GLOBAL INSOLVENCY PRACTICE COURSE 2019

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Flow Management

Assignment Answers

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<u>Question 1</u>

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 Harvey (2011, p. 15) causes of corporate decline are broadly divided into two categories – internal factors and external factors. Although, in Harvey (2011, p. 14), it is stated that “poor management is universally regarded as the leading cause of business decline”. In Slatter & Lovett (1999, p.19), this view is largely supported in that it is stated that “one can, if one wants to, trace virtually all reasons for declining performance back to ‘bad management’”.

Using the Harvey (2011) approach, the causes of financial distress at Flow Management Holdings BV (“Flow Management”), can be divided between internal and external factors. Whilst information pertaining to Flow Management’s situation does not provide any insight into the broader, macro-environment to enable commentary on the external factors at play, one can debate whether these could have had an influence on the financial position at Flow Management. Therefore, *examples* of the external factors that may have impacted on the financial distress of Flow Management are included for illustrative purposes.

Internal Factors	*External Factors*
Poor management • Delay in identifying distress and driving the operational restructuring that is required. • Management’s inability to adequately calculate the cost price through the lack of identification of an error in a spreadsheet • Management did not perform benchmarking analysis – i.e. they did not compare current costs with those calculated according to their formula	*Economy* • *In an economy on a downward trajectory, it is likely that consumer spending habits may be curtailed. This could potentially affect both the trucking and leasing divisions of Flow Management.*

• Management also did not keep abreast of the competitive environment as a price increase could probably have been instituted earlier as the reaction to it was not overwhelmingly negative. • Overall, lack of confidence in the ability to generate financial information that can be relied upon by key stakeholders	
Lack of governance • Large management bonuses have been incorrectly awarded and paid. • There should be clear governance frameworks about the award of bonuses and signoff required before payment.	*Competition* • *We are unaware of the competitive landscape within which Flow Management operates. This could contribute towards declining sales* • *For example, a business like Uber may be detracting from the car leasing business in the territories where Uber is present*
Ineffective board of directors • The board of directors did not hold the CEO and CFO to account and did not interrogate the financials. Had they done so, they may have identified some of the material financial issues much earlier. • Lack of attention to recapitalising the business through additional shareholder liquidity calls, rather a focus on reaching agreement with creditors / additional working capital.	*Environmental factors* • *With environmental impact being at the forefront of most consumers thinking, it may be that carbon emissions from trucking and leasing are having some impact on reduced revenues*
Inappropriate financial policies • Contingency gains had been incorrectly allocated and recorded	*Exchange rates* • *We are aware that Flow Management operates across a number of different countries. However, no mention is made*

• Recognition of profit in anticipation of a future event. This is incorrect in terms of accounting standards.	*of how the exchange rate fluctuations are managed, and whether the business is vulnerable to exchange rate losses from open / unhedged positions.* • *However, given the inherent weakness in financial accounting department, it is a probability that there were inadequate measures in place to hedge against exchange rate fluctuations*
High cost structure • Management's turnaround plan identifies spending cuts that can be implemented. On the assumption that spending cuts identify costs that can be eliminated, it can be assumed that Flow Management was operating in a high-cost structure.	*Strikes* *Flow Management has operations in South Africa which is known for its labour unrest and trade union environment. The only information we are given is that each overseas subsidiary is loss-making, not the reason why. However, the bargaining power of the labour force in South Africa could have contributed to the losses in this territory.*

It is difficult to determine whether the financial distress could have been avoided in its entirety as the influence of the macro-economic factors are not known. However, what is clear from the information available is that there are certain measures, which had they been implemented earlier, could have had an earlier positive affect on cash flows. The cumulative effect thereof is difficult to determine, but potentially earlier price increases, cost-reduction strategies, no bonus payments, could have alleviated the loss-making scenario somewhat. Certainly, had management identified the financial decline of the business earlier, it could have been more agile in its response – for example, identifying 'self-help' measures such as delay in new asset purchases, improvements in the working capital cycle, labour-force rationalisation and renegotiation of key contracts (maintenance, insurance etc). The ability to provide reliable financial information could also have sped up the reorganisation discussions with the banking institutions and potentially have removed the requirement of the lending institutions to appoint a financial advisor to provide reliable financial information. This would also have reduced the cost of the reorganisation.

One can also argue that due to poor or weak management, the organisational financial distress was inevitable.

