Company Voluntary Arrangement Guidance Notes

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CVA Guidance Notes

CVA Guidance Notes

What is a Company Voluntary Arrangement ("CVA")?

A CVA is a formal procedure which enables a company to compromise its liabilities to creditors, subject to an affirmative vote of 75 per cent by value of creditors voting on the proposal, with the principal aim of rescuing the company as a going concern.

The procedure is introduced by Part 1 of the Insolvency Act 1986 and is deemed to be a simple alternative to a Companies Act Scheme of Arrangement.

The process typically involves directors presenting a proposal to the Court, with the help of a qualified insolvency practitioner, and if the creditors accept the terms of the proposal the insolvency practitioner would supervise the arrangement and pay the creditors in accordance with the accepted proposals.

CVA Procedure

A CVA may be proposed by the directors of the company or, where a company is already in liquidation or administration, by the liquidator or administrator respectively.

Step 1: Viability

A CVA should only be proposed where a company is insolvent but, in the event that the historic debt of the company is written off and / or the Company is able to restructure its business, the underlying business is profitable.

It is therefore important to consider the following questions and, where it can be answered yes to each, a CVA would appear a viable option for your company:

Is the company insolvent?

There are three principal tests to establish if a company is insolvent:

- The cash flow test: Is the company unable to pay its debts as they fall due?
- The balance sheet test: Do the company's assets exceed its liabilities on the company balance sheet, i.e. do you owe more than you own?
- The legal action test: Has a creditor obtained a county court judgement or a statutory demand against the company which could lead to that creditor petitioning to wind the company up.

Is the company making a profit?

CVAs ordinarily (but not always) involve a monthly repayment schedule to creditors over an agreed period of time. In order for the CVA to be successful, the company would need to make sufficient profit so that there is a cash surplus available after the ordinary trading expenses and overheads to meet the repayment schedule laid out in the CVA proposal.

If the business is not profitable, or cannot be restructured on the approval of the CVA in order to generate a profit, then the company is unlikely to have a CVA successfully approved and/or implemented or avoid further financial difficulties, and more severe insolvency processes, in the near future.

Would the company have support of 75% of its creditors?

A total of 75% by value of creditors must be in favour of the CVA proposal in order for it to be passed and the company's debt compromised, e.g. where four creditors are voting on a proposal, each owed £20k, three out of the four creditors will be required to vote in favour of it in order for the proposal to be approved.

You therefore need to consider who the majority creditors are, the company's relationship with them and which creditors are likely to vote in favour of the proposal.

Would the company have support of 50% by value of unconnected creditors?

There are effectively two separate counts of the creditors' votes taken.
Assuming the first count of all unsecured creditors voting on the proposal, including connected creditors (such as relatives, business partners, businesses with common

directors, etc.), achieves the requisite 75% by value in favour, a second calculation is performed. For this calculation, the connected creditors' votes are excluded and 50% in value of the unconnected creditors voting on the proposal must be in favour.

Does the company have insufficient assets to repay its debts?

If the company owns assets, such as land and buildings, plant and machinery, vehicles, chattels, etc and these assets were sold and the sale proceeds were sufficient to clear the company's debt in full, creditors would ordinarily refuse to accept the proposal and expect repayment in full.

It needs to be demonstrated to creditors that the outcome for them in a CVA scenario would be superior to that in either a liquidation or administration scenario.

Step 2: Consider creditor pressure

The extent of creditor pressure on the company will affect the speed at which the CVA proposal will need to be drafted and whether any additional work will need to be done in order to protect the company against any enforcement action that may be instigated by a creditor prior to the CVA being approved.

The standard CVA procedure does not have the benefit of any statutory moratorium or protection from creditors. This means the company could be wound up and placed into liquidation whilst the proposal for a CVA is being drafted or considered by creditors.

The Corporate Insolvency and Governance Act 2020 ("CIGA 2020"), however, introduced a new moratorium which provides eligible companies with protection from its creditors and can be used by a company while proposals for a CVA are being drafted.

