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Quickguides

An Overview of Company Voluntary Arrangements

Quickguide overview

This Quickguide provides an overview of company voluntary arrangements (CVA). It also sets out:

- the grounds on which a CVA can be challenged; and
- how CVAs compare with other insolvency processes.

An Overview of Company Voluntary Arrangements

1. Introduction to CVAs

What is a company voluntary arrangement?

A company voluntary arrangement (**CVA**) is a statutory procedure intended to assist in the rescue of a company in financial difficulties. A CVA allows a company to agree a composition or an arrangement with its creditors in satisfaction of some, or all, of its debts. In recent years CVAs have been used to restructure leases of underperforming properties, most notably in the retail and leisure sectors. CVAs have also been of assistance in compromising unsecured bonds, significant trade or unsecured guarantee liabilities.

The process for implementing a CVA is set out in Part I of the Insolvency Act 1986 (the **Act**) and the Insolvency (England and Wales) Rules 2016 (the **Rules**). A CVA is implemented under the supervision of an insolvency practitioner, but the existing management remains in place throughout the life of the CVA. Technically, there is no statutory requirement that the company proposing a CVA be insolvent or unable to pay its debts, but in practice a CVA is used where there is at least a risk of insolvency.

To be effective, a CVA requires the approval of the requisite majorities of the company's creditors and shareholders:

- in the case of creditors, a majority of three-quarters or more (in value) of those responding must vote in favour of the proposals to approve the CVA (a resolution will, however, be invalid if those voting against it include more than half of the total value of creditors unconnected to the company whose claims have been admitted for voting); and
- in the case of shareholders, more than half in value of the company's shareholders present in person or by proxy and voting at a meeting on the resolution to approve the CVA.

There are a variety of voting methods available for CVAs under the Rules. Previously, the nominee would automatically convene a physical meeting of creditors but following a change to the Rules in April 2017, a nominee can propose voting by correspondence or virtual meeting or other electronic means, marking a move away from meetings as the only way in which the views of creditors may be determined. However, creditors who meet certain threshold criteria may request a physical meeting, which is, in practice, what often happens, especially for higher value CVAs.

The CVA takes effect if approved by both the creditors and the shareholders. If there is a difference of decision between the creditors and the shareholders, the decision of the creditors will prevail, subject to any order of the court.

Once the CVA is approved, it binds all the company's unsecured creditors who were entitled to vote at the meeting (regardless of whether or not they voted) or would have been so entitled had they received notice of the meeting. However a CVA cannot bind secured or preferential creditors without their consent. Furthermore, a CVA must not unfairly prejudice the interests of any creditor.

Who can propose a CVA?

The company's directors, an administrator (where the company is in administration) or a liquidator (where the company is in liquidation) may make a proposal (**Proposal**) to the company and its creditors for a CVA. Neither creditors nor shareholders have standing to propose a CVA.

Who is the nominee/supervisor?

While the directors remain in control of the management of the company throughout the CVA process, an insolvency practitioner, called a nominee, is responsible for assisting the directors with the preparation of the Proposal. Once the CVA has been approved, the nominee assumes the role of

supervisor and oversees the subsequent implementation of the CVA. As part of their role, the nominee/supervisor will:

- consider the Proposal in order to form an opinion as to whether a CVA is an appropriate method of dealing with the company's affairs;
- prepare the nominee's report stating:
  - why the nominee considers the Proposal does (or does not) have a reasonable prospect of being approved and implemented; and
  - why the members and creditors should (or should not) be invited to consider and vote on the Proposal;
- summon the shareholders' meeting;
- invite the creditors to consider the Proposal by way of a decision procedure[1] and administer it; and
- if the Proposal is approved, assist in the implementation of the CVA and act as its supervisor.

Will a CVA result in a statutory moratorium?

