
# CVAs: An Overview for Lenders

Key takeaways for a lender:

- In the right context, a company voluntary arrangement ("CVA") CVA can be an effective and quick way for a company to address causes of financial stress in its business
- With the support of 75% (by value) of the unsecured creditors who choose to vote on the proposal (at least 50% of whom must not be connected to the company), a company can use a CVA to impose legally binding terms on dissenting unsecured creditors
- A CVA proposal must be sent to all known creditors at least 14 days before holding a vote. All unsecured creditors have a vote, whether or not the proposal affects their rights
- A CVA proposal carries risks for the business and therefore for all stakeholders (including lenders), notably due to the lack of formal protection from creditor action during the proposal period
- In all but the most exceptional circumstances, a lender (secured or unsecured) can be assured that in practice a borrower will not propose a CVA without first obtaining the support of its lender(s)
- Borrowers that meet the criteria of a “small” company have certain additional rights to help them in proposing a CVA, which include temporarily suspending a secured lender’s enforcement rights
- A company’s intention to propose a CVA may be welcomed by its lender(s). With the assistance of its own advisers, at an early stage, a lender will want to scrutinise a potential CVA proposal, understand the associated risks and the situation generally

## A controversial procedure?

Some high-profile corporate failures have been preceded by a CVA e.g. the UK retailers **BHS** and **Toys R Us** both used a CVA only shortly before collapsing into administration. As a result, the CVA as a restructuring tool is not universally held in high regard and a CVA proposal can often be viewed by certain stakeholders with suspicion.

A view is that a CVA is too often used as a “sticking plaster”, to delay insolvency or as a last roll of the dice, which can result in prejudice being suffered by some or all of the creditors. Defenders of CVAs say that a CVA is used only by companies that are already in a reasonably high degree of financial distress and the failure rate for such CVAs should be viewed in that context, without necessarily meaning that a CVA was the wrong choice.

The recent prevalence of "landlord only" CVAs has resulted in certain landlords crying foul, as further explored below.

It is our view that a CVA is an important part of the restructuring toolkit and can be a key factor in a company’s successful turnaround. The success of a CVA, as with any other restructuring tool, depends on a myriad of other factors and each one needs to be considered on its merits and in the specific circumstances.

**What is a CVA?** In a nutshell, a company voluntary arrangement ("**CVA**") is a mechanism provided for under statute that enables a company to enter into some kind of compromise or arrangement with its creditors overseen by an insolvency practitioner which, once approved by the requisite majority of unsecured creditors, is legally binding on all unsecured creditors.

**Uses of a CVA:** Typically, a CVA will include a re-scheduling or reduction in a company's unsecured debts (or some of them) as part of a company's attempt to address its financial difficulties and thereby avoid entering administration or liquidation.

CVAs have been extensively used in the last 10 years or so and particularly in 2017 and 2018, by UK companies as a means to rationalise their leasehold commitments without needing to agree terms with every landlord. So-called "landlord only" CVAs, used to reduce the rent for a period of two to three years on certain sites and exit completely other sites, whilst other unsecured creditors are unaffected, have been popular among UK retailers (e.g. **House of Fraser**; **Mothercare; Carpetright; Toys R Us** and **BHS**) and in the casual dining sector (e.g. **Jamie's Italian**; **Byron Burger**).

A CVA can also be used to "clean up" a company as part of preparing it for sale, where that is a better means of realising value than an asset sale by an administrator e.g. **Oilexco**, the oil and gas E&P company.

As well as its use as a rescue tool for struggling businesses, a CVA can be used by insolvent companies as a mechanism to distribute funds to creditors as an alternative to liquidation.

This note considers only CVAs as a rescue tool, and focuses on a lender's perspective.

## Advantages of a CVA

- No need to prove insolvency, so a CVA can be used by a company when there are early signs of financial distress
- Legally-binding and flexible tool that can be used to cram down dissenting unsecured creditors
- Relatively quick, with no court hearings (unless challenged) and tends to be cheaper than other formal options such as administration or a scheme of arrangement
- The directors remain in control (albeit with implementation of the CVA overseen by a supervisor) and the company is able to carry on trading largely as usual
- At present and pending Brexit, a CVA benefits from being automatically and compulsorily recognised in all EU States (other than Denmark), unlike a scheme of arrangement, for example, where there can be uncertainty (although local law advice would be needed on the effectiveness of compromising claims arising under laws other than in the UK).