Where a moratorium is unavailable, the company may first be placed into administration or liquidation, which will provide the company with the necessary protection to prevent any enforcement action being taken by creditors. The appointed administrator or liquidator may then seek to rescue the company by proposing a CVA to creditors in the same way that the directors would have. On the approval of the administrators' or liquidators' CVA, the company would exit administration or liquidation and the directors would regain control of the company.

Please note, the ability to appoint a liquidator or administrator in order to facilitate a successful CVA may rely on the approval of the company's members, creditors or, where applicable, any floating charge holder. See additional Cork Gully LLP publications for guidance on the processes of placing a company into administration or liquidation.

Depending on the circumstances and the relationship the company has with the creditor threatening enforcement action, it may be possible for the directors, or any advising insolvency practitioner, to simply negotiate with the creditor in order to buy more time with which to present the proposal. This solution, however, does not provide any formal protection and a creditor could rescind on any agreement reached.

Step 3: Appoint a Nominee & draft the CVA proposal

Where the company is not already in administration or liquidation it is for the directors to propose a CVA and it will effectively be their proposal to the company's creditors.

The directors will first need to elect a Nominee, who must be a qualified insolvency practitioner. The Nominee is required to perform an independent and objective review of the proposal and report to the Court whether, in their opinion, the CVA has a reasonable prospect of being approved by creditors and implemented.

It is common practice for the selected Nominee to collate the information required for the proposal from the directors and draft the document on their behalf.

The CVA proposal is a formal legal document which, when approved, is legally binding. Many points must be covered as a matter of law and best practice, such as:

- Desirability
  An explanation as to why, in the director's opinion, a CVA is desirable and reasons why the company's creditors may be expected to concur with it. This should include some background to the company's affairs, reasons for the present insolvency and comparative outcome statements to alternative solutions.
- Assets
  Details of the company's assets, with an estimate of their realisable values, confirmation as to the extent to which assets are granted as security and charged to creditors and any particular assets which are to continued trading should be included.

— Statement of Affairs (signed by directors)
  A formal document quantifying the company's assets and liabilities and the present deficit to creditors and members needs to be signed by the directors of the company and attached. The document should also include an exhaustive list of the names and addresses of the company's creditors.
— Business
  An explanation as to how the business of the company will be conducted and funded during the course of the arrangement and the grounds for the belief that the company can return to profitable trading. This may include details of a proposed restructuring of the business after the approval of the CVA.
— Duration
  The proposed duration of the CVA should be given. It is not unusual for arrangements to last three to five years, with monthly contributions from trading profits forming part of the assets available to creditors for dividend purposes.
— Distributions & estimates
  The proposed dates of distributions to creditors, along with estimates of their amounts, should be given.
— Remuneration & expenses
  The amount proposed to be paid to the Nominee by way of remuneration and expenses should be stated. Also, the manner in which it is proposed that any subsequently appointed Supervisor to the arrangement should be remunerated and expenses paid, as well as the cost of any specialist advice needed by the company to implement the CVA.
— Guarantees
  Whether any, and if so what, guarantees have been given of the company's debts by other parties and which, if any, of the guarantors are connected to the company.
— Supervisor
  The identity and qualifications of the proposed Supervisor, along with his statutory powers and proposed functions, need to be set out clearly.
— Voidable transactions
  Any potential claims that the company may have against its directors under insolvency legislation, such as those relating to preferential payments to creditors, transactions at an undervalue or extortionate credit transactions, need to be disclosed where applicable and how it is proposed to indemnify the company in respect of such claims.

Step 4: Filing at Court

Once the proposal is completed, the directors must sign it and forward to the Nominee.

The Nominee will review the signed proposal and confirm his consent to act.

Within 28 days of receiving the signed proposal and consenting to act, the Nominee files in Court a copy of the proposal and a copy of the Nominee's report confirming that the CVA has a reasonable prospect of being achieved and that, accordingly, a meeting of creditors should be convened.

The CVA proposal is only filed at Court to ensure that it carries a legal originating number. The Court does not have an active role in the acceptance of the proposal, however, the CVA proposal sent to all known creditors and members must be a true signed copy of the document filed at court.

