Global Insolvency Practice Course 2019/2020 **TAMMY FU**

<u>Module A – Case Study 1 – Flow Management</u>

Question 1: What were the causes of financial distress at Flow Management?

There are a variety of potential causes of financial distress at Flow Management with potentially both internal and external factors at the root.

Internal factors

Management:

In November 2013, Flow Management's Board raised concerns in relation to significant inaccuracies/material faults in earlier reporting. Whilst it is suggested that the errors and issues are caused by a variety of reasons, the explanations all point to weak internal controls, inadequate systems and/or poor processes. Controls, systems and processes should be initially set/agreed and then regularly reviewed by management. Without internal controls, a business operates inefficiently and potentially out of compliance with applicable laws and regulations.

Additionally, for Flow Management, a contributing factor toward losses and negative corrections (€3million) is cited as management bonuses which were wrongfully issued. There is no proposal that these monies be returned to the Company which could be a result of the wrongful payments having been made to the CEO and CFO of Flow Management Holding BV which are likely the parties controlling information. It is also unclear if they also serve as board members. The Board is a key internal control mechanism for setting CEO compensation and theory suggests that CEOs will attempt to circumvent board control in an effort to maximise salary (Boyd, 1994).

The ultimate owners of the Flow Management group are the Johnson family (30%) along with two UK investment companies (40% and 30%). It is not clear whether the Johnson family are the ultimate beneficiaries of or have connections to the investment companies. It is also not clear if the Johnson family are represented on the Boards of Lease Group Holding UK Ltd and/or Flow Management Holding BV, however, it appears that the CFO of Lease Group Holding UK Ltd is charged with making proposals in relation to the restructuring of Flow Management Holding BV. It is important from the perspective of the banks to ensure that there is some independence between the entities and that the shareholder (acting by its CFO) is not conflicted. With reference to board composition (in terms of the ratio of non-executive to executive directors), some studies suggest a positive relationship between board composition and firm performance (Weisbach, 1988) (Pearce & Zahira, 1992) (Daily & Dalton, 1993) (Krivogorsky, 2006).

The CFO of Flow Management Holding BV would be ultimately responsible for accounting and forecasting. A number of initial issues are identified as being the result of wrongfully booked items such as the

contingency gain received in 2012 and the book profit to be realised in 2013. These issues were identified in or before November 2013 however an announcement to replace the CFO was not made until January 2014. Even then it is not clear if or when the CFO was actually replaced. Further, it is not until April 2014 that the CEO of Flow Management Holding BV is replaced by the board of Lease Group Holding UK Ltd and later still that a chief restructuring officer (CRO) is appointed following request from the banks.

Systems and accounting:

A number of the issues faced by Flow Management are a direct result of failed systems and accounting such as the cost price calculation. In addition forecasts are repeatedly inaccurate with significant variances. Accounting systems are only as reliable as the information used and/or the user themselves. Arguably, the failure in the accountings system(s) leads back to the CFO and management.

Controls:

Flow Management failed to periodically check the real costs against the results of the cost price calculation and therefore, as a result of a formula error, set the sales prices too low. This formula error was a material error that had a significant impact on the current business and potentially also customer relationships which would cause issues for future business. For important matters such as pricing calculations, sole reliance should not be placed on a single source i.e. a spreadsheet calculation. Additional controls and/or checks should be implemented by management. As a minimum, the calculations should be reviewed regularly with control checks.

In support of this point, the Committee of Sponsoring Organisations of the Treadway Commission (COSO) asserts that improved internal control monitoring practices should enhance the efficiency, effectiveness and assurance of internal control processes (Committee of Sponsoring Organizations of the Treadway Commission, 2009). COSO issued a Framework (updated in 2013) which helps organisations design and implement internal controls and clarifies the requirements for determining what constitutes effective internal controls. It can be deduced from the scenario that Flow Management did not follow the guidance set out in the Framework.

External factors

Flow Management could have been facing external environment pressures that kept the prices low e.g. competitive market but this is not specifically noted in the scenario. Equally, the market environment could have changed but Flow Management executives had not understood or accounted for this.