Mellahi & Wilkinson (2004), acknowledge two schools of thought in understanding the causes of organisational failure – the 'classical industrial organization (IO) and organisation ecology (OE)" viewpoint which argues that the broader environment constrains strategic reaction of management as management cannot control the external environment and therefore management influence on corporate failure should be ignored; contrasted against the 'organisation studies (OS) and organisational psychology (OP)' viewpoint that states managers and principal decision-makers are responsible for a corporate's demise – there is emphasis on who makes the decision rather than the external context within which the decision is made. Mellahi & Wilkinson (2004) argue that an integrated framework is a better approach in determining the cause of corporate failure.

The integrated framework supports the view that there are both internal and external factors at play when seeking the cause of financial distress. The combination of the external environment and how management reacts to it, together with management capability, determines the cause for success or failure.

Question 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?

In Adriaanse & Kuijl (2006), three distinct advantages are noted for what is termed "informal reorganisation", which is akin to out-of-court restructuring or workout strategies. Adriaanse & Kuijl (2006) define an informal reorganisation as a "route which takes place outside the statutory framework – therefore in the shadow of the law – with the objective of restoring the health of a company in financial difficulties". The three distinct advantages noted by Adriaanse & Kuijl (2006) include:

- Flexibility
- Silence
- Control

Flexibility:

Informal reorganisation is less rigid than statutory processes or formal procedures, because by its very nature it is based on agreement and not dictated by law. The solutions can be adapted to the exact circumstance and any required deviations to take into account specific creditor groups can be agreed. When contrast with Business Rescue proceedings – the 'rescue' provisions contained in Chapter 6 of the South African Companies Act 71 of 2008 ("the Act"), there is little to no flexibility in how creditors are treated. A body of creditors will vote to approve the plan that is tabled before them under s150 of the Act.

Silence:

Put another way, an informal reorganisation can take place out of the scrutiny of the public eye. Whilst a formal process is public and can be very damaging due to the negative connotations associated with bankruptcy or insolvency procedures, there are no formal reporting requirements for those businesses undergoing informal reorganisation.

In Harvey (2011, p. 132), this is also noted as an advantage – termed a "veil of secrecy" - so that trade creditors especially are not notified of the exact financial position of the business which if they were, might precipitate a "race to collect". A public process can be seen as a "self-fulfilling prophecy" as it would usually result in the liquidation of the business as creditors, especially those with security that requires court perfection, race to the courts to petition for liquidation to improve their returns.

Control:

Adriaanse & Kuijl (2006) correctly indicate that this is a distinct advantage for the incumbent management, not necessarily for the stakeholders at large. Whilst in a court-driven process, an independent (usually officer of the court) individual is appointed to oversee the process and ensure adherence to the legal framework wherein these procedures are contained, in an informal reorganisation, no such requirement is in place for an independent to be appointed and therefore management remain in control. This is often not necessarily in the best interest of the business as it could be argued that the business is more often than not in financial distress due to the very actions of the incumbent management and therefore having someone independent and competent in turnaround management or reorganisation situations is preferable for stakeholders.

In addition to these three advantages identified by Adriaanse & Kuijl (2006), ease of negotiation, cost & employment may also be considered an advantage:

Ease of Negotiation:

Garrido & Mondiale (2006) conclude that due to the less confrontational nature of informal restructuring, this provides a more conducive environment for negotiations. Due to the lack of procedural rules, engagement amongst the company and its creditors, or between creditors, can take any form that the parties decide upon. This view is confirmed by "9 Advantages of an Informal Debt Restructuring Workout," (2015).

Cost:

An out-of-court reorganisation is considered to be less costly than a formal, court-driven process. Remuneration can be dictated by statute or regulation and this may reduce the return to the creditors in the process. Harvey (2011, p. 132) also states that cost and time factors of a formal rescue mechanism have to be taken into consideration as a court-driven procedure is expensive and often very time consuming, factors which could themselves result in the company failing to recover from its financial distress.

Employment:

In a formal process, or a court-driven process, it is more likely that there will be higher redundancies as necessarily compared with an informal process. In the instance where there is a pre-pack scenario in the use of Business Rescue, or a thorough pre-assessment has taken place and the business is sold as a going concern using Business Rescue as an implementation tool, it may be that the redundancies are the similar as in an informal workout scenario.

