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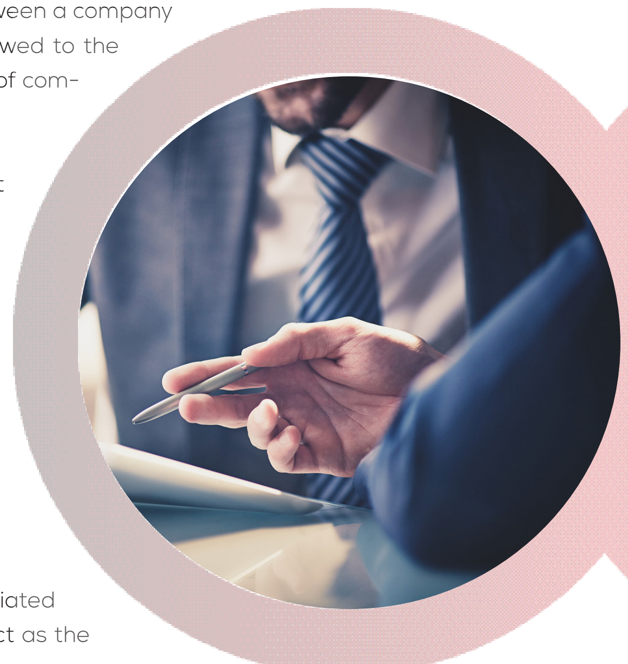
Guide to the Company Voluntary Arrangement Process

Moorfields
Corporate Restructuring & Insolvency

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

A Company Voluntary Arrangement ("CVA") is a legally binding agreement between a company and its creditors. Such an agreement proposes that all or part of the debt owed to the company's creditors be paid out of future profits or from a controlled disposal of company assets.



The primary objective of such a process is to preserve viable businesses whilst ensuring that creditors receive a higher return than they would do in the alternative processes such as liquidation or Administration.

During the CVA process, the existing management and directors remain in control of the company. One or more qualified Insolvency Practitioners ("IP") are appointed by the company to report to creditors on the proposal, as 'Nominee', and to monitor the progress of the arrangement as 'Supervisor" (once approved). The IP must retain independence from the directors and company and owes a duty to the creditors generally as well as the company proposing the CVA.

The process is set out in the Insolvency Act 1986 ("IA86") together with associated legislation and only persons qualified to act as Insolvency Practitioners may act as the 'Nominee' or 'Supervisor'.

When can a CVA be proposed?

Insolvent companies that wish to avoid liquidation or Administration may be able to use the CVA process. If a company is unable to pay its debts as they fall due or has liabilities in excess of its assets then it is insolvent.

It is important that directors of an insolvent company seek professional advice as to the options available and action that should be taken to avoid subsequent criticism from creditors or appointed Insolvency Practitioner. Failure to take steps to minimise the losses to creditors could render the directors personally liable for the debts of the company.

CVAs are not appropriate in all circumstances and specific advice should be sought. Some of the main matters that will be considered when determining whether a CVA is appropriate are:

- A viable business that is, or is returning to, profitability;
- A better outcome to creditors than in alternative Insolvency processes;
- A commercially acceptable proposal for repayment – both timing and quantum;
- Reasons for the financial difficulties;
- History of previous problems;
- Availability of additional funding;
- Relationships with key suppliers/creditors; and
- Management team – reputation and commitment to implementing the restructuring process.

It is paramount that the interests of creditors are considered at all times and if a CVA is not considered to be in their interests then a CVA will not be appropriate.

Who can propose a CVA?

A business loan / overdraft may or may not come from a main stream provider e.g. a Bank often referred to as a term loan, bridging loan, unsecured loan or overdraft.

Directors of a company can propose a CVA to the company's creditors. In certain circumstances a liquidator or Administrator may also propose a CVA (this document does not deal with this type of proposal).

Basis

Directors typically seek professional assistance in the drafting of the proposals from a firm of Insolvency Practitioners (and potentially a firm of solicitors depending upon the complexity of the proposal). However, the proposals are signed by the directors and the ultimate responsibility for them rests with them.

The proposals must be accurate and credible. Failure to ensure this is the case may result in creditors rejecting the proposals, the Supervisor failing the arrangement and placing the company into liquidation and any false information or misrepresentation by the directors within the proposals may be punishable by a fine, imprisonment or both.

The directors must ensure that the proposals are achievable as failure to implement the proposal may result in the company being wound up. In this respect directors must make realistic projections of future performance and take into consideration the potential effect of the CVA on its working capital requirements (e.g. some suppliers may require future supplies to be paid on a proforma basis).