## Disadvantages of a CVA

- No automatic moratorium: other than for "small" companies[1], a company proposing a CVA does not benefit from a moratorium and so is vulnerable to actions that creditors may take, such as applying for a winding-up order, re-possessing assets or forfeiting a lease. For this reason, CVAs are sometimes combined with administration to benefit from the moratorium that arises in an administration
- A CVA cannot affect the rights of a secured creditor[2] to enforce its security without its express consent
- A CVA cannot be used to reduce the priority of any preferential debt or treat preferential creditors unequally without the preferential debt holder's express agreement
- Stigma? Although intended as a rescue tool that can be used by companies at an early stage of financial distress and without any insolvency requirement, a CVA may still be perceived as a public declaration of potential (if not actual) insolvency that could damage the business irrevocably. The process is also likely to put the business under intense pressure, pending approval of the CVA

> *"… the success of a CVA…depends on a myriad of other factors*

## What level of support is needed for a CVA to be approved?

To become binding, a CVA proposal must be voted for by at least 75% (by value) of the company's creditors who participate in the decision-making process[3] and will be approved unless more than 50% (by value) of unconnected creditors vote against it[4].

[1] See page 5 for meaning of "small"
[2] See page 4 for meaning of "secured creditor"
3 As a result of recent changes to the Insolvency Rules, physical meetings are only available where requested by the relevant threshold of creditors: that is 10% by value, 10% in number or simply 10 creditors. Alternative decision making procedures include virtual meetings (for example, by skype), electronic voting and correspondence.

4 There is a broad and quite complicated definition (in the Insolvency Act) of what makes a company "connected" to a party (in this case a creditor) and it includes, for example, other wholly-owned group companies, directors and parties that hold the right to exercise a third or more of the voting power of the company (or another company which has control over the company, such as a holding company and the ultimate parent).

> …determining the voting rights of creditors…can be difficult…

The company's shareholders are also given the opportunity to vote on a CVA proposal but the shareholders' support is not needed if the creditors vote in favour of it. Therefore, effectively the creditors' views prevail over those of the shareholders, subject to a dissenting shareholder's right to challenge a CVA (see below).

A CVA that is approved by the requisite majorities binds all unsecured creditors, including those that voted against it and including those creditors who did not even receive notice of the proposal.

Determining the voting rights of creditors in relation to disputed, unliquidated or unascertained debts can be a difficult and potentially contentious task for the nominee (acting as Chairman of the creditors' meeting), given that the value of the debt owed to a creditor determines that creditor's voting power on the CVA proposal. The general position is that claims of an unascertained amount will likely be admitted, for voting purposes, for £1 unless the Chairman can safely and in good faith attribute a higher value to the claim. Case law shows that the court is unlikely to allow challenges to estimates of the amount of creditors' debts if they are made by the nominee in good faith.

### Can any company use a CVA? Are there any eligibility criteria?

Any company or LLP incorporated in England and Wales (E&W) or Scotland may use a CVA. An overseas company may also use a CVA if its centre of main interests (COMI) is located in E&W or Scotland or in another EU member state (other than Denmark) or if its registered office is within the EEA.

Unlike with a directors' application to put a company into administration, there is no express requirement that a company be unable to pay its debts (or be likely to become unable to pay its debts) in order to be able to propose a CVA. Nevertheless, the company will need to show a degree of financial stress to persuade creditors to support a CVA proposal that requires concessions on their part.

### How are unsecured creditors' rights protected?

**-Notice**: the company is obliged to send notice of the proposed CVA to all known creditors (including secured creditors) at least 14 days before the decision date[5]. Failure to do so could result in the CVA being overturned on the grounds of procedural irregularity and for the directors to fail to do so deliberately is a criminal offence.

**- Prescribed contents**: statute requires that a CVA proposal sets out all *'matters that the [company] considers appropriate to enable creditors … to reach an informed decision'*. Such matters must include for example: (1) how creditors connected with the company will be dealt with; and (2) if there are circumstances that could give rise to a preference or undervalue claim if the company entered administration or liquidation. It is a criminal offence for a director to make a false representation for the purposes of obtaining the approval of a CVA proposal.

**- Independent view on proposal**: directors who plan to propose a CVA must involve a person who is authorised to act as a "nominee" for the proposal. This is typically a licensed insolvency practitioner, although there are some other persons who can be so authorised.