Disadvantages could include the following:

In Harvey (2011, p. 132) it is stated that a "serious drawback to attempting an informal creditor workout … is that there is no moratorium". In South Africa, a moratorium is granted upon the commencement of Business Rescue proceedings under Chapter 6 of the South African Companies Act 71 of 2008 ("the Act"). The moratorium ends when a certificate of Substantial Implementation is filed with the regulator (Companies & Intellectual Properties Commission). The benefit of the moratorium is that it provides immediate relief against any potential enforcement action against the Company in business rescue. Therefore, a "standstill" does not need to be negotiated or agreed with the relevant creditors, it is enforced through the law. The lack of a moratorium in an informal workout scenario can leave the company vulnerable to potential threats of liquidation from trade creditors who are not party to any 'relevant creditor' standstill agreement. Whilst under the protection of a s133 moratorium, no trade creditor can take enforcement action or initiate liquidation proceedings (unless with leave of the Business Rescue Practitioner or court).

For creditors who are not considered 'relevant' creditors, there can be a lack of transparency in the process. Trade creditors are not notified that the business is in financial distress and is negotiating with key creditors regarding a plan for the survival of the business.

Garrido & Mondiale (2006) also state a few further disadvantages:

<u>Analysis of the financial situation</u>: Insolvency proceedings are better placed to determine the true financial position of any entity. Whilst in informal restructuring understanding the true financial position is critical to determining viability and ultimately the reason for concluding a restructuring as opposed to liquidation, it is often difficult to determine with certainty due to the short timeframes and complex legal documentation underpinning various creditor facilities.

<u>Investigation into Irregularities</u>: Formal insolvency proceedings require that the insolvency practitioner investigate the behaviour of officers of the company connected to the insolvency. In South Africa, only the liquidation provisions allow for a formal enquiry to take place. The Business Rescue provisions contained in the Act do not include the ability to call an enquiry, although this has been made a condition of court-appointed BRPs in recent case law. Equally, the ability to investigate antecedent transactions and potentially void these, lies within formal insolvency frameworks.

<u>Question 3:</u>

Were the turnaround/reorganization approaches as presented in the reading material (see e.g. Adriaanse & Kuijl, 2006; Pajunen 2006; Sudasanam S Lai, 2001, Schmitt, A; Raisch 2013) applied in this case? If yes, explain in what way. If no, detail what in your opinion should have been done differently.

In Pajunen (2006), the influence of the stakeholder is considered paramount. The ability to identify the stakeholders that are the most influential in the ability of the organisations survival, it a crucial component of the restructuring process. Pujanen (2006, p. 1262) states that when an organisation faces a crisis, "it is of secondary importance to define the broad stakeholder group to which a stakeholder belongs. The primary concern is to define the stakeholders that have an influence". A stakeholder of influence is a stakeholder without whose cooperation or participation, the business could not survive. Pujanen (2006) then goes on to address the management of these influential stakeholders.

In Flow Management, the business quickly identified that it was the financiers who were the stakeholders with the most influence and whose cooperation was critical to the successful reorganisation. Had the banks cancelled their credit facilities and enforced their security, there would be no business to attempt to salvage. They were initially invited to the board meeting to explain the deterioration in the financial performance. With the ability to place the business into a formal restructuring procedure due to what must be debt covenant breaches and certainly payment breaches post 31 December 2013, their continued support for the approach adopted was more important than any other stakeholder position or influence.

In considering the management of influential stakeholders, Pujanen (2006) considers the importance of transparent and regular communication and the correlation this has with organisation survival. Regular and transparent communication builds trust between management and influential stakeholders and trust is vital for the support of the stakeholders in any restructure. In Flow Management, discussions between management and stakeholders appears to be infrequent, with significant periods of time between meetings. Trust only starts to be gained when the banks feel that they can rely on the financial information provided by the CRO and ultimately the banks do support the restructure plan.

In Sudarsanam & Lai (2001), they suggests that the *timing* and *intensity* of management responses and *effective implementation* of turnaround strategies determines the success of a turnaround. The authors note that similar strategies are adopted by organisations that fail and those that succeed. However, the differential is in their strategic choices over time. The authors note that those organisations that are successful in their turnarounds, tend to have a more transactional focus – either acquisitions or disposals; whilst those organisations which are unsuccessful in their turnarounds, tend to have a more internal view and focus on the operational and financial restructuring strategies only.

