Company Voluntary Arrangements:

A route to rehabilitate companies while optimising value and outcomes for stakeholders

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Publication

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Synopsis

The coronavirus pandemic has brought about and accelerated change in every corner of the UK economy and the world, none more so than in the restructuring sector.

This publication will explore the changes introduced in the new Corporate Insolvency and Governance Act, what it means in practice and how it could support the increased use of Company Voluntary Arrangements (CVAs) as a route to rehabilitate companies while optimising value and outcomes for stakeholders.

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Corporate Insolvency and Governance Act

The new Corporate Insolvency and Governance Act has been described as one of the most significant changes in corporate insolvency law for nearly 20 years. It looks to change the landscape of the restructuring market and heralds the resurgence of a rescue culture that focuses on rehabilitating businesses.

One of the main areas of the Act to support business rescue is the new moratorium.

A statutory moratorium is available to give struggling businesses an initial 20 business day period as the breathing space they need to implement a rescue plan. This could be solvently, through a CVA, or via a restructuring plan. The moratorium prevents creditor action while options are being discussed, and it can be extended by a further 20 business days or longer if further time is needed – as long as consent is given.

In many cases, reasoned dialogue with stakeholders who are kept fully informed as a CVA progresses avoids the need for a moratorium. However, if time is needed, the moratorium will see company directors retain control under the supervision of an appointed insolvency practitioner, whose duty is to ensure that a rescue continues to remain possible.

What are the common issues that cause financial difficulty?

A CVA works particularly well when there has been a shock to the system – for many businesses the COVID-19 pandemic has been the biggest shock of all. It has created a situation in which many well-run and previously profitable businesses are now struggling and whose future looks uncertain or unpredictable.

Businesses have been able to take advantage of emergency loan funding, such as the Coronavirus Business Interruption Loan Scheme (CBILS) and the Bounce Back Loan Scheme (BBLS), defer VAT payments to early 2021, enter into Time to Pay arrangements with HMRC, as well as obtain rent and repayment holidays from landlords and finance companies. These are all welcome and practical measures in these unprecedented times, but they all have one major caveat. They still need to be repaid.

To support the rehabilitation of these companies, a fair platform where all stakeholders work together for longer-term mutual benefit is needed.

There is an opportunity to look at CVAs more constructively and creatively than the industry has done before, and it is likely that more than any other time in recent history viable businesses will need a CVA to be able to repay or compromise debts.

This can be achieved in a way that aligns with the intention behind the Corporate Insolvency and Governance Act 2020, which is ultimately to help viable businesses succeed.

What is a CVA?

CVAs have been a construct of the restructuring market for almost 35 years, having first been introduced in the Insolvency Act 1986. It is a statutory process that can be used to successfully rehabilitate fundamentally sound companies which, for a variety of reasons, may be facing financial challenges and need support in order to continue to operate. It can enable a business to repay creditors over a fixed period, while also better protecting jobs.

This is done by establishing a binding formal agreement or compromise with a company's creditors. Importantly, it also provides an opportunity to address any operational issues within the business at the same time.

Despite the CVA being implemented under the supervision of an insolvency practitioner, the existing management remains in place and the repayment arrangement remains between the company and its creditors. Typically, a CVA will be contribution-based over a term of three to five years, with contributions paid to creditors at regular intervals. Alternatively, it can involve the payment of a lump sum – often provided by a third party – that enables a prompter distribution to creditors.

In order to be put in place, a CVA must be approved by 75 per cent or more of its voting creditors. A second vote is then undertaken with creditors unconnected to the business and if more than 50 per cent approve, the CVA will be passed.

Once approved, a CVA binds all of the company's unsecured creditors who were entitled to vote at the meeting, regardless of whether or not they voted. However, a CVA cannot bind secured or preferential creditors without their consent.

While there is no statutory requirement that the business proposing a CVA be insolvent or unable to pay its debts, in practice a CVA is used where there is at least a risk of failure or insolvency.

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Ian Corfield
Partner

When is a CVA appropriate?

There are some important factors to consider before agreeing to a CVA to ensure it isn't a short-term fix. This includes understanding why a business is struggling and asking questions about its resilience and the viability of its long-term future. If the proposition will not stand the test of time, then it is likely that a CVA is not appropriate.

A CVA can fail for a number of reasons; from insufficient restructuring and inadequate working capital facilities post CVA, to reputational issues, loss of key customer contracts and an inability to obtain sufficient credit facilities from suppliers. Problems can also arise from overpromising at the outset in order to satisfy demanding creditors who may control the vote.

It is important to understand the reasons behind a CVA failure to ascertain if it is an appropriate route forward for your business. A detailed and thorough viability and feasibility assessment is therefore critical to confirm that a CVA is an appropriate tool in the circumstances and to ensure a well-drafted CVA that will address all these concerns at the outset.

If this requirement is satisfied, the CVA regime is a well-placed and productive rescue mechanism that should be embraced.

What is needed to make a CVA successful?