Pressure from the banks could have caused management to make rash restructuring decisions. Fielding questions and concerns from the four separate banks could have also distracted management from focusing on the needs of the business.

As quoted by Kalle Pajunen, the continued existence of business organisations is dependent on their relationships to stakeholders and this dependency is likely to culminate in a crisis situation (Pajunen, 2006).

The banks' positions are weakened due to potential problem(s) with the validity of the banks' security over the assets. The banks reluctance to terminate the credit agreements for this reason could have been misconstrued as support from the banks giving the management positivity or a more relaxed attitude toward firmer restructuring measures.

Whilst the banks (and potentially the shareholder) believed that a sale of Flow Management Holding BV was a 'good possibility' in February 2014, it later transpired (in June 2014) that a sale was not a possibility due to lack of interest. This could be an indication of difficult market conditions that the banks (and company) are unaware of.

Could the financial distress have been prevented?

Internal factors

Fink (1986) argues that, in a crisis situation, quick decisions need to be taken. The Board of Flow Management Holding BV had identified numerous severe issues in November 2013 (potentially earlier) but no noteworthy action was taken until mid-April 2014.

For Flow Management, decisions were made based on poor data/systems and inaccurate estimates of future performance. Poor forecasting of future performance has a disastrous effect and makes it difficult to put in place effective changes.

If better systems and controls were in place earlier enabling the detection of material accounting discrepancies and also pricing inaccuracies, Flow Management would not have been in such a dire situation. Equally if the management had been better informed and/or more effective, they could have either taken action sooner or acted differently to the situation.

A July 2015 thought paper produced in collaboration between COSO and The Institute of Internal Auditors, Inc. refers to The Three Lines of Defense (the Model). The Model addresses how specific duties related to risk and control could be assigned and coordinated within an organisation, regardless of its size or complexity. The responsibilities of each of the 'lines' are:

1. Own and manage risk and control (front line operating management)
2. Monitor risk and control in support of management (risk, control and compliance functions put in place by management)
3. Provide independent assurance to the board and senior management concerning the effectiveness of management of risk and control (internal audit)

In Flow Management, there appears to have been a lack of both procedure and independent oversight, specifically in identified risk areas such as pricing and forecasting. If management and the Board were assigned roles or assumed responsibilities as set out in the Framework, inaccuracies and errors should have been more easily identified (Anderson & Eubanks, 2015).

External factors

A potential solution to external factors is the possible formation of a common price agreement with other leasing companies. As set out by K.Pajunen (2006), this was one of the ways in which issues were tackled by Kymi Corporation.

Question 2: What are the advantages and disadvantages of an out-of-court restructuring (workout) as compared to a formal bankruptcy procedure?

A company will always have concern for its reputation and the regard of its customers. A formal bankruptcy procedure will often have a detrimental effect on both, or at least that is the perception of company executives and management.

In addition, a formal bankruptcy procedure can trigger non-favourable provisions within customer, service or financing contracts which may make an out-of-court restructuring a more attractive solution.

Whilst cost may differ dependent upon which jurisdiction a process is to be commenced, it is highly likely that the restructuring costs within a formal procedure would be significantly higher than the costs of an informal (out-of-court) process, particularly within a group that operates in a number of jurisdictions.

Again, dependent upon the jurisdiction within which a process is to be commenced, it is likely that a formal court procedure would be more time consuming as there are additional approvals, complexities and formalities that must be considered.

That said, the benefits that a formal bankruptcy procedure could bring are significant.

A formal process brings structure and transparency. In addition, experienced restructuring professionals will typically be engaged that are able to better navigate the process and identify needs.

A bankruptcy/liquidation specialist can act as an independent broker for negotiations and discussions with financiers and/or customers which can remove any personal feeling or 'bad blood' that may exist. In addition an independent bankruptcy/liquidation specialist could be used to help mediate internal disagreement among executives and management.

A formal process, dependent on jurisdiction, also brings the ability to cram down dissenting creditors e.g. a scheme of arrangement may require less than 100% buy-in to a potential solution but could also have a binding effect on those that are not in favour.

