pitmans

MAKING IT HUMANLY POSSIBLE

Turnaround or Fall Over?

Corporate Debt Restructuring through a Company Voluntary Agreement

In the current economic climate most businesses will experience temporary or longer term cash flow pressure resulting in stressful trading and creditor pressure.

Managing creditors within reasonable cash flow parameters is not only an essential part of business operations but also an integral part of effecting a successful turnaround. A business can initially approach its creditors with a view to trying to implement informal revised repayment terms or a “standstill” agreement. Such agreements are achievable in the short term but, one of the issues with informal agreements is that they may not bind all of the creditors and may be neither realistic nor certain depending on the circumstances. It only takes one creditor unilaterally to break ranks for such an arrangement to fail.

Alternatively, a company may use a Company Voluntary Arrangement (“CVA”) to come to a legally binding agreement with all of its unsecured creditors to pay off historic debt over a period of time thereby ring fencing liabilities to allow the company breathing space to trade on. A CVA is a useful restructuring tool where the underlying business is sound, the management are committed to a return to profitability and the continued trading of the business of the company will produce funds sufficient to service the CVA obligations as well as ongoing trading commitments.

To effect a CVA, the directors will propose terms to creditors aided by a licensed insolvency practitioner acting as nominee. The nominee will need to provide positive feedback on the efficacy of the proposal before it is presented to creditors and members. If the proposals are not realistic and place the company under too much financial pressure too quickly, at a time when it is already struggling financially, the CVA is unlikely to succeed.

A CVA must demonstrate that it satisfies a number of criteria, particularly the ability of the company to continue with profitable trading activity throughout the term of the CVA based on realistic forecasts and cash flows.

From the company’s perspective the CVA proposal will permit lower contributions at the start of the CVA increasing towards the end as the company recovers and becomes profitable. The CVA should be structured so that, as the company’s finances improve, then so do its contributions to creditors through the CVA.

The CVA must offer a greater potential dividend return to creditors than would be achieved if the company were to enter into insolvent liquidation. The creditors must approve the proposal by an excess of 75% in value. Some creditors will require standard or other terms to be included within a CVA before it will be approved particularly those creditors with whom there will be an ongoing relationship post CVA.

The term of the average CVA used to be 3 to 5 years. More recently the term has been shortened to, in some cases, a period of no longer than 12 months (with any time period over 12 months only being accepted in exceptional circumstances), on the basis that payment to creditors is to be made as quickly as possible. If creditors will only accept a 12 month CVA then consideration should be given as to whether the company will obtain any benefit at all from entering the CVA.

The nominee will usually become the Supervisor (of the arrangement but not the business) upon approval. Once approved the CVA becomes a contract between the company and its creditors. However, the rights of secured or preferential creditors cannot be adversely affected by the proposals for a CVA without their express consent.

CVA's are an effective tool to ring fence all or just certain liabilities. An example would be those owed to landlords (where the survival of the company depends on mid to large property portfolio liabilities being dealt with). However, care needs to be exercised in any CVA involving the composition of liabilities to landlords who have the benefit of parent or group company guarantees, where it is proposed to remove or strip out the guarantee.

CVA's are frequently considered as part of a toolkit to assist in the restructure of corporate groups where they may be proposed for the group as a whole or for just a small number of (or one) under performing subsidiary/ies within the group. In such cases, the subsidiary benefits from the CVA, allowing it time to get back on its feet, which in turn benefits the group as a whole. Such CVA's may need continued support from the parent or removal from the group structure in any event and will always depend on any cross guarantee group liability.

One of the perceived weaknesses of a CVA for the majority of companies is the absence of any moratorium on creditor action whilst the CVA is being approved. As such, it has become necessary in some cases for a company to enter into administration to achieve the purpose of "survival of the company" through a planned CVA exit from administration. For the directors of "small companies" there is a statutory moratorium available designed to protect the company from creditor actions whilst the CVA proposal is put to the creditors. A "small company" is defined as one whose turnover does not exceed £5.6 million; its balance sheet total does not exceed £2.8 million and has no more than 50 employees.

It appears that the popularity of the CVA is on the increase as a useful process in the right circumstances. The key to successful approval and implementation is to act proactively in relation to predicted cash flow difficulties based on up to date accounts and forecasts.

Suzanne Brooker
Partner, Head of Insolvency & Restructuring
T: +44 (0)118 957 0516
E: sbrooker@pitmans.com

Adrian Wilmot
Solicitor
T: +44 (0)118 957 0595
E: awilmot@pitmans.com

www.pitmans.com/insolvency-restructuring

REGULATED BY THE SOLICITORS REGULATION AUTHORITY UNDER NO 57601
A LIST OF PARTNERS IS OPEN TO INSPECTION AT 47 CASTLE STREET, READING
THE FIRM IS A MEMBER OF INTERACT EUROPE (A EUROPEAN NETWORK OF INDEPENDENT LEGAL PRACTICES)
VAT REGISTRATION NO GB199496974