**Global Insolvency Practice Course 2023/2024**

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**Case Study I**

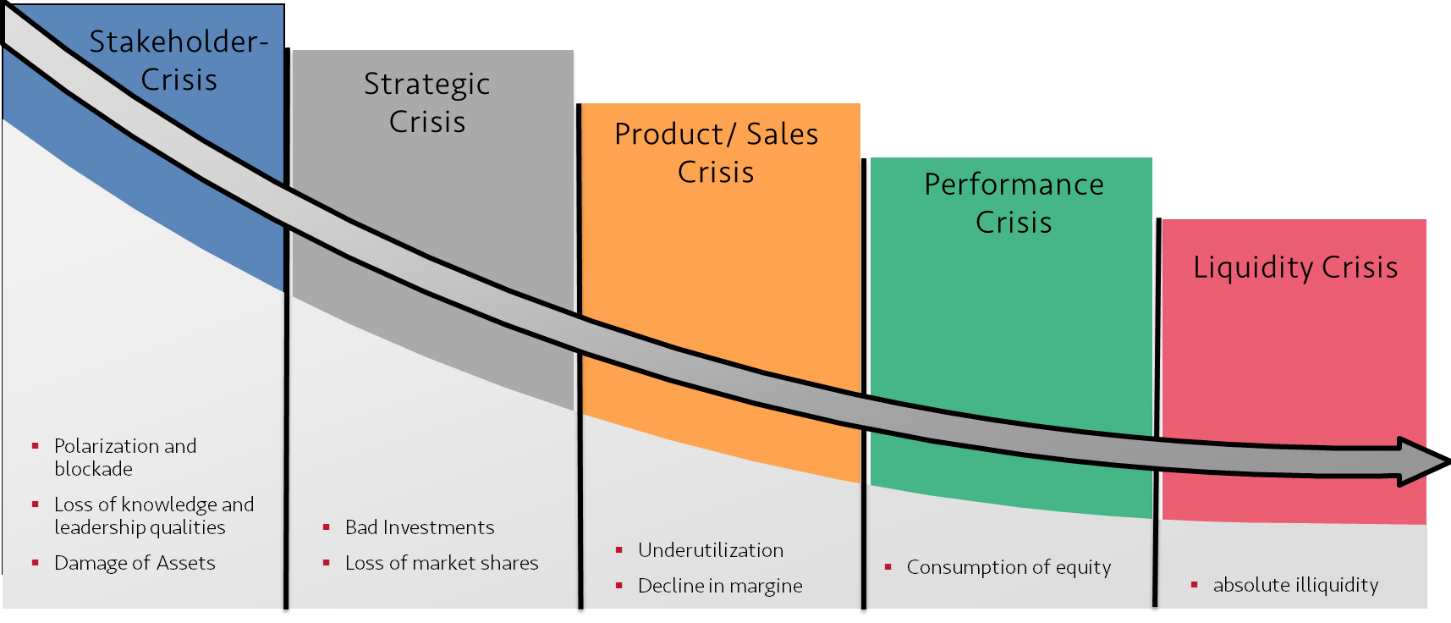
**„Flow Management“**

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?***

In my opinion, the causes of financial distress in the present case at Flow Management are manifold and could have been prevented.

In this respect the financial distress at Flow Management has organizational and enviromental factors. The investigation had already shown that the accounting system of the firm suffered from serious deficiencies. They had to reorganize the entire system.

From 2013 to 2015 Flow Management went through all phases of the crises described as follows:



The failures generally become noticeable late and appear in waves. Therefore it is important to implement early warning systems.

The reorganization of Flow Management therefore should have two main focuses.

* On the one hand, the **performance-related restructuring**.
* The second is the **financial restructuring**.

The approach of the Management suggests that the focus is not so much on optimizing the organization or the business model in the long term, but rather on short-term cost savings and sales increases.

The forecast results were corrected downwards without stable and long-term countermeasures being taken.

A change in the organization or a rethinking of the current business case under new global influences was not carried out.

The management was only replaced after pressure from the banks.

In particular, the focus in December 2013 was on reducing costs and increasing sales.

Cost reductions mainly through redundancies of 130 employees and increases in turnover through price increases. This will save 3.3 million and increase sales by 7.8 million. The long-term effects of the price increases on the business case were not fully considered. The entire business mix (product-range) was only evaluated and reassessed by the end of March 2014.

The actions of the management show that the external factors were not understood and that the internal organization therefore caused failure.

A fundamental transformation has not taken place, but was urgently needed.

In addition, the development of competition and customer behavior was not taken into account. The price increases were not properly controlled. It should be noted that there was almost exclusively positive feedback.

However, customers were not presented with a comprehensible justification for the price increases. As a result of the further deterioration in the forecast result, it can be assumed that although customers gave positive feedback, they placed fewer orders or went to other companies.

Management only made fundamental changes with the increasing influence of the banks as key stakeholders.