A formal process can also bring reduced risk for executives and management e.g. if an asset sale is necessary in order to restructure, the asset sale itself may be subject to a specific court approval process bringing comfort and protection to the decision makers.

In the Cayman Islands:

Restructuring in the Cayman Islands is typically effected through a provisional liquidation. Provisional liquidation is a flexible tool with the role and duties of the appointed provisional liquidator(s) being set in the court order appointing them. This gives the Cayman Court real flexibility to create a suite of powers that is appropriate in any given situation.

The Cayman Islands Winding Up Rules expressly acknowledge that the appointment of provisional liquidators need not necessarily displace the powers of the directors. The order appointing the provisional liquidators will also set out which powers are to be retained by the directors, if any. For example, day to day operations and business decisions can sit with the directors but with the provisional liquidators in a supervisory or consultative role.

For cross-border restructurings, the flexibility is particularly advantageous as it can allow the Cayman process to mirror or support another process in another jurisdiction. The provisional liquidation of Trident Microsystems (Far East) Limited which was also in Chapter 11 before the United States Bankruptcy Court for the District of Delaware is a prime example of this. The provisional liquidation progressed in parallel with the Chapter 11 proceedings to ensure that the assets of the company could be realised efficiently and restructuring options explored. Both the Cayman Court and the Delaware Court were fully involved with all key decisions, with certain decisions being made by joint telephone hearings with attorneys in both the Cayman Islands and Delaware making submissions.

Other specific advantages of the Cayman Islands as a restructuring jurisdiction include:

- The legal system is an English common law system – well established and respected.
- As the Cayman Islands is an offshore jurisdiction, the vast majority of business that is undertaken is of a cross-border nature so the courts are experienced in handling large multi-national financial disputes.
- The Cayman Islands is home to a large number of well-respected and experienced restructuring professionals.

By way of example to support these statements, the Ocean Rig group deliberately selected the Cayman Islands as the jurisdiction within which to implement its restructuring. This restructuring is recognised as the largest Cayman Islands restructuring in recent history that sought to restructure around $3.69 billion of New York governed debt. The companies were Marshall Islands companies but as the Marshall Islands had no restructuring procedure and both Chapter 11 and English scheme proceedings were unattractive (Chapter 11 due to cost and time, and English schemes due to adverse tax consequences), the decision was made to restructure in the Cayman Islands. To do this, a COMI shift was necessary and the Cayman

Court’s view was that forum shopping is not abusive where it is carried out with achieving the best possible outcome for creditors. The success of the Ocean Rig restructuring sets a precedent for the use of the Cayman Islands as a location to conduct modern, complex cross-border restructurings.

A US Chapter 11 is potentially an alternative to a Cayman Islands provisional liquidation and has advantages such as the ability to cram down a class of creditors which is not possible in the Cayman Islands. However, the costs of a Chapter 11 case tend to be very substantial and the timing can be difficult to control.

Given the flexibility, cost and timing of a provisional liquidation process in the Cayman Islands (particularly in comparison to other jurisdictions), I would argue that the advantages outweigh any disadvantages of a formal process as opposed to an out-of-court restructuring. However, the disadvantages as with any formal procedure would also apply in the Cayman Islands e.g. potential trigger for non-favourable contract provisions, reputation and customer relationship damage, and cost.

Question 3: Were the turnaround/reorganisation approaches as presented in the reading material applied in this case?

Adriaanse & Kuijl, 2006

This article is focuses on informal reorganisation.

Adriaanse & Kuijl described informal reorganisation consisting of business restructuring and financial restructuring. The idea is that it is impossible and undesirable to carry through financial restructuring without restructuring the business operations (which are typically the cause of the financial distress).

Business restructuring is noted to be a comprehensive plan which aims to restore profitability with phases such as (i) stabilising, (ii) analysing, (iii) repositioning, and (iv) reinforcing.

Flow Management’s initial business restructuring appears to be limited to introducing labour cuts and hosting client discussions in relation to price increases. It could be argued that these measures were Flow Management’s attempt to stabilise the business however these changes did not have the desired effect as the necessary ‘breathing space’ was not created.