Management's inaction, self-interest concerns and eternal hope can lead to more rapid or further deterioration in financial performance. It shouldn't be a surprise, therefore, that one of the supposed prerequisites for a successful turnaround is a change in top management. This was evident in Flow Management where a CRO was appointed to drive the turnaround and provide reliable information to the lending institutions for decision-making purposes.

A distinction is made between operational restructuring and asset restructuring. The former generally comprising cost reduction, revenue generation and operating-asset efficiency and the latter focusing on strategic shifts to achieve long-term growth and profitability through the changes in the asset portfolio or product / market changes.

Schmitt & Raisch (2013) present an argument that supports that both retrenchment and recovery are a 'duality' – being contradictory and enabling – that the interaction between both retrenchment and recovery enhances overall turnaround performance. Similar to Sudarsanam & Lai (2001); Schmitt & Raisch (2013) relate 'cost retrenchment' to operational restructuring; whilst 'recovery' is akin to asset restructuring, being more strategic in nature. The authors discuss whether retrenchment and recovery strategies should be pursued sequentially or in parallel, noting that prior research states: 'the retrenchment phase is considered to extend from the onset or the turnaround situation until asset and cost reduction ceased whereas the recovery phase was considered to extend from the cessation of asset and cost reductions until the firm achieved or failed to achieve turnaround'.

In Flow Management, there was evidence of operational restructuring through revenue generating strategies (price increases) and cost efficiencies / retrenchments (redundancies, renegotiation of contracts, savings initiatives). The restructure that was concluded on 4 July 2015 is evidence of financial restructuring – being the 'reworking of a firms capital structure' and includes equity and debt-based structures. There is no evidence of asset restructuring / recovery strategies. Management is not shifting or altering the strategic focus of the business, rather it continues to provide the same service to predominantly the same clients in the same market.

When considering the literature on the success of turnarounds, Flow Management did not embark upon bold, strategic step-changes in their turnaround strategy. Rather the focus was much more heavily weighted to operational restructuring and financial restructuring. Literature suggests that turnaround success (being the return to the same performance level of the firm as before its distress – Sudarsanam & Lai (2001, p. 187) is achieved when both strategies are employed.

<u>Question 4:</u>

Banks C&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 lawyer of the other two banks?

Given the subordinated nature of the claims that Banks C & D have, it is likely that in an insolvency, they would have received very little, if anything. This puts them in the position where there is 'little or nothing to lose' in playing 'hardball'. By derailing the process, they could force a worse outcome for Banks A & B (particularly given issues with their security) and therefore, it might be easier for Banks A & B to buy the claims of Banks C & D or agree a settlement with them. This would have the advantage for Banks C & D of potentially improving their positions (i.e. gaining a higher return than they would have in liquidation) and providing immediate liquidity for their own institutions. By taking the write-off early, they could also potentially improve their Non-Performing Loan ratios that they would need to report on in their Annual Financial Statements.

Another factor that could lead to this behaviour by Banks C & D is how the performance of the individuals in their restructuring teams are measured at their respective Banks. Restructuring units in the banking industry can be incentivised to minimize time to recover and in the hope that Banks A & B will buy their position, this could be a motivation to seek the early settlement.

As the lawyer for Banks A & B, you are left with two choices – call their bluff and threaten to liquidate should there be non-cooperation. By demonstrating that liquidation is not a disastrous outcome for Banks A & B, this may remove the perceived bargaining power of Banks C&D as they are counting on the fact that Banks A & B do not want a liquidation scenario.

The other alternative is to consult with Banks A & B and offer Banks C & D a marginally higher return than what they would achieve in liquidation to purchase their claims against Flow Management, together with any security that they may hold.

<u>Question 5:</u>

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)?

