can be managed with careful planning, legal consultation, and sensibly paced execution. Engaging with knowledgeable legal counsel and experts in respective countries can smooth the process and reduce these risks.

Question 9

In the specific financial context of October 2014, the consideration of calling for a moratorium, as outlined in scenario 4, emerges as a strategic and potentially beneficial option for resolving the financial distress facing the company. The decision to opt for a moratorium should be carefully evaluated, taking into account both the advantages and considerations inherent in such a protective measure.

Advantages:

1. **Breathing Space and Comprehensive Evaluation:** The primary advantage of a moratorium lies in providing the company with a crucial breathing space. This temporal reprieve shields the company from immediate creditor actions, affording the management team the necessary time to conduct a comprehensive evaluation of the financial landscape. This evaluation can delve into the root causes of financial distress, allowing for a nuanced understanding of both internal and external factors affecting the company. Identification of weaknesses and strengths becomes feasible within the protective cocoon of the moratorium.

2. **Negotiation Leverage and Stakeholder Alignment:** The moratorium creates an environment conducive to negotiation. The company gains a more robust negotiating position with creditors, facilitating constructive discussions around a potential restructuring plan. This negotiation phase is crucial for achieving alignment among various stakeholders. A unified approach involving creditors, management, and possibly external consultants can be fostered, leading to a more collaborative and sustainable resolution.

3. **Preservation of Value and Going-Concern Viability:** By preventing a chaotic rush by creditors to collect, the moratorium serves as a safeguard for preserving the going-concern value of the company. This is pivotal for ensuring a higher recovery rate for creditors in the long term.

Value preservation extends beyond immediate financial concerns. It encompasses maintaining the company's operational capabilities, customer relationships, and overall market standing, contributing to a more robust and viable entity post-restructuring.

Considerations and Implementation Factors:

1. **Legal Framework and Compliance:** The success of a moratorium is contingent upon the strength and adaptability of the legal framework. In-depth knowledge of the jurisdiction's bankruptcy laws is crucial for ensuring the legality and enforceability of the protective measures. Compliance with legal requirements is paramount. A carefully crafted moratorium plan, aligning with legal standards, enhances the chances of its successful implementation.

2. **Creditor Relationships and Communication:** Effective communication with creditors is pivotal. Transparency about the restructuring plan, the anticipated impact on creditors, and the envisaged recovery timeline can mitigate potential discontent. Maintaining positive relationships with creditors, even in the face of financial distress, is essential. Collaborative negotiations foster an atmosphere of trust, potentially leading to greater flexibility from creditors.

3. **Comprehensive Restructuring Plan:** The success of a moratorium relies heavily on the formulation and presentation of a well-defined restructuring plan. This plan should

address the identified weaknesses, propose strategic operational changes, and outline financial restructuring measures. A comprehensive restructuring plan not only instils confidence among creditors, it also serves as a roadmap for the company's recovery.

Conclusion:

In conclusion, considering the intricate dynamics of the financial situation in October 2014, the implementation of a moratorium emerges as a prudent and potentially effective strategy. The advantages, including breathing space, negotiation leverage, and value preservation, align with the fundamental goals of navigating financial distress. The legal landscape and compliance considerations are crucial implementation factors, demanding a thorough understanding of the jurisdiction's bankruptcy laws. Moreover, proactive communication and collaboration with creditors, coupled with a robust and transparent restructuring plan, contribute to the viability and success of the moratorium. As a legal recommendation, the option of calling for a moratorium stands out as a strategic and legally viable approach to steer the company through the challenges posed by the financial situation at that specific juncture.