Flow Management later formulated a restructuring plan which included reference to the strategy being focused on increasing turnover in combination with large cutbacks (albeit with little detail in terms of how this is to be achieved). Whilst this was potentially a further step by Flow Management to deal with operational deficiencies, the plan/strategy does not appear to be well defined and the strategies were not further developed alongside the financial restructuring steps that were later implemented.

In the analysing phase, it is necessary for a company to look at its long terms prospects and incorporate those into a reorganisation plan. For Flow Management, attempts were made but with inaccuracies in the accounting and forecasting, it is impossible to formulate an effective strategy.

The article also describes the common necessity to recruit or consult a person (interim-manager, advisor etc.) as a method of restoring confidence. Flow Management made this step by appointing a Chief Restructuring Officer, albeit this was at the request of the banks.

Phase III, re-positioning, is where the management implement the re-organisation as outlined in the reorganisation plan. It is not clear that all of the proposed operational changes were implemented.

Phase IV, reinforcing, is understood to mean 'reinforcing' the company's management as well as the company's balance sheet which can be achieved by transferring the company to another (healthy) company.

In July 2015, Flow Management finalised a Restructuring agreement which outlined a number of financial restructuring measures but did not further address the business/operational restructuring.

Adriaanse & Kuijl state that the most common cause of financial difficulties mainly relate to poor management. The appointment of the CRO (at the instigation of the banks) supports this as the view of at least bank A.

In conclusion, in my view, Flow Management followed certain aspects of the methodology described in the article by Adriaanse & Kuijl but not all. The fundamental principle is that an effective restructuring must deal with both business and operational issues and this did not happen at the levels necessary in Flow Management. If further focus and attention was given to the operational restructuring needs, this may have yielded better and quicker results for Flow Management.

Pajunen, 2006

This article relates specific types of behaviours of influential stakeholders to the probability of organisational survival. It is argued that in a crisis situation, it is important to understand what types of stakeholders are the most influential and how those stakeholders are handled.

Primary stakeholders are described as those stakeholders who are essential to the ongoing continuity of the business.

The article describes a model which can be used to identify stakeholders by considering resource dependencies and network positions.

For Flow Management, it is assumed that banks A, B, C and D are key stakeholders as a result of the amount of WC financing (€360million) and other loans (€55million), however, it does not appear that Flow Management went through the full identification process described within the article. That said, Flow Management did attempt to ensure the support of the banks by hosting regular meetings and offering

additional (more regular) information. These actions indicate that Flow Management support the view that open and active communication with governing and potential stakeholders has a positive effect on their support for organisational survival.

In addition, Flow Management identified its main clients, also key stakeholders, and visited them in order to discuss and agree upon the necessary price increases. Other clients that were not identified as 'main' clients were simply notified of the changes. This step indicates that Flow Management did undertake steps to identify its key, most influential, clients.

Sudarsanam, S, Lai, J., 2001

This article deals with turnaround strategies and management responses to performance decline. Sudarsanam and Lai tested the effectiveness of various restructuring strategies including managerial restructuring, operational restructuring, asset restructuring and financial restructuring. Findings show that those that have a successful recovery have often chosen investment and acquisition to lead them out of trouble as opposed to operational and financial restructuring. This supports the view that firms with more forward-looking, expansionary and external market focused strategies are more likely to recover. The analysis of timing also suggests that recovery should take place over a longer period, allowing potential changes in response to the pace of recovery or the effectiveness of earlier actions.

Flow Management does not appear to have followed the research-based approach presented in this article as its restructuring was very much reactive as opposed to proactive. There was no market study or forward-thinking strategy considered. That said, the restructuring was carried out over time with adaptations made as (at the time) were considered appropriate. Regardless of management's response time, due to the inadequacies of Flow Management's data and systems, it was difficult to properly identify the causes of distress and therefore develop appropriate and timely restructuring strategies.

Schmitt, A., Raisch, S., 2013

This article considers two categories of turnaround activities: retrenchment and recovery. Retrenchment focuses on increasing efficiency through cost and asset reductions while recovery concentrates on improving a firm's market position through strategic change. Schmitt and Raisch develop the thought that both retrenchment and recovery contribute to turnaround success, and that retrenchment and recovery are beneficial at all stages of the turnaround process.