In order to adequately answer the question, it is important to identify the eight principles of the "Statement of Principles for a Global Approach to Multi-Creditor Workouts II". These are summarised in the table below on the left and the indication in Flow Management is included on the right:

Principle for Multi-Creditor Workouts		Evident in Flow Management
1.	All relevant creditors should be prepared to cooperate with each other to give sufficient time (the "Standstill Period") to the financially distressed debtor in order to obtain information and evaluate the information about the debtor and for proposals to be formulated and assessed	Co-operation amongst the creditor group of Flow Management is evident. Banks A, B, C & D appear to work together, initially determining that a 'joint approach' is desired. Although at one point, Banks C & D appear to waiver in the desire for the financial institutions to speak with one voice and this potentially provides Flow Management with leverage and negotiating power. The banks ultimately collectively drove the agreement of a standstill period. However, the standstill could only be agreed once certain conditions had been met.
2.	During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims or to reduce their claims (other than by way of sale of their claim) but are entitled to expect that during the Standstill Period their relative positions should not be prejudiced. Conflicts of interest in the creditor group should be identified early and dealt with appropriately	In Flow Management, once the standstill had been agreed, no further enforcement action did take place.
3.	The debtor should not take any steps during the Standstill Period to negatively affect the return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement date	There is no evidence that Flow Management acted to the detriment of the Creditors during the standstill period.

4.	Interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Representative co-ordination committees and the appointment of professional advisors to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole	It is not clear in the case study that a committee was formed with a single spokesperson identified to communicate and negotiate on behalf of the creditor body. Whilst there is evidence that an advisor was appointed to investigate procedures, an independent turnaround consultancy was appointed to determine viability and a CRO was appointed in Flow Management, it is not evident that either the Advisor or the CRO acted as a representative on behalf of the creditor group.
5.	During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their advisors reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors	Banks A, B, C & D appointed an advisor early in the process to assist them with understanding the procedures undertaken at Flow Management given the significant downward adjustments to profitability. The advisors were also requested to opine on the viability and sustainability of the business going forward. The advisors concluded that there was a viable business and this gave the relevant creditors (Banks A, B, C &D) the confidence to continue to negotiate a financial restructure to allow the business to continue, rather than suffering a liquidation loss (especially due to the deficiencies with their security).
6.	Proposals for resolving the financial difficulties of the debtor and so far as practicable, arrangement between relevant creditors relating to any standstill should reflect applicable law and the relative	The subsidiaries of Flow Management are in different jurisdictions. Whilst it is not explicitly stated, it can be assumed that the restructuring of the group will be done in accordance with the relevant local laws. The closure of the subsidiary entities will likely be

	positions of relevant creditors at the Standstill Commencement Date	subject to the local laws regarding winding down operations, most likely solvent or insolvent liquidation procedures.
7.	Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.	Whilst the aspect of confidentiality is not explicitly addressed, it is evident that relevant financial information was made available to the relevant creditors. A significant issue encountered by the relevant creditors was the credibility of the information as profit / loss forecasts kept changing. This precipitated the need for the appointment of the CRO who could provide confidence to the relevant creditor group regarding the veracity of the information being provided to them for the purposes of decision making.
8.	If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors	The additional funding that was provided by banks C&D was paid as a priority when compared to the debt that was in existence at the commencement of the standstill period.

Question 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?

In South Africa, it has been the case that the banking institutions have been reticent to appoint professional advisors and have rather chosen to appoint the 'lead bank' to facilitate the negotiation process and co-ordinate the provision of information to creditors. The 'lead bank' is generally the bank with the largest, highest ranking debt.

Only with the increase in large restructurings, and the change in the creditor mix in restructurings (more multi-jurisdictional, private capital and unregulated debt providers), have the local banking institutions seen the benefit of having a professional advisor to fulfil the role envisaged in the Fourth Principle of the Statement of Principles for a Global Approach to Multi-Creditor Workouts II (2017).

Formal Standstill Agreements have also not generally been drafted and agreed. Rather, it is held that the banks will agree amongst themselves whether or not to enforce, without the need for a formal standstill agreement. This is problematic as it doesn't provide the certainty required by the debtor that there is some space within which to outline a restructuring plan. Again, with the changing mix and dynamic of creditor groups in South Africa, the requirement to have a formal Standstill Agreement is likely to become more prevalent.

Question 7:

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

The banks concluded that a sale as a going concern was the best outcome for them in terms of minimizing the loss that they are likely to suffer compared to if the group should face liquidation.

The liquidation scenarios were well understood – i.e. the likely return for each stakeholder group (secured creditors, unsecured creditors, shareholders) – and these have been used to inform the restructured balance sheet.

In order to package a group structure that is attractive for sale, a Special Purpose Vehicle has been created to house the assets of the group – being the operating entities of Flow Management Holding BV. This SPV essentially removes the operating entities and assets thereof from the previous group under Flow Management Holding BV.