Before the CVA proposal can be formally proposed to creditors and shareholders, the nominee must make a statement to court that in his or her opinion the CVA has a *'reasonable prospect of being accepted and being implemented successfully'*. As part of his/her assessment, the nominee must be satisfied that cash flow forecasts show that the company will be able to meet the CVA terms.

**- Opportunity to challenge**: in the 28 days after the outcome of CVA meetings has been reported to court, any creditor or shareholder may challenge the approved CVA by application to court on grounds that:

(i) the CVA unfairly prejudices the interests of a creditor or shareholder; and/or

(ii) there has been some material irregularity at, or in relation to, the meetings at which the proposal was voted upon.

There is no single or universal test for what constitutes 'unfair prejudice'. A CVA will, by definition, be *prejudicial* to those creditors whose interests are being in some way compromised by the CVA. The real question therefore is whether a

[5] A creditor will receive: the CVA proposal; the company's statement of affairs; and the nominee's comments on the proposal as well as a guide as to how to vote.

disgruntled creditor (e.g a landlord being compromised by a "landlord only" CVA) can satisfy the court that such prejudice is *unfair* and persuade the court to exercise its power to revoke or suspend the CVA notwithstanding that it was approved at the creditors' meeting. The court will consider the question of fairness in all of the circumstances and will compare the relevant creditor's position under the CVA with:

> *… debt owed to secured creditors cannot be compromised by a CVA and must be dealt with by direct negotiation or be repaid in full*

- the position which the creditor would be in absent the CVA (the "vertical comparison"), i.e. what is the likely alternative scenario to the CVA – typically an insolvent liquidation or administration – and is the creditor clearly better off under the CVA?
- the treatment of other creditors under the CVA (the "horizontal comparison"), i.e. is the relevant creditor worse off when compared to other creditors and, if so, is any differential treatment based on objective criteria and/or necessary for the survival of the business as a going concern, such that is not unfair.

**- Supervision of implementation**: the nominee becomes the supervisor of the CVA, whose job it is to oversee implementation of the CVA in accordance with its terms.

### What about secured creditors' rights and role?

A CVA cannot affect the right of a secured creditor[6] to enforce its security, except with its express consent. This effectively means that debt owed to secured creditors cannot be compromised by a CVA and would need to be negotiated separately, or be repaid in full.

A lender's right to enforce security (or crystallise its floating charge over the company's assets) will be temporarily suspended if a CVA is proposed by a "small" company. See further below under 'What is a "small" company…'.

Secured creditors cannot vote on a CVA, save to the extent that their debt is unsecured. See further below under 'A lender's perspective'.

### What role does the court play in a CVA?

In short, the court plays a purely administrative role, unless the CVA is challenged.

A nominee's report (mentioned above) is simply filed at court as a report on the outcome of the creditors' meeting. The court has no judicial role in relation to a CVA unless a CVA is challenged.

> *… the court has no judicial role in relation to a CVA unless challenged*

### Why would a creditor vote in favour of a CVA?

Creditors are usually willing to support a CVA that has been thoughtfully put together - even though they are unlikely to recover all that they are owed - as opposed to alternative solutions such as liquidation, which would see them receive significantly less and perhaps nothing.

Once a CVA becomes effective, existing contractual terms are deemed changed to reflect the terms of the CVA. Agreements are usually reached in situations where creditors stand to gain more by accepting the CVA proposal, rather than forcing the company into administration or liquidation. An added benefit for some of the affected creditors may be the potential of trading with a viable counterparty in the future.

For a CVA to be approved, creditors will need reassuring that the payment proposals and projections are realistic as part of satisfying themselves that the CVA will improve the prospects of the company continuing as a going concern.

With a "landlord only" CVA, a landlord may prefer to accept a reduction in rent to taking back the premises and then having to find a new tenant.

### What is the process and the typical timeline?

It will typically take at least two to three months from advisors being engaged by the company to a CVA being approved.