Flow Management adopted retrenchment activities by way of its initial proposal to sell 350 cars in order to improve the solvency rate, its later proposal to make 130 staff members redundant and further proposals to sell off the shares of the companies outside the Benelux-countries and also make large cutbacks. Whilst these activities were undertaken, it could be argued that these were not effective retrenchment activities as there was no reported significant improvement specifically as a result of the

changes. It is not clear whether these retrenchment activities considered Flow Management's long-term strategic goals, or indeed whether Flow Management had any long-term strategic goals at this time.

The article describes recovery activities as pro-active actions that allow innovation and reorientation required to overcome a firm's difficulties. Schmitt and Raisch support a 'duality' perspective, integrating the two activities (retrenchment and recovery) to create benefits. However, it is noted that the benefits from integrating retrenchment and recovery cannot be realised without incurring additional costs and it is therefore important to identify the optimum interaction level to ensure costs and benefits are equal.

Flow Management appears to acknowledge its need for recovery efforts as plans include the statement 'the strategy must be focused on increasing turnover itself...'. However, recovery activities are not implemented.

If Flow Management had been able to adopt a dual approach as outlined by Schmitt and Raisch, this would have potentially led to better results and also a more saleable business. Flow Management attempted to sell the business on a number of occasions but was either faced with no interest or a lack of desire to progress initial discussions.

Question 4: What could have been the reason(s) for banks C and D's frustration of the process?

The reasons for bank C and D's actions could have been both rational and opportunistic.

Rational

The interests of the banks are not entirely aligned due to the differing lending levels in working capital financing (€360million) and potentially also the other loans (€55million), and/or the level and quality of security. If the interests are not exactly aligned then the proposed repayments (scheduled in 2015 and beyond) may result in different decisions/positions being taken by the individual banks.

In addition, the differing views at the banks could also be a result of internal pressures such as pressure from their own stakeholders to take action.

The management of banks C and D may take a more risk averse position than the management of banks A and B as a result of their own internal policies. This could have also been driven by banks C and D obtaining additional (or differing) information which has led them to form the view that, at that time, Flow Management is unstable and not to be supported.

Opportunistic

In or around March 2014, banks A and B investigate the possibility of buying out banks C and D. Banks C and D could have determined that this would be the best outcome for them and therefore made opportunistic moves in order to push that option.

Alternatively, banks C and D could have had exposure or a connection (banking or other relationship) to one (or more) of Flow Management's competitors which may have led them to conclude that the survival of Flow Management was not desired and/or critical to their own business.

What would you have done in that situation in your role as lawyer to banks A and B?

Given that time is critical in such a crisis situation, more focus should have been given to obtaining a standstill agreement to ensure that the parties would act in unison.

Earlier agreement could have potentially created an opportunity for the company (and lenders) to better explore and evaluate the options outside of a formal insolvency process. Delays typically prolong uncertainty and ultimately increase costs.

In December 2013, the banks concluded that Flow Management must take measures with regard to management and in particular the CFO. In January 2014, the company announces that it will appoint a new CFO *soon*. In April 2014 the CEO is replaced and in May/June 2014 a CRO is appointed at the instigation of bank A. As lawyer to banks A and B, I would have made demands for changes to take effect sooner rather than later.

The information flow between Flow Management and the banks does not appear to be regular (particularly given the crisis situation) and the quality of the information and forecasts is poor. As lawyer to banks A and B, I would have made demands for additional and more regular information to make Flow Management more accountable for its promises (in terms of change/actions) and also its financial forecasts. In addition, a working group could have been formed amongst the stakeholders (including all banks) which would have allowed for better communication. This may have had a beneficial effect on the actions (or non-actions) taken by banks C and D which appear to be primarily caused by the lack of trust and faith in the information provided and actions taken by Flow Management.

It is noted that the banks had concerns over their security on the company's assets and, as lawyer to banks A and B, it would have been of paramount importance to ensure that the security was perfected. This could have potentially been obtained by way of negotiation e.g. entering a limited forbearance agreement in exchange for revised security documents. This would have placed banks A and B in a stronger position with potentially better options.