Unlike an administration, the implementation of a CVA does not automatically result in a statutory moratorium preventing the creditors from taking action to recover their debts or enforce their security. However, it is possible for certain eligible or small companies to receive the benefit of a 28-day moratorium if they meet two or more of the following three requirements, being:

- a turnover no greater than £10.2m;
- balance sheet assets no greater than £5.1m; and
- no more than 50 employees.

In practice, this "small companies' moratorium" is rarely used.

A moratorium for medium or large companies can only be achieved if a CVA is combined with an administration, where the moratorium is therefore effected by virtue of the administration.

2. The process of implementing a CVA

Implementing a CVA involves the following steps:

Preparation of the Proposal and statement of affairs

The CVA process begins with the drafting of the Proposal and the preparation of a statement of affairs containing details of the company's creditors, debts, liabilities and assets, and an explanation from the directors explaining the company's circumstances. This is prepared by the directors (although in practice this is usually done in conjunction with the nominee and the company's legal advisers). A "nominee" will also be appointed to consider the Proposal and later supervise its implementation.

Consideration of the Proposal by the nominee, preparation of the nominee's report and the summoning of the shareholders' and creditors' meetings

Where the nominee is not a liquidator or an administrator, the nominee will consider the Proposal and, within 28 days (or such longer period as the court will allow) of receiving the Proposal, submit a report to the court. The nominee's report should be accurately written in a manner that aims to be clear and useful, and provide sufficient information to enable the company's stakeholders to make informed decisions in relation to the Proposal. No step towards implementing the Proposal can be taken until

[1] Note that the requirement for a nominee to obtain the creditor's approval by way of one of the decision procedures introduced by the Rules replaced the requirement for convening a creditor's meeting.

the Proposal and the nominee's report have been submitted to the court, although the court's role at this stage is purely administrative.

If the nominee recommends to the court that a meeting (or meetings) of shareholders be held and that the approval of the creditors be sought, the nominee may then go ahead and send the Proposal to shareholders and creditors. The nominee then summons the shareholders' meeting(s) and implements a decision procedure for the creditors to vote on the Proposal.

However, if the nominee is a liquidator or administrator, they may simply summon a meeting of shareholders and send out notices of the Proposal to the creditors at any time they think fit, without the prior need to refer to the court. The nominee's report will usually then be filed at court on the day the documents announcing the Proposal are dispatched to creditors.

Announcement of the CVA

The nominee must send notices to every shareholder, and every creditor of the company of whose claim and address the nominee is aware together with the following documents:

- a copy of the Proposal;
- a copy of the statement of affairs or a summary statement of affairs (which should include a list of creditors and the amounts of their debts);
- the nominee's report on the Proposal; and
- in the case of shareholders, details of each resolution to be voted on; and in the case of creditors, a voting form, a notice of claim form and a proxy form to be completed and returned;

The creditors must be given 14 clear days' notice of the decision date. The shareholders' notice period will be in accordance with its constitution.

The Shareholders' meeting(s)

The shareholders of the company will vote at their meeting(s) and decide whether or not to approve the Proposal with or without modifications. The nominee will usually be appointed as chairman of the meeting.

The Proposal must be approved by a simple majority of shareholders (subject to any conflicting provisions in the company's articles).

Creditors' decision procedure

The Proposal is considered and voted on by the company's creditors by way of one of a number of permitted procedures, which include e-mail, correspondence and virtual meetings. As a result, the company is likely to know well in advance whether it is going to achieve the necessary thresholds. A CVA cannot, however, be approved by deemed consent.

Given that the decision procedure which is used will need to allow for creditors to propose and consider modifications to the Proposal, it is likely that the "virtual meeting" procedure will often be the most appropriate choice. The creditors will also have the option to request a physical meeting, and this frequently happens.

The Proposal must be approved by three-quarters or more (in value) of those creditors responding. A resolution will, however, be invalid if those voting against it include more than half in value of the creditors unconnected to the company.

If the decisions taken by the shareholders and the creditors differ, the decision of the creditors' will prevail. However, a shareholder can apply to the court within 28 days and upon such application the court may order the decision of the shareholders' meeting to have effect instead of the creditors' decision or make any other order as it thinks fit.