A CVA must be approved by 75 per cent or more of its voting creditors. But how can this be achieved? Key considerations for any CVA proposal include:

- Analysis – a detailed overview of what has happened to the business and the impact on the immediate and future financial position.
- Open and honest communication – all creditors must be communicated with from the outset. This includes constructive discussions that explain the benefits and implications of approving the CVA.
- A clear statement of changes – creditors must be told how the business has changed, why the situation is investible and how legacy issues have been resolved.
- Confirmation of support – outline those stakeholders who, despite having little or no voting capacity, are needed for ongoing working capital requirements or industry standing and are supportive of the proposal. This includes contingent creditors, regulators, trade bodies and secured creditors.
- The ask from compromised creditors – demonstrate that as many relevant stakeholders as possible are being asked to contribute in some form to the restructuring, and where possible do not isolate one class.
- Align interests – where possible align interests to include creative ways for compromised creditors to benefit from future performance and to secure a return.
- Alternative outcomes – a detailed statement of alternative outcomes should be included in case the CVA was not approved. This is to demonstrate the impact of alternative outcomes, but should not just focus on liquidation as an alternative.
- Thorough preparation and realistic expectations – there is no 'quick' feasibility and execution process for a CVA, constructing a robust and supportable proposal is time consuming but, if done thoroughly, it can be a powerful tool for a company and its stakeholders operating in any sector of the UK economy.

When used correctly, and in the right circumstances, a Company Voluntary Arrangement can help to rebuild a resilient business model and realign economic interests for investors, employees, customers, suppliers and UK plc.

Ian Corfield
Partner

Advantages of a CVA

When used correctly, and in the right circumstances, a CVA can help to rebuild a resilient business model and realign economic interests for investors, employees, customers, suppliers and UK plc. There are a number of advantages to the process:

- No change in ownership – the directors and shareholders remain in control.
- Solvent vs insolvent – unlike other restructuring processes, there is no requirement for the business to be insolvent before proposing a CVA. This means positive action can be taken earlier in order to help safeguard the future of the company.
- Confidentiality – a CVA is a private contract between the business and its creditors. It is not advertised and only noted publicly on Companies House.
- Flexibility – the legally binding terms of a CVA are freely negotiated between a company and its creditors.
- Assets retained – there is no requirement to market or sell the business nor its assets. This means certain assets, such as accreditations and intellectual property, can be protected.
- Limited court involvement – professional fees are lower than some alternative restructuring processes as a CVA does not typically involve a court hearing and creditor returns are substantially enhanced. A CVA would only involve a court hearing if it was challenged.
- Continued uninterrupted trading – a CVA allows the core business to trade on with no disruption to customers.
- Secured creditors – a CVA cannot bind any secured or preferential creditor without their consent, which means they are more likely to be supportive of the proposals.

75

Percentage of creditors that must approve the CVA

1986

CVA introduced to the Insolvency Act

20

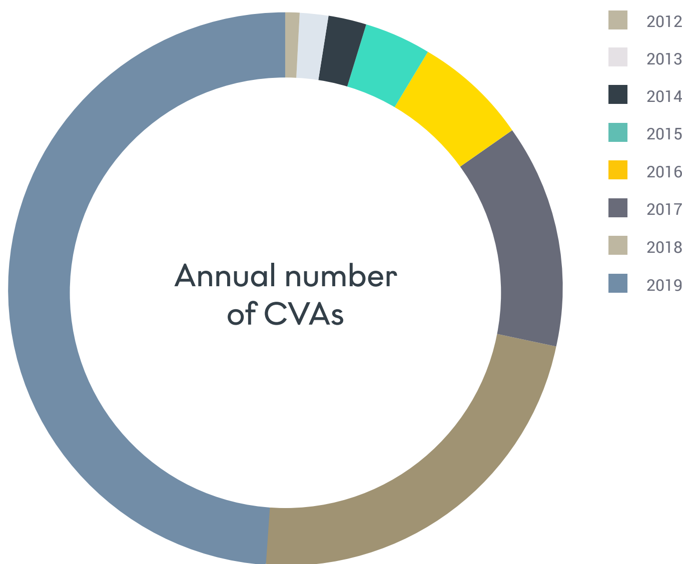
Day statutory moratorium period

Supply chain

The CVA can be a powerful tool for a company and its stakeholders operating in any sector of the UK economy, particularly those with a complex supply chain.

If one business struggles, there is usually a ripple effect for businesses in its supply chain or adjacent industries, and globalisation means companies can now also be impacted by problems overseas.

Figure 1



A typical timetable

Having concluded that a CVA is an appropriate route to help protect the business, the first step is to draft the proposal. This includes the preparation of a statement of affairs, which contains details of the company's creditors, debts, liabilities and assets, and an explanation from the directors that outlines the company's individual circumstances.

Conclusion

In the current climate it is more important than ever that companies and their advisers explore every avenue to promote the rehabilitation of businesses, be that through solvent rescue financing or through strategic and rationalised use of insolvency regimes.

The CVA should be used to preserve value for businesses that deserve it and it can provide an opportunity to creatively restructure and reposition companies that are determined to make a genuine change to their business models in order to protect the future of their organisation.

→ Restructuring advisory

→ Corporate restructuring

→ Corporate advisory

→ Contentious insolvency

→ Solvent restructuring

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