Question 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)?

The first principle is that all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time i.e. a standstill period to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed.

Whilst it was arguably put in place later than what is ideal, a standstill agreement is eventually signed by all banks which did allow for the various scenarios to be drawn up for consideration. That said, it is not clear that Flow Management considered or consulted with any other (if any) creditor classes.

The second principle is that during the standstill period, creditors should refrain from taking action. However the creditors are also entitled to expect that their position relative to other creditors and each other will not be prejudiced.

In the Flow Management scenario, after the standstill agreement was signed but before the restructuring agreement is signed, €25million is paid back only to the providers of *additional* working capital. Unless this was agreed within the terms of the standstill agreement, this action seems to contravene the principle of those creditors that did not provide additional working capital not being prejudiced.

The third principle being that the debtor should not take action to adversely affect the prospective return to creditors (collectively or individually) does not appear to have been met as a result of the €25million repayment of additional working capital.

The fourth principle refers to the appointment of committee and/or professional adviser to ensure a co-ordinated approach. Given the limited number of stakeholders in the Flow Management scenario, it may have been deemed unnecessary to form a committee as each creditor was represented within negotiations. That said, the scenario does not make this point clear.

The fifth principle states that the debtor should provide sufficient time to access all relevant information relating to its assets, business and prospects in order to properly evaluate the financial position of the debtor and any proposals put forward. It appears that a 9 month period elapsed between the four scenarios being drawn up and the restructuring agreement being agreed. This indicates that ample time was provided although it is not clear what information was made available during that period.

The sixth principle relates to the proposals and that they reflect applicable law and the relative positions of the relevant creditors at the commencement of the standstill. The Flow Management scenario specifically states that the restructuring agreement reflects the relative positions of the financiers involved and it is assumed that this is also in accordance with relevant laws.

The seventh principle relates to the provision of information, specifically that it be made available to all creditors and be treated as confidential. It is assumed that this principle was followed by Flow Management and its creditors as there are no arguments to the contrary.

The eighth principle refers to the provision of funding and that such funding be accorded a priority status. However, in the Flow Management scenario, additional deposits and funding does not appear necessary due to the sale of surplus assets and incoming cashflows.

Question 6: If it is not possible to convince other creditors to adopt the Statement of Principles, are there other possibilities for 'soft law' to use? If not, are there alternative (informal) possibilities?

'Soft law' option

In the Cayman Islands, a common restructuring tool used is a provisional liquidation – this has proven to be a very useful and flexible tool. A moratorium is triggered on the appointment of provisional liquidators which provides breathing space for a debtor to negotiate with its stakeholders and propose and implement a restructuring without the risk of the process being derailed by the actions of one or more dissenting creditors. The presentation of a winding up petition against a company is a necessary pre-requisite to the application to open provisional liquidation proceedings. However, whilst that winding up petition is the gateway to accessing the Cayman Islands provisional liquidation regime, provisional liquidation does not necessarily result in the formal winding up and liquidation of the debtor. In addition, provisional liquidators can be appointed in a 'light touch' capacity i.e. in a consultative or supervisory role with directors retaining powers (as ordered by the court). Where provisional liquidation is used to support a successful financial restructuring through which the company survives, the end result is usually that the winding up petition is dismissed and the newly restructured company continues as a going concern.

Alternative (informal) possibilities

Whilst a formal scheme of arrangement requires requisite majorities (varying levels dependent on jurisdiction) which is ultimately approved by the relevant court to have a binding effect on any dissenting creditors, it may not be necessary to turn to a formal scheme. In the Cayman Islands, a binding restructuring can be effected without any court involvement if all affected parties agree to it. This type of arrangement is often difficult in a crisis situation as it may be hard to find suitable terms that are supported in full by all parties.

Alternatively, it may be possible to negotiate the terms of a restructuring support agreement (RSA) with individual key creditors. Whilst preferable, the terms of an RSA need not be consistent across all creditors as individual creditors may have differing needs. The RSAs should, however, all have a common goal to support a proposed restructuring strategy.