Reporting the meeting(s)/decision outcomes

After the conclusion of the shareholders' meeting and the creditors' decision, the nominee (as chair of the meeting(s)) has the following obligations:

- to report the result of the shareholders' meeting(s) and the creditors' decision to the court;
- immediately after reporting to the court, to give notice of the results to all known creditors; and
- send a copy of the chairman's report to the Registrar of Companies.

Effect of approval

Should the Proposal be approved by the requisite majority of creditors and shareholders, the CVA will bind all the unsecured creditors who were entitled to vote on the Proposals.

This means that a CVA binds:

- creditors who voted in favour of the CVA;
- creditors who voted against the CVA;
- creditors who received notice of the CVA proposal but who did not vote; and
- creditors who would have been entitled to vote but did not receive notice of the CVA proposal, despite being entitled to be notified of it.

It is important to note that all unsecured creditors receive a vote in the process, even if their own liabilities are not being restructured. This means that creditors such as HMRC and the Pension Protection Fund may participate in the voting.

Dissenting creditors are therefore bound by a resolution of the requisite majority. Once bound by a CVA, a creditor is prevented from taking steps against the company that the terms of the CVA prohibit. Typically these terms will be drafted to prevent the creditor from recovering any debt that falls within the scope of the CVA, other than through the proposed mechanism.

3. Challenges to CVAs

Who can challenge a CVA?

Any person entitled to vote on the Proposal can, by application to court, challenge the implementation of the CVA within 28 days of the date the result of the vote is filed in Court.

On what grounds can a CVA be challenged?

In order to successfully challenge an approved CVA, it must either be shown that:

- there was some material irregularity at or in relation to the shareholders' meeting or the creditors' decision procedure, such as failure to supply the required information (*material irregularity challenge*); or
- that the CVA unfairly prejudices the interests of a creditor, member or contributory of the company (*prejudice challenge*). This is the more substantive form of challenge.

While establishing prejudice may be easy (any CVA which leaves a creditor in a worse position than before the CVA will be prejudicial), the more difficult question is whether the prejudice is "unfair". The court will usually compare the challenger's position with that of other creditors or classes of creditors. The court is also likely to consider whether the interests of the challenger would have been better served had the company been liquidated or subject to a scheme of arrangement under the Companies Act 2006.

Finally, note that these grounds of challenge are only concerned with events leading up to the implementation of an arrangement and not with complaints about the conduct of the

supervisor/nominee. There is a separate mechanism for creditors with complaints about the implementation of the CVA.

When hearing a challenge to a CVA, it is open to the court to make an order to revoke the CVA, or convene a meeting to consider a revised CVA, or dismiss the application.

What is the effect of a challenge on the continuity of the CVA?

Once the CVA takes effect, it continues to be effective even though a challenge is mounted. This is subject to any directions which may be given by the court. However, many CVAs are drafted so that they will only be implemented if and when any challenge is successfully resolved.

4. Why use a CVA?

A company should consider a CVA for the following reasons:

- **A CVA is a flexible tool**. CVAs do not dictate the content or shape of a deal. They simply provide a framework to make it binding. A CVA can stand alone or supplement other insolvency procedures, for example, administration. In addition, although the CVA is administered by an insolvency practitioner, the arrangement is between the company and its creditors; the supervisor is not a party to the agreement.
- **A CVA does not require the company to be insolvent**. This means that action can be taken early at the first signs of distress.
- **A CVA does not involve a court hearing** unless a CVA is challenged. It can, therefore, be cheaper than other formal procedures such as a scheme of arrangement.
- **A CVA is a mechanism to "cram down" dissenting unsecured creditors**. A CVA provides a mechanism which can be used to make commercial deals binding on all unsecured creditors even where there is a dissenting minority and so dispense with the need for unanimity.
- **If there is no need to compromise the claims of secured creditors**. Unlike a scheme of arrangement, a CVA cannot bind any secured or preferential creditor without his consent. A secured creditor is entitled to vote but only in respect of the unsecured part of its claim.
- **If EU recognition is necessary**. CVAs are recognised in EU Member States under the EU Regulation on Insolvency Proceedings. This means that a CVA is afforded automatic recognition across the EU jurisdictions (save for Denmark). This benefit may cease if the UK leaves the EU without a deal, however.