The director's proposal may be amended at any time, with the agreement of the Nominee, up to delivery of the Nominee's report to court.

Step 5: Meeting of creditors & members

Once the proposal has been forwarded to Court, it must be sent to all known creditors and members who will then consider the proposal's terms prior to the decision procedure.

The proposal must be sent with notice of the meetings of creditors and members, providing details of the creditors' decision procedure and the members' general meeting.

The decision procedure must be held within 28 days from that which the proposal was filed in court by the Nominee and at least 14 days' notice must be given to creditors (excluding the date of deemed delivery and the date of the meeting).

At the meetings, the Nominee will act as Chairman. There is no requirement for company directors / officers to attend the meetings unless notice for them to do so is specifically given by the Nominee.

Every creditor who has received notice of the meeting is entitled to vote at the meeting.

The creditors meeting has to take place first. Votes at this meeting are calculated according to the amount of the creditor's debt as at the date of the meeting or, where the company is being wound up or is in administration, the date of it going into liquidation or administration.

A creditor may vote in respect of a debt for an unliquidated amount, or any debt whose value is not yet ascertained, and for the purposes of voting (but not otherwise) his debt shall be valued at £1 unless the Chairman agrees to assign a higher value upon it.

The Chairman shall ascertain the entitlement of persons wishing to vote and shall admit or reject their claims accordingly.

A resolution to approve the proposal is passed when a majority of 75% or more creditors by value of those present and voting in person or by proxy have voted in favour of it. Any resolution to approve the proposal is invalid if 50% or more of the unconnected creditors by value do not vote in favour of it.

A creditor may also propose modifications to the proposal at the meeting for the other creditors to consider and vote upon.

Following the creditors meeting, the members meeting takes place. The members meeting can be held up to seven days later than the creditors' meeting and at a different venue where practicable. Votes at the members meeting are calculated according to the rights attaching to the member's shares in accordance with the company's Articles of Association.

Please note, the decision of the members meeting is irrelevant as the decision of the creditor's meeting has immediate effect and, where the members reach a different decision to that of creditors, the creditors' decision takes precedent.

Step 6: The CVA begins

Where the proposal for a CVA is accepted by creditors in accordance with the voting rules, the CVA takes effect from the time of the creditors' meeting and legally binds every person who was entitled to vote at the meeting (whether or not they received notice, were present or represented).

A report detailing the proceedings and outcome of the meetings of creditors and members is sent to the court, the creditors and the members by the Nominee acting in his capacity as Chairman of the meeting.

The nominated Supervisor of the CVA is now deemed to have been appointed and the director(s) of the company are responsible for placing the Supervisor in possession of the assets included in the arrangement as soon as possible.

Where the CVA provides for the company to contribute to the CVA instalments from future trading profits for a specified period of time, the Supervisor will monitor and safeguard such realisations.

The debts owed to the creditors are effectively compromised on approval of the CVA, however, this is subject to successful implementation of the CVA. If the CVA fails, for whatever reason, the debts revert to being repayable in full and an administration or liquidation procedure is likely to be instigated.

Step 7: End of the CVA

Once the Supervisor has received all assets payable into the CVA and paid a dividend to creditors in accordance with the proposal's terms, the CVA is deemed to have been successfully implemented and the balance of each creditor's debt as at the date of the meeting of creditors can be written off. The company is now debt free (subject to ongoing trading debts incurred following the meeting of creditors having been paid as they fall due).

The Supervisor must, within 28 days after the final completion of the CVA, send to creditors, members, the registrar of companies and the court a notice that the CVA has been completed. Once this has been done, the Supervisor will vacate office and the company is no longer subject to a voluntary arrangement.

Where payments have been made to creditors and an arrangement has been completed, any amount payable under the arrangement to a creditor bound by it, but who did not receive notice of it and thus could not submit a claim for dividend purposes, becomes a liability of the company.