The shareholders of the SPV are importantly:

- The Banks: there is acknowledgement that a portion of their historic debt was equity-like in nature. Given that there been certain debt-forgiveness as part of the restructure, the banks will see equity-uplift upon the sale of the Group as a going concern – this is a classic partial debt-for-equity swap. This equity uplift will be used to offset/compensate for the credit loss that was recorded as a result of the debt forgiveness. Importantly, the equity-uplift is only available to the consortium of banks that provided the original working capital facility and were considered 'secured'. The unsecured or subordinated creditors do not receive any equity to compensate for their loss suffered.

- Board members, including the CRO: The CRO, especially, and remaining board members need to be incentivised to achieve the best possible value for the group upon sale. By making them equity-holders, their interests are now aligned with those of the Banks and the Banks can be confident that there should not be conflicts of interest between them, the Board, the CRO and the ultimate objective of a sale as a going concern. It is now in everyone's interest (from a key stakeholder perspective) to strive for maximised returns over a defined time period.

The original shareholder of Flow Management Holding BV does not have any equity in the SPV – again this reflects the position at liquidation – that the equity holder would have not received anything in a liquidation scenario.

To clean up the group structure and ensure that no third party claims exist, Flow Management Holding BV will be liquidated. Given the loss suffered by the banks, it is important that the shareholder of Flow Management Holding BV also cancels any claim against Flow Management Holding BV.

Any residual claim by Flow Management Holding BV and its shareholder will also be cancelled against claims in Flow Management II BV and its subsidiaries. This is important to ensure that there is no benefit received by Flow Management Holding BV and its shareholder in the event that Flow Management II BV is sold and that they can also not influence or negatively affect the sale process. It could be that due to their loss of equity and ultimately value (the shareholder provided some emergency capital of €10m), they may issue a spurious liquidation application against Flow Management II BV to prevent or deter any going concern sale. This action would undoubtedly harm the value that Flow Management II BV could achieve on sale and may derail the whole process. Therefore, it is critical to ensure that they do not have a claim to pursue or use as leverage against the new shareholders of Flow Management II BV.

The seniority of the banking facilities is acknowledged in the haircut that the banks / consortium of banks have to suffer. The consortium who provided secured working capital (secured by the pledges against the assets of Flow Management Work BV), will retain a claim against Flow Management Work BV for the value of their secured claim. The balance will be waivered and equity is provided to compensate.

The banks (C & D) that previously provided additional working capital to Flow Management Work BV, together with the financier(s) that provided the €55m loan, will write off their full amount as these were subordinated claims to the secured creditor consortium above. Therefore, in a liquidation scenario, these creditors would not have received any dividend and therefore the restructured position reflects this as well.

The result of the restructuring agreement is that a platform for the going-concern sale of the group of operating entities has been packaged to deliver an attractive balance sheet, which impacts on the profitability forecasts (reduced debt service payments will generate a cash flow and profit benefit, which from a value perspective will increase price) and provide additional equity-returns to the creditors that have had to suffer a write-off of the original, secured working capital facility.

Question 8:

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

Cross-border issues arise when groups of companies have operations and / or assets in several jurisdictions. The main issue is which insolvency proceedings take precedence as the general rule is that the main insolvency proceedings should take place in the jurisdiction of the entity where it has its 'centre of main interest' or COMI.

The uncertainty that is created through competing insolvency laws in multi-jurisdiction proceedings exacerbates the complexity of Group insolvencies. Different treatment of disputed issues as a result of differing local laws may create situations where a creditor may seek an alternative to the COMI to litigate and thereby progress their argument in the jurisdiction which is most favourable to their argument. This could potentially result in parallel litigation across different jurisdictions.

In the case study, each subsidiary of Flow Management Holdings BV operates in a different country and therefore, will be subject to the insolvency / restructuring laws of that country, were the Restructuring to fail and the entities commence insolvency proceedings. Any assets held or pledged as security in those jurisdictions, will be subject to local security law.

The COMI has been acknowledged as The Netherlands – being the country where Flow Management Holdings BV is registered. As part of the restructure of the group, this entity will be liquidated. There may be assets of the Flow Management Holding BV which are outside the Netherlands and repatriation back to The Netherlands may be complex as the proceedings will require recognition in the foreign country.