Contents

The proposals are a complex legal document containing details of the proposal and setting out the operation of the CVA. The main items that the document would cover are:

- Background – reasons for the problems, historic financial performance, etc.
- Statement of Affairs – details of the assets and liabilities of the company together with the realisable values and the expected outcome in liquidation compared to the CVA.
- Proposals
- Level of monthly contributions and method of calculation;
- Period for which the arrangement will operate;
- Assets to be realised for the benefit of creditors;
- Details of any third party funds;
- Details of creditors to be included;
- Details of any creditors to be excluded and the reasons for this (note secured creditors must each consent if the proposals will affect their security);
- Whether the business is to continue to trade, any restrictions to be placed upon trade and the role of the Supervisor in monitoring the ongoing trade;
- Whether the business is to be sold as a going concern and how this is to be marketed;
- Powers and duties of the Supervisor;
- How funds are to be distributed;
- How the costs of the Arrangement are to be met and the basis for the remuneration of the Supervisor;
- Whether a creditors committee is to be formed, its role and functions; and
- Action to be taken in the even of default;
- Future performance – projections etc. to support the proposals; and
- How the business is to be funded – details of support from the secured lenders and any additional sources of finance.

Although CVAs vary considerably, the majority are based upon the company making set monthly payments to the Supervisor for the benefit of creditors, with an additional payment should it meet certain profit objectives. The term for the arrangement varies with a typical CVA lasting 5 years.

Key Stakeholders

Although drafted by the directors, the proposals must take account of the requirements of the various stakeholders in the business. It is usually necessary to discuss the draft proposals with the secured creditors who fund the business and any key suppliers as well as the company's shareholders.

The interests of these parties must be considered, although the directors have an overriding responsibility to the existing creditors of the company.

Process

The process for proposing and implementing a CVA is defined by the IA86. A summary of the main parts of the procedure are outlined below:

Moratorium

Once the proposals have been drafted, the directors consider whether protection from creditors is required during the period in the lead up to the meetings of members and creditors. This is typically required if there are aggressive creditors seeking to enforce their position through, for example, levying distress or repossessing key assets. In many circumstances the creditors can be dealt with through clear communication and no moratorium is necessary.

Small Company Moratorium

A CVA moratorium is only available to 'Small Companies' as defined by the Companies Act 1985. To be a small company it must fulfil 2 of the 3 following requirements:

- Turnover less than or equal to £6.5 million;
- Assets no greater than £3.26 million;
- No more than 50 employees in the last financial year.

In addition a company may not file for a moratorium if:

- An Administration Order is in force;
- The company is being wound up;
- There is an Administrative Receiver in office;
- There is a CVA in place;
- There is a Provisional Liquidator in office;
- There has been a moratorium in force during the last 12 months and either the CVA has no effect or the CVA came to a premature end; or
- The company is an insurance company, bank, holding company (unless part of a 'small' or 'medium' group), party to market or money market contracts, party to capital market arrangements where issued debt in excess of £10m or public/private partnerships with step in rights.

In order to obtain the moratorium the directors provide the Nominee with the proposal, a statement of affairs and any other information requested by the Nominee. The Nominee issues a statement confirming that they consider there is a reasonable prospect of implementation of the arrangement, there are sufficient funds for the company to continue to trade during the moratorium and that a meeting of members should be summonsed.

A moratorium becomes effective once the following documents are filed in court:

- The proposal;
- A statement the company is eligible;
- The Nominee statement above; and
- The Nominee's agreement to act.

The moratorium lasts until the meeting of creditors, but no longer than 28 days. During this time creditors are restricted in exercising their enforcement rights without consent of the Nominee or leave of court.

During this period the company must disclose the fact it is subject to a moratorium if obtaining credit of more than £250 and can only dispose of assets in the ordinary course of business (unless the Nominee consents).

Alternative moratorium

Should the company not qualify for the above moratorium then the appointment of an Administrator could be considered to protect the company against its creditors. Such an appointment would result in Administrators taking control of the company and making the proposal for a CVA to creditors. Once approved management would be handed back to the existing directors. The appointment of an Administrator is not covered by this document and requires a different process.

Endorsement

Once the proposals have been drafted the directors would send these to the IP together with a written notice of proposal. Where a moratorium has been sought, once filed in court the notice of proposal is sent to the Nominee.

Upon receipt of this notice the IP would endorse the notice and return it to the directors to confirm that the IP is willing to act as Nominee.

Statement of Affairs

The Statement of Affairs, detailing the company's assets and liabilities must be delivered to the Nominee within 7 days of the notice of proposal and must have been prepared no more than 2 weeks prior to the notice.

This statement must be certified as correct by 2 or more directors or one director and the company secretary.

In practical terms this is usually delivered at the same time as the proposal.