Advantages of CVA

A CVA has a number of major advantages for a company with debt problems and its directors, shareholders and even creditors, particularly when compared to other formal insolvency processes such as administration or liquidation. The main advantages are:

- The company continues to trade under the control of its Directors.
- Historic debts are frozen and no further interest or costs will accrue.
- Fixed date of creditors meeting means crystallising of creditors positions and effectively a 'clean slate' thereafter for the company.
- Payment of debt is deferred therefore easing cash flow pressure.

- The balance of unsecured debt that the company cannot afford to repay is written off.
- The terms of the CVA are flexible; the company pays what it can afford to pay and certain assets may be excluded, such as those required to facilitate ongoing trade.
- Once approved, creditors are legally bound by the terms of the arrangement. They cannot rescind on the agreement.
- Once approved, creditors are unable to instigate enforcement action or winding up proceedings against the company. Additional court protection may also be obtained whilst the CVA proposal is considered by creditors.
- No public notifications are required; therefore, it may help preserve goodwill.
- It preserves jobs, shareholdings and the value of the company's book debt ledger.
- Higher returns to creditors due to future contributions from profitable trading or an eventual sale of the company as a going concern.
- Trade creditors can secure future orders.
- The need for a formal liquidation, administration or pre-pack sale of the company's business and assets is avoided. These processes incur professional fees and, where the directors seek to continue trading through re-acquiring the business and assets of the company, additional finance needs to be raised to facilitate such an acquisition.
- Existing finance arrangements may be left in place and personal guarantees not 'called in'.
- No report on director's conduct is required to be filed.
- The terms of the proposal may be varied (subject to creditor approval). If the company is struggling to meet the terms of the arrangement, creditors can be asked to reconsider the terms that were previously agreed.
- Tax advantages:
  - Capital gains on asset disposals may be set against losses.
  - No re-purchase of assets is required from administrators or liquidators thus saving potential stamp duty.
  - Trading losses are not lost and may be set off against future profits.
- Generally, a cheaper solution to more severe insolvency processes (however the individual circumstances of each case will determine the costs).

Disadvantages of CVA

Whilst the advantages of proposing a CVA are extensive, it is important to also consider the following disadvantages:

- Protection from creditors is not granted until the meeting of creditors has taken place and the CVA has been approved. Protection may need to be obtained whilst the proposal is being drafted and creditors consider its terms by either:
  - Appointing an administrator and therefore obtaining the benefit of the moratorium, however, this has the disadvantage of increased costs; or
  - Obtaining a moratorium pursuant to Part A1 of CIGA 2020, however, this procedure is not available for all companies.
- If the company cannot comply with the terms of the proposal the CVA will fail. In this event, liquidation is likely to be the only remaining course of action.
- Whilst there is flexibility to vary the terms of the CVA, this is dependent upon the creditors' approval. If the company's majority unsecured creditors are not on-side, the CVA proposal will not be approved.
- A CVA may affect the company's ability to obtain credit in the future.
- Creditors are able to challenge the approval of the CVA through applying to court on the grounds that it unfairly prejudices the interests of a creditor and/or there has been some material irregularity.
  - A claim of unfair prejudice will only succeed where the prejudice arises from the unfairness of the proposal itself, e.g. treating different types of unsecured creditors differently in regard to the payment of dividends.
  - Material irregularity involves procedural matters, for example, a complaint that the chairman of the meeting has rejected a valid claim for voting purposes or the omission of relevant information in the director's proposal. Emphasis should be placed on whether such irregularities were material to the proposal being either approved or rejected.
  - An application for such challenges must be made within 28 days of the Nominee filing his report on the outcome of the creditors meeting with the court.