The liquidator of Flow Management Holdings BV will need to satisfy him- / herself regarding the transaction that has taken place whereby the assets of Flow Management Holdings BV (the shares in the subsidiary entities) are transferred to a SPV entity. This could be considered a voidable disposition and if found to be so, could result in the unwinding of the transaction which could impact on the cross-border complexity.

The parent company of Flow Management Holdings BV and associate companies (Lease Cayman Real Estate Ltd and Lease and Truck Repair Sweden Holding Ltd) may have intercompany loans outstanding or due to Flow Management Holding BV. The calling of these intercompany loans by the liquidator of Flow Management Holding BV may trigger insolvency proceedings in those jurisdictions and the requirement for the Netherlands proceedings to be recognised in each of Sweden, United Kingdom and Cayman Islands (assuming this is the jurisdiction for Lease Cayman Real Estate Ltd).

Question 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 the time? [you are allowed to give your opinion based on your own countries' Bankruptcy Act; be as detailed as possible]

As at October 2014, the Standstill Agreement had been signed by the Banks allowing for a 120-day Standstill period. This, in essence, allowed Flow Management Holding BV breathing space up until the end of January 2015. In many respects, an informal moratorium had been granted by the key creditors - those that had the strongest ability to commence enforcement action. The standstill agreement will prevent any one of the parties to it from taking enforcement action provided that their respective positions are not jeopardised and conditions of the standstill agreement are not breached.

Without a moratorium, the business is at risk from third party creditors (not party to the Standstill Agreement) taking enforcement action. However, depending on the size of the claims, the key creditors may choose to settle these claims should they arise to nullify the enforcement threat. However, this does come with risk as once it is known that the Banks will settle claims to avoid a formal process, a flurry of liquidation applications from trade creditors is likely.

In my opinion, it was a good idea not to seek a moratorium at this point as this would mean, from a South African insolvency perspective, that Business Rescue proceedings have commenced as the moratorium in terms of s133 of Chapter 6 of the South African Companies Act 71 of 2008 ("the Act") provides for a moratorium during business rescue proceedings.

The argument that asset valuation is greater in Business Rescue as opposed to liquidation does not appear to hold much weight as the connotation surrounding Business Rescue and the stigma that is attached to companies that file for Business Rescue is overwhelmingly negative. Potential purchasers of assets and businesses out of Business Rescue are just as eager to achieve a 'bargain' and low-ball a price due to the inherent insolvent nature of the business and the desperation that seemingly goes hand-in-hand with these proceedings.

Equally, invoking Business Rescue proceedings in South Africa is a risky strategy as there are very few competent Business Rescue Practitioners ("BRPs"). The incumbent CRO will not be able to lead the Business Rescue process, despite probably being best placed to effect the strategy, as she will fall foul of the independence criteria that is contained in s130(1)(b)(ii) of the Act. Therefore, control is handed over to an individual who may not be suitably qualified to deliver the results and strategy that had been agreed upon with creditors. Should the BRP be incompetent or delinquent, the ability to remove them and have them disciplined is notoriously difficult in South Africa due to the time it takes for a case to be heard in the South African courts and the ineffective Regulator. The result being, that creditors will be hard-placed to remove a BRP that is not acting in terms of the Act.

The requirement to provide bridging finance is also a difficult decision for the Bankers, particularly in a Business Rescue framework. Such bridging finance is termed Post Commencement Finance and achieves a "super-priority" in terms of s135(3) of the Act. However, there is much ambiguity and debate regarding the true waterfall of proceeds and whether the security that the banks current have for their existing debt, is at risk. This is particularly relevant when you analyse the Flow Management Holding BV scenario - a consortium of banks had security for their original working capital facility to Flow Management Work BV. However, those that provided additional working capital facilities (Banks C & D), have no security. So in the instance that Banks C & D provide Post Commencement Finance and a judge determines that their claim ranks ahead of the secured creditors, with a right to proceeds from that security, this is absolutely to the detriment of the consortium of banks of the original working capital facility. This interpretation, although supporting case law is weak, has the potential to destabilise the lending landscape in South Africa and also prolong any recovery or rescue of the group due to the litigation that would ensue.

Given that it appears that the strategy to pursue a going concern sale of the company can be achieved through an 'informal' restructure and standstill agreement, this is more likely to achieve the objective of minimizing loss for the banks than a formal, Business Rescue process where the moratorium is invoked.

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