Company Voluntary Arrangements: A Step by Step Guide

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A Guide to Company Voluntary Arrangements

What is a Company Voluntary Arrangement (CVA)?

A Company Voluntary Arrangement, or CVA, is a legally-binding agreement between an insolvent company and its creditors to repay all, or a proportion, of its debts over a specified period of time, usually from future profits. A CVA is a powerful restructuring tool which offers directors the opportunity to retain control of their business whilst operations are streamlined and the company is turned around, and offers creditors a better return than they would receive if the company were to cease trading and enter liquidation. Typically, CVA creditors can expect to receive 25-100% of their debts over a period of 3-5 years.

When is a CVA appropriate?

Generally, a CVA is appropriate where the core business is good, but trading is crippled by mounting cash flow pressures. This may be due to historic tax liabilities, insolvent customers, underestimated costs and job pricing, unprofitable contracts, or any number of other common problems. The business must have a viable future and committed directors: trading through a CVA can be extremely challenging, and the directors must be prepared for significant changes ahead. Essentially, the directors must be confident that the company will be in a position not only to meet all of its ongoing trade and tax liabilities, but also to make regular contributions to the Supervisor to pay CVA creditors. Working capital financing may be required.

What are the advantages of a CVA?

A successful CVA will result in the rescue of the company as a going concern, and there are numerous advantages along the way:

- Directors retain control of the business and can trade out of difficulty
- CVA is flexible and adaptable, and can be varied part-way through if necessary
- CVA may result in a substantial level of debts being written off, without necessitating the demise of the business
- The company can be protected from creditors whilst CVA proposals are prepared, giving the directors breathing space to consider their options for restructuring the business without the threat of legal action or winding up proceedings

- Although contributions are required in settlement of the company's debts, these are payable by instalments over time and can be structured to suit seasonal businesses
- CVAs can rapidly improve cash flow, as current liabilities frozen at the date of approval and debt repayments are consolidated into one regular (usually monthly) contribution
- A CVA is the only process which enables a trading company to reduce staff at no cost to the business
- A CVA enables a company to terminate unprofitable contracts and exit onerous leases at no cost to the business
- Unlike other formal insolvency scenarios, there is no investigation into the affairs of the company or the conduct of the directors
- The company can benefit from offsetting previous losses against tax on future profits
- All creditors are bound by an approved CVA, even if they did not exercise their right to vote on the proposals
- The costs of the procedure are lower than alternative options such as receivership or administration

As there are very few statutory requirements for a CVA proposal, the process is extremely flexible. The main principle is that the proposal is fair and reasonable, and has a good prospect of being approved and implemented.

How does the CVA process work?

Directors should seek professional advice as soon as they realise that the company is, or is likely to become, unable to pay its debts. Whilst the directors may have already concluded that they want to propose a CVA, a licensed insolvency practitioner (IP) can provide practical advice on all of their potential options, having regard to the particular advantages and disadvantages of each, and ensure that appropriate advice is given.

During this initial stage, the insolvency practitioner acts in an advisory capacity to the company and its directors, and will assist the directors in examining the company's financial position and preparing a business plan and cash flow forecasts for the proposed CVA. The IP will assist the directors in preparing their proposal (effectively, the deal to be put to creditors).

If necessary, protection can be obtained at this stage to prevent creditors from commencing or continuing any legal action, including winding up proceedings, against the company. For small companies, an application can be made for a small company moratorium. For larger companies, an administration appointment can be effected to give the company the breathing space it needs to propose the CVA.

Once the proposal is drafted and a statement of affairs prepared, the IP takes on the role of Nominee. His duty of care is now primarily to the company's creditors. The Nominee's role is to examine the proposal and ensure that it is reasonable and feasible, to prepare a report on the proposal to be filed at court, and to convene the meetings of members and creditors, on at least 14 days' notice, to consider the proposal. If the creditors are largely supportive, but require certain conditions to be met in order to approve the CVA, they may submit modifications to the proposal to be approved at the meeting.