Nominees report

Once the above documents have been prepared, the Nominee would then prepare a report on the proposal covering the following:

- Extent of the investigations conducted by the Nominee into the company's circumstances;
- The basis of the valuations contained in the proposals;
- The attitude and co-operation from management;
- Extent to which reliance can be placed upon the values of liabilities included in the proposals;
- Result of discussions with the secured creditors and other parties upon which the proposals depend;
- History of previous failures;
- Alternatives available to creditors and why a CVA is considered more beneficial;
- The likely effect of rejection by the creditors;
- Details of any transactions that could be challenged in an alternative process; and Whether the Nominee is of the opinion that:
- The proposals have a realistic prospect of approval and implementation;
- A meeting of creditors should be summoned to consider the proposals; and
- The proposals are fair to creditors.

A copy of this report would be sent to the company and a copy filed in court together with the proposal and statement of affairs.

Convening meetings

14 days notice must be provided but the meetings must be held within 28 days of filing the Nominee's report. The meetings must be held on a working day between 10 am and 4 pm and take into consideration the convenience of creditors.

Every creditor and shareholder of the company must be circulated. Failure to do so could have significant implications to both the company and its directors.

Creditors' meeting

The creditors' meeting is held before the shareholders' meeting. Creditors may attend and vote in person or by proxy but they must provide details of their claim against the company. The chairman of the meeting is the Nominee or other experienced member of staff from the firm.

In order to be approved in excess of 75% of the value of creditors voting must vote for the acceptance of the proposals. In addition, there must be in excess of 50% in value voting for the proposals when connected creditors are left out of account.

At this meeting there are 4 potential outcomes;

- The proposals are approved;
- The proposals are approved with modifications;
- The proposals are rejected; or
- The Chairman adjourns the meeting for up to 14 days.

Creditors can suggest modifications to the proposals. If these are unacceptable the proposals may be deemed rejected or the meeting adjourned and discussions with the creditors undertaken to establish a mutually agreeable solution.

Shareholders' meeting

Following the meeting of creditors, the shareholders resolve on the proposals. For these to be approved, a simple majority is required.

Should the shareholders reject the proposals then the decision of the creditors takes precedent, although shareholders may appeal to court within 28 days.

What happens following the appointment?

The outcome of these meetings is reported to the creditors, shareholders, court and the registrar of companies.

Role of the supervisor

The role of the Supervisor would be set out in the terms of the proposal. Their responsibilities would include monitoring performance of the business and taking action considered necessary to protect the creditors' position. The Supervisor would not manage the business or take on any personal liability.

The company would typically be obligated to furnish the Supervisor with regular management accounts and information regarding the performance of the business.

Effect of approval

Once approved, all creditors circulated with the proposals would be bound by its terms whether or not they voted for or against them.

The existing directors continue to manage the company and implement the proposals. There is no need to disclose the CVA to future contracting parties but care should be taken to ensure that the company can meet its liabilities as they fall due.

The fact that the company is subject to a CVA is disclosed on Companies House and therefore the company's credit rating is likely to be affected by its approval.

Distribution to creditors

The proposals will set out when creditors receive payments out of the funds paid into the arrangement. There would typically be interim distributions where it is considered cost effective to pay funds to the creditors.

Effect of approval Default

The action required by the Supervisor in the event of a default would be set out in the terms of the proposal. In this event the Supervisor may be obligated to petition for the winding up of the company or in certain circumstances may be able to call a meeting of creditors to vary the terms of the proposal.

Completion

When the company has complied with the terms of the arrangement, it is released from liability in respect of the creditors bound by it. Therefore any amounts that remain owed to those creditors are effectively written off.

At this stage the Supervisor would seek to distribute any remaining funds, would file a certificate of completion and would cease to have any involvement in the company.

About Moorfields

At Moorfields, we understand that any business – no matter what its size – can experience a reversal in fortune. We also know that when things are taking a turn for the worse, innovative thinking is as important to your survival as capital. And that's exactly what we offer.

We're business owners ourselves, so we know all about the pressures of trying to keep your stakeholders happy. We've also got years of experience in the world of finance, so we know a thing or two about keeping companies afloat.

But our innovative thinking isn't just about expert business advice. It's about breaking the mould of insolvency and rescue practitioners: helping you through your problems, treating you like a human being, and actually understanding exactly what you're facing.

We'll never surprise you with last-minute charges, because our fees are totally transparent (and actually quite affordable). We'll also never try to force you into a one-size-fits-all solution. Because we get it: your business is unique.

Finally, we'll never back out when the going gets really tough. We do what we say we'll do. And whatever happens with your business, we'll be here to help you every step of the way.

If you would like to discuss how Moorfields can assist you with a CVA or any other issues please contact

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