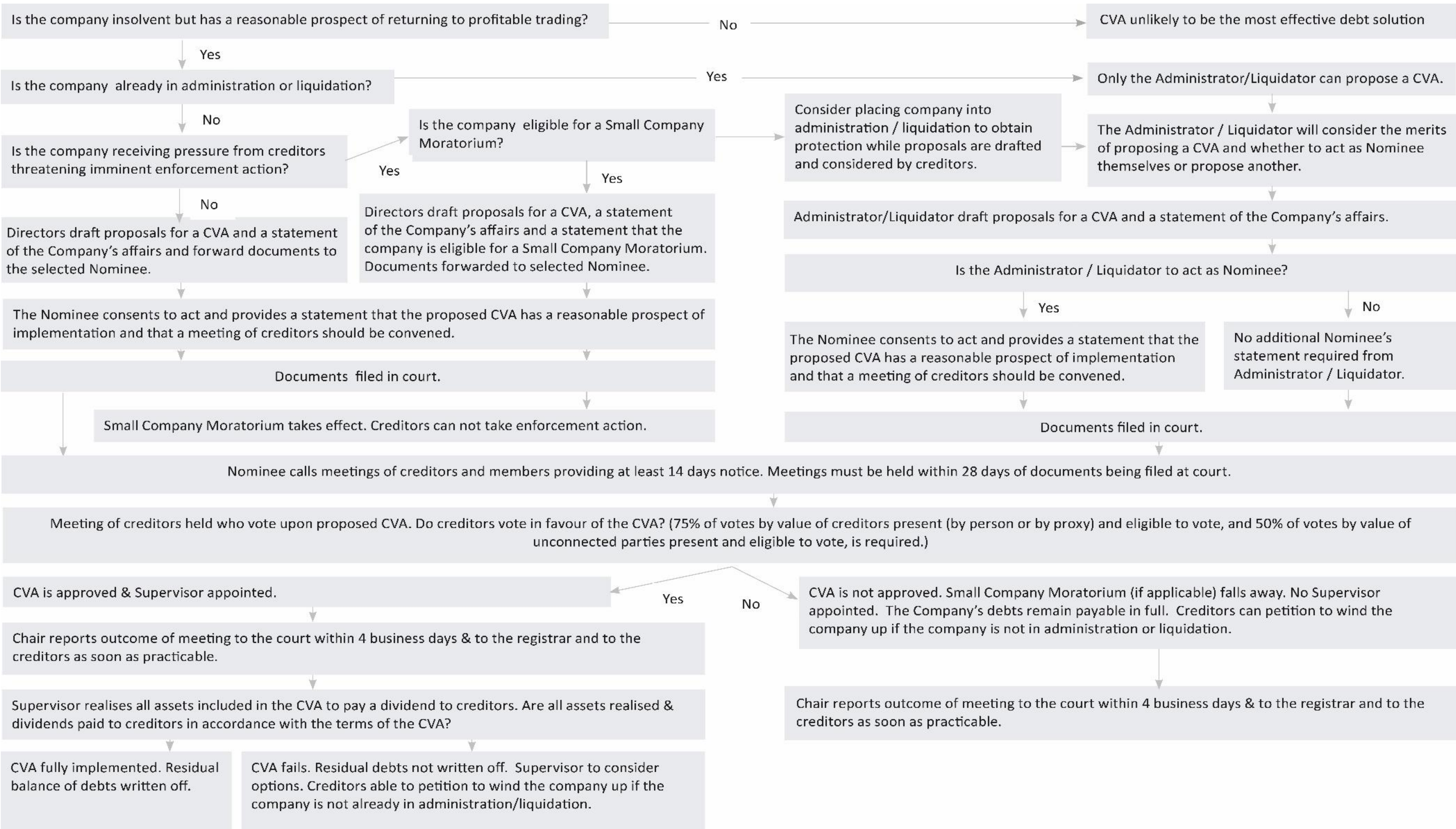
CVA's preceded by Administration or Liquidation

In the event that the CVA proposal is being presented to creditors and the company is already in administration or liquidation, the key differences in the procedures are:

- The drafted CVA proposal is deemed to be that of the administrator or liquidator and not that of the directors of the company.
- The nominee and supervisor are generally the liquidator or administrator already in office.

- Protection against enforcement action is automatically provided and therefore there is no need to consider applying for a moratorium.
- The relevant date for quantification of claims and the debt being compromised is taken as the day the company entered administration or liquidation as opposed to the day of the meeting of creditors.

CVA Flowchart



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