5. Disadvantages of a CVA

- **Unfair?** Dissentient creditors will be bound by the Proposal despite not having voted for the CVA.
- **Precursor to insolvency?**: While there have been cases where CVAs have been used to successfully rescue a business, there are also plenty of examples where a CVA has subsequently been followed by administration. For example, the Toys R Us CVA was proposed to creditors in December 2017. By 28 February 2018, the group had entered administration. According to figures published by PwC in March 2019, 51% of retail CVAs failed.

6. CVAs compared with schemes of arrangement

A scheme of arrangement is a statutory procedure pursuant to Part 26 of the Companies Act 2006, whereby a company may make a compromise or arrangement with its members or creditors. However, unlike a CVA, a scheme of arrangement can bind secured creditors even without their express consent if the requisite majorities are achieved.

A short comparison between schemes of arrangement and CVAs is set out below:

SCHEME OF ARRANGEMENT	CVA
Extensive court involvement.	Court involvement only if the CVA is challenged, therefore less costly.
Only creditors vote on the scheme of arrangement; no shareholder vote is required.	Shareholder majority also required, but any vote of the creditors will take preference.
Approval by different classes of creditors (arguably providing greater scope for veto or 'hold-out' rights to each category of creditors).	Single class of unsecured creditors. However, different groups of creditors can be treated differently within the single class.
Secured and preferential creditors can be bound by a scheme.	Secured and preferential creditors cannot be bound by a CVA without their consent.
No statutory moratorium.	Statutory moratorium available for small companies only.
No requirement to have a scheme administrator.	CVA process guided by a nominee/supervisor.
A scheme might not trigger insolvency-related cross-defaults as it is outside the scope of the insolvency statutory regime.	Would trigger insolvency-related cross-defaults in company contracts.
Jurisdictional requirement: sufficient connection to England and Wales.	Jurisdictional requirement: COMI in England and Wales.

7. CVAs compared with administration

An administration is an insolvency procedure set out in schedule B1 to the Act. An administration automatically triggers a statutory moratorium, thereby affording the company some breathing space in which to reorganise, refinance or effect a sale of its business.

A short comparison between an administration and a CVA is set out below:

ADMINISTRATION	CVA
Automatic statutory moratorium upon filing of a notice of intention to appoint administrators and the actual appointment.	No automatic statutory moratorium. As a result, CVAs are sometimes combined with administrations to benefit from the moratorium available.
Appointed administrators have custody and control of the company's business and assets. The powers of directors are severely curtailed to the extent that directors will only be able to exercise managerial functions with the express consent of administrators.	Directors remain in charge of the company.
Quick entry process but can be a lengthy implementation process.	Longer entry process, but can be quick and efficient implementation (depending on its terms).
No cramdown of creditors possible.	Cramdown of dissenting minority unsecured creditors possible.
Usually results in asset sales: companies rarely "emerge" from administration.	If CVA is successful, company lives to fight another day.
Duty on the administrator to investigate transactions and director conduct in the lead up to the administration, and power to bring challenges.	No opportunity for full investigation into the affairs of the company by the supervisor.

8. Future reforms

The government announced plans in August 2018 to introduce reforms to the UK's restructuring regime that would include a standalone statutory moratorium, which could be used in conjunction with a CVA. It is not yet known when such plans will be brought into law.

These reform plans also include a proposal to introduce a new rescue tool comprising a reorganisation plan process, broadly modelled on the scheme of arrangement, but with the additional ability to cram-down a whole junior dissenting class if certain conditions are met.

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