A general outline of the CVA process:

- A licensed insolvency practitioner (**IP**) is approached by the directors – the IP will assess the company's situation and decide whether a CVA is appropriate and potentially viable. The views of the company's lenders will likely be sought at an early stage

[6] A creditor is considered to be a "secured creditor" if in England & Wales it holds any mortgage, charge (fixed or floating), lien or other security over property of the company in respect of its debt

- A CVA proposal will be prepared by the company's lawyers following the IP's detailed review of the company's business, its liabilities and assets (often with the input of property specialists). Key creditors (or industry representatives such as the British Property Federation in the case of landlords) may be consulted and the proposal may be revised in the light of comments received. If the company has a defined benefit pension scheme, it may also be necessary or appropriate to engage with the scheme trustees and Pension Protection Fund (and possibly The Pensions Regulator)
- The IP must be satisfied that the final form of the proposal has a reasonable prospect of being approved and implemented and therefore should be put to creditors
- The final form of the proposal, together with the nominee's report and the company's statement of affairs, is filed at court. Copies of the same are sent to all known creditors
- The IP arranges separate meetings for creditors and shareholders to be held not less than 14 days from the date of delivery of the CVA proposal and other papers
- The IP chairs each meeting and, on successful approval, files a report with the court, all creditors and Companies House within four business days of the meetings. The report details the outcome of each meeting, the attendees, and the results of each vote
- The CVA takes effect from the time of approval at the creditors' meeting
- The 28 day 'cooling off' period, mentioned above, begins on the day that the IP files his/her report at court

## What is a "small" company and how does the process differ for such companies?

A "small" company is any company which satisfies at least two of the following criteria:

(a) turnover not more than £6.5 million;

(b) balance sheet total not more than £3.26 million; and

(c) not more than 50 employees.[7]

Certain types of companies that meet the above-mentioned criteria are nevertheless ineligible for the temporary moratorium. These include any bank, insurance company, PPI company or a company that has incurred a liability under an agreement in excess of £10 million.

By filing documents at court, any "small" company which intends to propose a CVA can avail itself of a temporary moratorium (of 28 days and which is extendable by the shareholders or creditors for up to a further 2 months) while it formulates its CVA proposal. In broad terms, the moratorium prevents other insolvency proceedings being commenced or enforcement action being taken in respect of the company or its property. It also prohibits a lender from enforcing its security or crystallising a floating charge.

## What happens if a CVA fails?

Well-advised companies will tend not to circulate a CVA proposal without first having a high degree of confidence that it will be approved. In practice, the terms of a CVA proposal are often negotiated in advance of creditors being asked to vote on it.

What happens if a CVA proposal is rejected by the creditors will depend on the circumstances. It may well be that the directors are left with little choice but to put the company into administration or liquidation.

A CVA may come to an end prematurely if it is not fully implemented. The supervisor must file notice that the CVA has been terminated (within 28 days of termination at court and with the registrar of companies) setting out the reasons for failure and summarising receipts and payments.

If the supervisor considers that the CVA should be abandoned (for example, because the company can no longer comply with its obligations under the terms of the CVA), the supervisor may apply to the court for an administration order, or an order that the company be wound up.

When considering a proposed CVA, among the points lenders will want advice on is whether it is proposed that any assets be put in trust outside the lenders' security.

A landlord will want to know, for example, if rent reduction imposed on it as part of the arrangement would be reversed if the company enters liquidation or administration before the end of the CVA term (a so-called 'spring back' clause).

[7] Each of the BPF and the PPF has issued guidance on CVAs, prompted in each case by the recent proliferation of "landlord only" CVAs. The PPF's guidance (dated 1 June 2018) includes a list of the issues that that the PPF expects an employer and its advisors proposing a CVA to address as part of a "landlord only" CVA, failing which the PPF would expect to vote against the proposal.

## A lender's perspective:

### *With all CVAs*

In theory, a CVA could be proposed by a company without first consulting its lender(s). In practice, it is extremely unlikely that a company could successfully propose a CVA without first having the support of its lender(s).

As for formal protection that a lender has in connection with a CVA:

— **Formal limits**: as noted above, a CVA cannot affect the rights of a secured creditor to enforce its security without the creditor's express consent. In practice, this means that a company is not able to use a CVA to reduce the indebtedness it owes to a secured creditor unless the secured creditor agrees (in contrast to what can be achieved with a scheme of arrangement, for example)

— **Event of Default**: a company taking formal steps towards the proposal of a CVA is likely to be an event of default under the loan agreement (but this may not be clear cut in all documents and should be checked). If so, the company will likely need the lender's formal consent before it proposes a CVA, even if the lender does not have any security over the company's assets

— **Nominee's report**: for a nominee to be willing to make the requisite statement to court that in his or her opinion the CVA has a reasonable prospect of being accepted and being implemented successfully, he/she will need (among other things) to see that the company has the support of its lender(s) to the extent that the company is reliant on credit facilities provided by the lender(s)

Unsecured lenders can vote on the proposal (even if the proposal does not seek to amend their rights at all) and their vote will be valued at the amount of the indebtedness they are owed as at the day of the creditors' meeting.

