COVID-19: UK INSOLVENCY REFORM - STANDARDISING COMPANY VOLUNTARY ARRANGEMENT PROPOSALS

Date: 3 November 2020

UK Restructuring and Insolvency alert

By: Jonathan Lawrence, Christina Nasioutzik

EXECUTIVE SUMMARY

R3 Association of Business Recovery Professionals (R3), a trade association for the United Kingdom's insolvency and restructuring industry, has launched a standard form proposal (Standard Form) for company voluntary arrangements (CVAs). A CVA is a contractual arrangement between a financially distressed company and its creditors. The Standard Form has been drafted in consultation with insolvency professionals and is being made available to the public at no cost. This comes in light of the COVID-19 pandemic (COVID-19) and the subsequent negative economic implications on businesses, especially small and medium-sized enterprises (SMEs).

BACKGROUND

Larger businesses, including retailers such as New Look, have used the CVA process during COVID-19, but CVAs were previously thought of as too costly and complicated for SMEs. R3's aim is that the Standard Form will make it easier for SMEs to restructure their businesses in a flexible and low cost way that will allow them to continue trading during COVID-19.

A CVA is a statutory agreement under Part I of the Insolvency Act 1986 between a company and its creditors. It allows the company to come to an arrangement with its creditors over payment of its debts or to pay only a proportion of the debt it owes, while continuing to trade. A company can only arrange a CVA through an insolvency practitioner and is required to show that the company is still viable as a going concern. The CVA must be approved by 75 percent (by debt value) of the creditors who vote. CVAs are legally binding on all unsecured creditors and will typically last from one to five years (although there is no legal limit). Once the CVA has been entered into, the company will need to make the scheduled payments outlined in the CVA.

The advantages of a CVA in comparison to certain insolvency processes are, among others, that the directors of the company remain in control throughout the process and the costs are typically lower.

KEY FEATURES OF THE STANDARD FORM

Key features of CVA proposals include a summary of why the company is insolvent, the value of the company's assets, a cash-flow forecast, and details regarding the duration and debt repayment schedule under the CVA.

Key features of the Standard Form include:

- A delayed period before payment of 100 percent of the company's debts (which R3 suggests should be six months). The duration of the delayed period will predominantly depend on the specific circumstances and creditors of the company, and the time periods suggested in the Standard Form should be viewed as guidelines only.
- An explicit statement that the company is experiencing financial distress due to COVID-19 and for which the company will have to provide supporting details of its circumstances.
- New trading costs incurred during the CVA are to be paid out of new trading income and support from the UK government, where available.
- An additional introductory period of a maximum of three months, designed for companies that are still unable to restart their operations following the initial UK lockdown that began on 16 March 2020.
- A moratorium against creditors enforcing their historic pre-CVA debts during the "introductory period" and the "breathing space period" of the CVA. The Standard Form also includes mechanisms to extend these periods.
- During the CVA, a number of restrictions will apply to the company's operations, including declaring dividends, increasing directors' salaries and borrowing or selling the company's business or assets (save in the ordinary course of business) without the consent of the CVA supervisor (the supervisor) or creditors.
- The ability to suspend payments if the company is located in an area that is currently under a local lockdown (such as businesses forced to close if they are in Tier 3 area).
- The ability to seek further decisions if more significant changes become necessary due to COVID-19.
- The costs of the supervisor are to be met from the company's operational cash flow.
- It will be a breach of the CVA if the company fails to meet its post-CVA trading liabilities or breaches the CVA restrictions. Upon breach, the supervisor may take steps to terminate the CVA and petition to wind up the company.

The Standard Form also includes the following appendices:

- Standard conditions (based on the R3 standard conditions for individual voluntary arrangements, with amendments to make them appropriate for companies, as opposed to individuals).
- Agreed amendments to the Standard Form between the creditors and the company will be shown separately so that creditors are able to compare the CVAs of multiple debtors.
- Statutory information the directors are obliged to provide to creditors, such as the members of the company.
- A summary of financial information about the company.
- A brief history of the company, including how the company has been affected by COVID-19 and details of furloughed employees.

- The remuneration and expenses of the proposed supervisor.

The Standard Form is designed to be read together with the Insolvency Act 1986 and the Insolvency (England and Wales) Rules 2016. R3 has also announced that specific standard form versions of the Standard Form will be prepared for Scotland and Northern Ireland to reflect jurisdiction-specific legislation.

A CVA will come into force when approved by 75 percent (by debt value) of the company's creditors. There is a further condition that no more than 50 percent (by debt value) of any creditors who vote against the proposal are creditors who are unconnected with the company. A CVA binds all creditors, including those who voted against it and those who did not vote. We note that secured creditors cannot be bound to a CVA without their consent. Once bound by the CVA, a creditor is prevented from taking steps against the company that the terms of the CVA prohibit. Once the payment period begins, the proceeds will be paid in the order set out in the Standard Form, which prioritises ordinary preferential creditors and secondary preferential creditors to unsecured creditors.

The main advantage of the Standard Form is the moratorium placed on creditors, which gives the company some breathing space before its creditors can enforce their debts against it. The Standard Form can also be used in conjunction with the new moratorium for businesses introduced by the Corporate Insolvency and Governance Act 2020.

It is important to note that the Standard Form is not "one size fits all." The Standard Form is also not intended to replace professional advice. Rather, it is intended to provide a foundation, which will save time and costs and make CVAs more accessible for SMEs. Before proceeding with a CVA, companies should consider with their legal advisors whether a CVA is the correct route to deal with the company's debts or whether another route (such as administration) would be more suitable.

CONCLUSION

Although CVAs are a bespoke process, the Standard Form will undoubtedly aid SMEs considering the CVA process. With the number of company insolvencies set to increase in the United Kingdom over the next few months, it is likely the Standard Form will be a useful tool for SMEs to set the foundation for further negotiations with their creditors. That being said, we note that the UK tax authority (HMRC) will fall into the definition of "secondary preferential creditors" from 1 December 2020 under the Finance Act 2020. If a company owes a large debt to HMRC, then any proposed CVA will most likely fail. Whether this leads to a decrease in CVAs after 1 December 2020, or if the UK government will intervene in light of COVID-19, remains to be seen.

KEY CONTACTS

JONATHAN LAWRENCE
PARTNER

LONDON
+44.20.7360.8242
JONATHAN.LAWRENCE@KLGATES.COM