Dependent on the situation, another alternative may be to negotiate an individual creditor settlement with a dissenting or non-cooperative creditor. This would remove specific problem(s) and allow focus on the business/restructuring needs.

Question 7: Explain the essence and result of the restructuring agreement signed on 4 July 2015.

The restructuring agreement essentially provides the framework for the restructuring of Flow Management's debt and allows the business to revert to a viable and saleable (hoped at the time) state.

The restructuring provides a significant reduction in Flow Management's debt, a total amount of €185million being waived/cancelled.

Each class of creditor will have made a determination that the effect of the restructuring proposal (and ultimately agreement) represents a better result than what they would face if Flow Management was to be liquidated without the restructuring.

The result of the restructuring agreement is that the net profit of the 'new' company is positive and the equity capital is strengthened. Whilst this does not appear to have opened the door for an immediate sale of the business, it has better prospects for future profitability and potential sale.

Question 8: Which potential legal or non-legal cross border issues – if any – do you recognise in the Flow Management restructuring process?

Foreign recognition of the main proceeding is potentially necessary to protect assets (more than 200,000 cars in its fleet) and for protection against claims in some or all of the other jurisdictions.

Contracts are likely governed by a variety of different laws as the shareholder is a UK company, the holding company is based in The Netherlands and the subsidiaries span a number of countries including Spain, France, Australia, South Africa and the USA. If this is the case, consideration will need to be given (and advice obtained) in respect of local laws and regulations when considering the termination or extension of the individual contracts. There is also a cost implication to retaining local counsel if advice is necessary.

Employment laws and employee protections will vary dependent on the country in which they are employed – given the group employs over 3,000 people, this could be a significant issue and cost if advice is necessary.

Local government or regulator interaction and involvement could be an issue, particularly if the company (or specific subsidiary) is deemed to be a significant local employer or key operator.

Potential language barriers with management and stakeholders of foreign subsidiaries, and also translation issues with documents and contracts.

Potential conflicts and/or disputes between management of the various operating companies.

Potential conflicts between stakeholders of the various operating companies.

Consistency of records, information and processes between jurisdictions can be difficult to manage if not already centralised within the group. Equally the collection of records and information may be difficult.

Funding is likely a key issue in any large restructuring but those with cross border elements can be more complex as it is necessary to consider the group as a whole as well as individual company operating needs.

Question 9: Why was or wasn't a moratorium (see scenario 4) a good option given the situation?

Firstly, scenario 4 required that the banks provide a bridging loan which is assumed to be funding for the liquidation process. Given the apparent lack of interested buyers, any asset sale would likely be a long and costly process. It is unlikely that the banks would be willing to inject further funds when the result is at best uncertain and more likely worse than an alternative workout process.

In a liquidation scenario, both the company and its creditors would potentially lose control of the process with assets likely being sold at a reduced value or over an unattractive time period.

It is not clear what the levels of other/unsecured creditors are but the banks had concerns regarding their security on the assets and it would have therefore been a significant risk in a liquidation scenario if their security was deemed to be invalid.

The appointed CRO appears to be the choice of the banks, specifically bank A. Presumably bank A (and potentially the other banks) had confidence and trust in the CRO. In a liquidation scenario [in the Cayman Islands], whilst a creditor is entitled to nominate a liquidator, a liquidator is ultimately appointed by the Court and given the work that the CRO had already undertaken for the company, a conflict (or perceived conflict) could have been argued by another creditor. As such, a newly appointed independent liquidator would likely be unattractive to the banks and the company for a number of reasons such as:

- cost - duplication of investigative and review work already undertaken
- knowledge (general background and industry specific)
- time involved in having to understand the current situation
- trust - relationship (or lack thereof) with management and the banks

Timing would also likely be an issue particularly as there is no identified buyer which leads to further uncertainty. The business and asset value would inevitably suffer in a protracted sale scenario.

The cost of a liquidation process is also a factor as the professionals involved would need to be paid (which could be significant with cross-border issues to consider) and those costs would rank ahead of creditors payments. In addition, assuming foreign recognition in other jurisdictions would be required (due to the locations of the operating subsidiaries), the cost of 'local' counsel to assist with the process and also advise on local issues would need to be factored.

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