Secured lenders do not have a vote in connection with a CVA proposal save that, if part of the lenders' debt is underwater (i.e. the amount of debt exceeds the value of the assets secured), the lenders are entitled to vote in respect of that "unsecured" element. For this to happen, the lenders would need to agree with the Chairman of the creditors' meeting (the nominee, most likely) the value of the lenders' security and therefore the amount for which their claim can be admitted for voting purposes. A separate point, to be assessed in the circumstances, is whether a lender wants to vote *and be seen to vote* (for example, on a proposal that may not affect the lender's rights but compromises the claim of various unsecured creditors).

### *With "small company" CVAs*

A secured creditor cannot enforce its security for the duration of a CVA moratorium without the consent of the court. There are also rules that prohibit a creditor from relying on the start of a CVA moratorium to crystallise a floating charge, irrespective of what the security documents provide.

There is no requirement to notify a secured creditor before filing for a CVA moratorium. However, from a practical point of view, the company may be unable to fund the business during the period of the moratorium without the secured creditor's support, noting also that a secured creditor's consent is required before the company can dispose of charged property. Accordingly, a lender (secured or unsecured) is likely to be involved in the directors' decision to file for a CVA moratorium.

> *There is no requirement to notify a secured creditor before filing for a CVA moratorium…*

## Practical steps for a lender

A lender to a borrower that is considering using a CVA will generally expect the company to share its plans with it at an early stage. The lender's initial requirements will likely include:

— the appointment of its own financial advisers to give an independent opinion on the viability of the CVA as part of a broader independent business review (with the usual section of such a report being solely for the lender's eyes as to the position of the business generally and the lender's options);

— being consulted prior to the company selecting a person to act as nominee in respect of the CVA proposal; and

— the appointment of its own legal advisers.

From an informed basis, a lender will then decide if it is willing to support the company's proposal to use a CVA and if so, on what terms.

## Future developments

Notwithstanding the recent surge in high-profile CVAs, the procedure has not been used as frequently or widely as was originally hoped by the legislature[8].

Two principal reasons are offered to explain this: (1) the procedure cannot cram down unwilling secured creditors; and (2) the procedure, for most companies, does not carry the benefit of a moratorium on creditor action pending approval of a proposal.

At the time of writing, the Government is in the process of reviewing the corporate insolvency regime generally in the UK with a view to encouraging further the use of rescue proceedings. This could include extending the availability of a preliminary moratorium for all companies seeking to use a CVA as part of its turnaround.

While reform is likely to remain on hold for the time being, reform in the medium term seems likely as the UK seeks to ensure its insolvency and restructuring procedures remain world class in a post-Brexit market.

A more immediate area for potential development is what may become of institutional landlords' complaints about the use of CVAs by UK retailers and casual dining chains.

## How we can help

CMS' Restructuring & Insolvency team has an established reputation for delivering expert advice and solutions to all types of stakeholder at all stages of the decline and recovery curves. Our clients include debtors, creditors, distressed debt investors, insolvency practitioners, boards of directors, pension trustees and regulators.

We have acted in relation to many of the recent high-profile CVAs, including for the company, lenders, the pension trustees or landlords.

Our London-based partners who specialise in Restructuring and Insolvency are:

**Martin Brown**
**Partner**
**T** +44 20 7367 2590
**E** martin.brown@cms-cmno.com

**Glen Flannery**
**Partner**
**T** +44 20 7524 6867
**E** glen.flannery@cms-cmno.com

**Patricia Godfrey**
**Partner**
**T** +44 20 7524 6444
**E** patricia.godfrey@cms-cmno.com

**Rita Lowe**
**Partner**
**T** +44 20 7367 2798
**E** rita.lowe@cms-cmno.com

**Emma Riddle**
**Partner**
**T** +44 20 7367 2563
**E** emma.riddle@cms-cmno.com

**Julian Turner**
**Partner**
**T** +44 20 7067 3552
**E** julian.turner@cms-cmno.com

**Peter Wiltshire**
**Partner**
**T** +44 20 7367 2896
**E** peter.wiltshire@cms-cmno.com



[8] In each of the last three years, for example, the Insolvency Service's statistics state that there were an average of c.330 CVAs used across the UK compared to an annual average of c.1,400 administrations.