1. ***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?***

The main advantages and disadvantages of a **formal bankruptcy procedure** are as follows:

**a. Advantages/disadvantages of a bankruptcy procedure**

**aa. Advantages**

* Enforcement protection for old liabilities
* Protection against dismissal for employees is restricted
* Non-profitable contracts can be terminated
* Sale to third parties possible without the consent of the shareholder
* Proceedings also possible without creditor support
* Insolvency labor law
* Liquidity-supporting measures in insolvency application proceedings
* Discharge of liability risks

**bb. Disadvantages**

* Unpredictable reactions from customers and suppliers
* Costs generally higher (court costs and remuneration of the insolvency administrator/representative)
* Cannot be planned in terms of duration and appointment of insolvency administrator
* Publication, no silent restructuring possible
* Utilization of shareholder collateral is approaching
* Unintentional sale to third parties
* Liabilities that have been fulfilled can no longer be "rolled back"

Out-of-court restructuring in germany offers considerable advantages for the company in crisis and its representatives.

**b. Advantages/disadvantages of an out-of-court restructuring**

**aa. Advantages**

* Lack of publicity, silent restructuring possible
* No insolvency administrator - control remains in the company
* More flexibility
* Lower costs (no court costs and remuneration of the insolvency administrator/representative)
* Shorter duration of proceedings
* Reduction of the management's criminal law risk
* Employees may have longer notice periods

**bb. Disadvantages**

* Only works with the support of the creditors, in principle all creditors must agree. Individual creditors hope for special advantages
* Despite lower procedural costs, it must be made clear that shareholders often have to provide additional financial resources

1. **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.**

The turnaround and reorganization approaches applied in this case partly.

The change in the influence of the banks at Flow Management is remarkable

The identification of such stakeholders thus becomes an essential function for an organization in crisis.

In November 2013, the banks did not yet have the necessary influence on the management. There were a problem with the securities (pledges) on the assets established at the banks. The liquidation or bancruptcy of the company would negatively affect the proceeds of the assets.

While the representatives of the Banks A, B, C and D were not totally satisfied with the arrangement, they accepted the agreement without further negotiation or clarification because, as they stated, such events might endanger the existence of the organization.

The influence of the banks has than grown since 2014.

The process of influence identification involves three phases.

In the first phase, since the resource space of a firm may be almost unlimited, the firm’s dependency on its primary stakeholder relationships is evaluated using resource dependence analysis. This was the case at Flow Management until November 2013.

The second phase consists of two parts. First, the central and peripheral stakeholders are defined by examining stakeholders’ betweenness centrality. Then, the qualities of the interstakeholder ties are defined using resource dependency theory. As in direct resource dependence analysis, all network positions of stakeholders can be evaluated using the snowball technique (Wasserman and Faust, 1994). In this study, stakeholders’ network centrality is considered from the focal organization’s perspective, however, without supposing that the firm needs to be structurally in the centre of that network. This was the case at Flow Management from March 2014 until August 2014.

The final phase combines both the stakeholders’ network position and resource dependence based powers on the same scale using a three-stage matrix.

The model makes possible the assessment of the different levels of powers. The low level indicates that the particular element of influence alone has no noteworthy effect on a firm’s survival.

The moderate level indicates that noteworthy implications are possible, and, finally, the high level suggests that the element probably has considerable implications for organizational survival.

Since September 2014 the banks as stakeholders have a high level of power and the needed resources and able to control the interaction and resource flows in the network, which ended up in signing a Restructurin Agreement on 4 July 2015.

1. ***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?***

As I understand, it was tactical behavior on the part of banks C and D.

In particular, Flow Management was dependent on the support of the banks with regard to the standstill agreement and was therefore prepared to relinquish influence and make compromises

If a debtor is in financial difficulties, its creditors tend to have two main strategies.

The first is to press the debtor for immediate repayment of the debt or the provision of security in the hope of removing or reducing the exposure. In some jurisdictions, attempts by a creditor to pressurise a debtor close to insolvency into giving it favourable treatment compared to other creditors can be open to legal challenge on the basis of preference.

In others, however, pressurising a debtor in this way protects the creditor from a preference challenge and therefore, if a creditor is successful in persuading a debtor to pay it off or to give it security, it may well be able to keep the benefit deriving from its tactics.

The problem with the “each creditor for itself” approach is that, even if such a strategy can in theory benefit the creditor in a way which avoids subsequent legal challenge, the likelihood is that it will, either by itself or by provoking other creditors into following a similar approach, result in the debtor being forced into formal insolvency, thereby destroying any prospective advantage the creditor was seeking to gain.

The willingness of management to relinquish influence is also largely dependent on how strong the company's market position is. A strong market position exists, for example, if the company has a unique position in the market with stable customers. Customers and banks are also more willing to provide interim financing.

As an advisor to banks A and B, I would have tried to increase my influence as a stakeholder in the company in order to steer and implement key restructuring steps.

Because banks C and D withdrew from a certain point in time, banks A and B were able to gain influence.