The CVA can be approved by a simple majority of shareholders. At the subsequent meeting of creditors, however, 75% by value of creditors present and voting must vote in favour of the proposal for the CVA to be approved. In addition, in order to prevent CVAs being approved on the basis of the votes of connected parties, no resolution of the creditors' meeting can be valid where more than 50% of unconnected creditors have voted against it. The meeting can be adjourned for up to 14 days if necessary, in order for modifications to the proposal to be proposed and examined. If the proposal is not accepted after the final adjournment, it is deemed rejected and cannot proceed.

Once the proposal is approved, the IP is appointed as Supervisor of the voluntary arrangement. His duty is to monitor the progress of the arrangement, receive contributions, and distribute funds to creditors in accordance with the terms of the proposal.

What happens after the CVA is approved?

The company's liabilities crystallise on the Supervisor's appointment and from that point forward the company has a clean slate, but it must pay its ongoing obligations as and when they fall due, or the CVA will fail. Whilst the directors retain control and continue to manage the company and its business, the Supervisor will monitor the progress of the arrangement and ensure that the terms of the CVA are adhered to.

Periodically, the CVA funds will be distributed to creditors. The timescale for distribution will be determined by the proposal, but quarterly or annual payments are common for the duration of the CVA. The CVA is completed when the final contribution has been received and the final dividend paid to creditors, at which point the Supervisor will notify the company, the court and the creditors of the full implementation of the arrangement and the full and final settlement of all the CVA debts.

If there is a breach of the CVA (e.g. arrears of contributions, failure to meet ongoing tax liabilities), the directors will be given the opportunity to remedy the breach in accordance with the terms of the proposal. If the breach is not, or cannot be remedied, the CVA will fail and the Supervisor may petition for the company to be wound up compulsorily. In this event, contributions already paid to the Supervisor are held on trust for the benefit of CVA creditors and will be distributed accordingly.

Will creditors support a CVA?

Directors are often concerned that the company's creditors will refuse to support a CVA. However, many suppliers would prefer to receive a proportion of their outstanding debt and retain a customer, than lose the customer and potentially write off the entirety of the debt if the customer cannot avoid liquidation. Part of the Nominee's role is to engage with key creditors and ascertain their views on the feasibility of the proposal and the reliability and commitment of the directors. Creditors' concerns are very often alleviated during this process, as the Nominee will strive to address any concerns raised and ensure that the proposal contains the appropriate safeguards to ensure that the interests of creditors are protected.

What are the potential disadvantages?

Whilst the CVA procedure is extremely flexible and leaves the directors in control of their own business, some aspects may be considered disadvantageous in comparison to alternative insolvency processes:

- A typical CVA lasts for between 3 and 5 years. Where debts are not projected to be paid in full and HMRC are a major creditor, they are likely to require the arrangement to

continue for the maximum 60 months. Accordingly, a CVA requires a great deal of lasting commitment to the future of the company.

- If there is widespread creditor dissatisfaction with the directors and the way the company has been run, there may be difficulties in obtaining the requisite majority votes in favour of the CVA.
- Secured debts cannot be included, unless the secured creditor agrees to surrender their security. Also, the rights of secured creditors to enforce their security cannot be affected by the CVA.
- The company going forward will have no credit rating, and may experience difficulty in obtaining finance or securing credit with suppliers.
- The CVA proposal takes time to prepare, and although a moratorium can be obtained preventing precipitous action by creditors, an administration appointment may be more appropriate where the situation is time critical.
- The CVA is likely to require regular contributions from future profits. Although cash flow may be improved simply by the removal of historic liabilities, the company may experience unforeseen circumstances in the future which leave the directors unable to maintain CVA contributions.

Further information

If your company is struggling to pay its debts when they fall due, but you believe the business has a viable future and a CVA may be appropriate, contact **Bridge Newland** for advice on your options. Bridge Newland are licensed insolvency practitioners experienced in dealing with all types of company insolvency and turnaround scenarios. **Contact us** for more information.