1. ***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)?***

The first principle explicit. The banks as a relevant creditor should be prepared to co-operate which each other and sign a standstill agreement. Also the banks have formulated and assesed the financial difficulties.

The second principle implicit. The banks agreed to a 180-day standstill as a part of the restructuring process without signing an agreement at this date. Nevertheless, the banks have not enforced their claims.

The fourth and fifth principle explicit. For the banks an accounting firm ist called in to investigate the reorganization procedure with the company.

The eighth principle explicit. In January 2015 a total of € 25 million is paid back tot he providers of the (additional) working capital.

1. ***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?***

In particular, the duties of loyalty and fiduciary duty, which impose an obligation to handle third-party assets responsibly, give rise to a special compliance topic: compliance under insolvency law.

But the ethical dimension should not be underestimated.

Particularly with regard to self-imposed standards (e.g. soft law) and moral principles, it is important to ensure proper conduct within the company, not least because this is also perceived on the market by contractual partners.

Coveivable are in particular subordination with certain creditors or deferral agreements are conceivable to avoid over-indebtness ord insolvency.

Another option would be the dept equity swap. In the case of a dept equity swap creditors convert receivables into equity. The Liabilities side is reduced and the assets side is strengthened. As a result the over-indebtedness is eliminated and new liquidity not necessarily required.

Debt conversion ist not possible against the will of the affected creditors

Existing creditor (now shareholder) gains a say in entrepreneurial matters and acquires opportunities for high returns in the restructured company

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

The agreement of July 4, 2015 is aimed at avoiding insolvency proceedings and is the beginning of an out-of-court financial restructuring of Flow Management.

By transferring the operations to the shell company Flow Management II BV the operational business will be secured.

The transfer of the shares secures the willingness of the stakeholders to provide further working capital and to waive claims

The liquidation of Flow Management Holding BV will lead to the write-off of the creditors' claims.

The damage to stakeholders would be even greater in the event of insolvency.

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

Cross-border problems could arise in particular with regard to responsibility for the liquidation of foreign subsidiaries. The connecting factor here is the cente of main interest (COMI).

International jurisdiction to open main insolvency proceedings is determined in accordance with Art. 3 (1) of the EU Insolvency Regulation.

According to this, the courts of the Member State in whose territory the debtor's center of main interests is situated have jurisdiction to open main insolvency proceedings. This center of the debtor's main interests is therefore the central connecting factor for determining international jurisdiction.

It should also be clarified under which insolvency law conditions contractual relationships can be terminated. Is the insolvency law of the respective country responsible?

In addition, cross-border tax issues within the group of companies must be clarified.

When liquidating individual companies, the respective national company law is also applicable.

1. ***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]***

A moratorium generally refers to an agreement between a creditor and debtor to postpone or temporarily refrain from making a payment that is due. In business, it is a temporary suspension of payments (of interest / loan repayments).

Insolvency, on the other hand, is the final suspension of payments. In this case, creditors can only expect payments if there is an insolvency estate, unless they can assert rights to separation or segregation. In order to avert this radical form of insolvency, an attempt can be made to continue the company as a going concern with a moratorium during the corporate crisis.

Moratorium and insolvency both constitute a credit event in their own right, which triggers the creditor's right of termination (loan termination) in the case of bonds or loan agreements or the guarantor's payment obligation in the case of credit default swaps.

On 1 January 2021, the StaRUG, which is based on an EU directive and is intended to be understood as a 'second chance law', came into force.

The abbreviation stands for "Corporate Stabilization and Restructuring Act".

The pre-insolvency restructuring procedure is a modular system. The debtor can reach into various drawers and select the instruments required in the specific case. The StaRUG provides a so-called "moratorium" as a further important instrument to safeguard restructuring plans.

At the debtor's request, the court should be able to issue stabilization orders prohibiting creditors from enforcing their claims by way of compulsory enforcement and the liquidation of collateral (Section 49 StaRUG).

The moratorium should be possible for a period of up to three months. Under certain circumstances, the duration of the order can be extended by a further month if a plan offer is submitted. Following the application for court confirmation, the extension is possible for up to eight months from the initial order.

In principle, the stabilization order can be ordered with effect vis-à-vis all creditors (with the exception of creditors whose claims cannot be restructured by means of a restructuring plan or can be limited to individual creditors or groups of creditors (Section 44 (2) StaRUG).

In practice, it will therefore have to be carefully weighed up whether extending the proceedings to supplier creditors in particular is appropriate and conducive to restructuring. This is because their inclusion will regularly result in the termination of the credit lines by trade credit insurers, or at least their freezing, which would noticeably increase the debtor company's liquidity requirements due to the significant reduction in payment terms or even the switch to advance payment. Any resulting working capital requirement would then have to be provided by financiers again, because there are no countervailing liquidity advantages, such as the insolvency money effect in insolvency proceedings.

Another significant advantage is during the moratorium, the right to file for insolvency is suspended for creditors of the debtor (section 58 StaRUG).