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INSOLVENCY PRACTITIONERS

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Company Voluntary Arrangement (CVA)

If a company has a viable future, the directors and management accept the need for change, are prepared to fight for its survival and the appropriate funding can be found, then a CVA is a very powerful tool. BUT be prepared - it is a tough fight and it is harder than liquidating the business. By proposing a CVA you are demonstrating that you are trying to maximise creditors' interests so it can often be viewed positively.

Essentially it is an arrangement between the company and its creditors to repay them from future profits or through a sale of assets

Vital Components of a successful CVA are:

- A viable business that can return to profitability.
- Commercially structured - can succeed without over promising creditors
- Introduction of appropriate levels of working capital in addition to the restructuring of debt.
- Management accepting that change is necessary.
- Determination & hard work is essential throughout the period of the CVA
- Directors need to use an experienced Insolvency Practitioner.
- Cautious forecasting. .

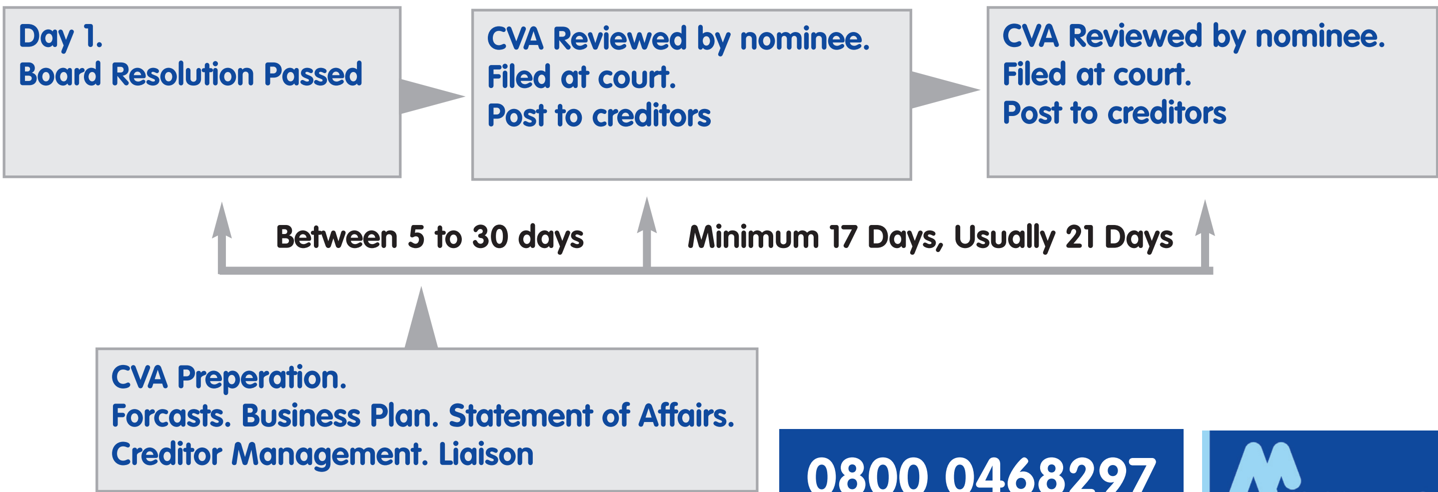
Who can propose a CVA?

A CVA may be proposed by the directors of the company. When the company is in administration, the administrator can propose a CVA. A CVA can only be proposed if a company is insolvent or contingently insolvent.

How long does it take?

In practice it often takes 7-10 weeks although the summary below is possible if all of the required information is available from the outset.

See CVA's Flowchart below -



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What happens at the end of the CVA period?

Once the agreed period is completed and the supervisor has issued a completion certificate, then the company leaves the CVA state. Any remaining unsecured debts (where partial repayment was approved) are written off and the directors continue to run the business for the shareholders.

Summary of the CVA mechanism.

It is also worth pointing out that the CVA is not a panacea for your company; but it is a very powerful framework for change and protection of a distressed but viable company. In reality although difficult to propose and get approved, getting the CVA approved is the easiest part of a rescue/turnaround– making a turnaround work is much more difficult and needs professional help. The CVA should aim to:

- **Maximise creditors' interests.**
- **Preserve viable but distressed businesses.**
- **Preserve economic activity and save jobs.**
- **In time return value to the creditors.**
- **Provide a real prospect of a return for shareholders**

Drafting a proposal:

1 The directors appoint advisors, such as turnaround practitioners or an insolvency practitioner (IP) to assist in the construction of the proposal. During this "hiatus" period the company should not materially increase or decrease debts to any creditor, suppliers should be paid for supplies made (not always easy!) and activity of the company continues.

2 A review of the company, its people, markets and systems should be undertaken. This is an important part of the process. Typically the CVA will include detailed 3-5 year financial forecasts to assist the creditors to make their decision to support the deal or not.
Once the draft proposal is ready the directors will typically review and refine it and agree that the proposal is appropriate, achievable and maximises creditors' interests. If the directors do not believe that it is sensibly structured, or that the process has highlighted weakness in the business then it is advisable to close the business.

3 Once the final CVA drafting has been completed the directors should then discuss the position with the company's' secured creditors. Experience tells us that the ability to deliver a quality draft proposal at this stage is preferable to verbal assurances that a CVA will be written and the bank told what the contents are when it's ready! We find that the banks are very keen to get involved and assist where they see a viable company.

4 Often they will want to see how the company will repay the bank's debts. This should be included in outline in the document - of course the bank may not agree with the suggested secured debt structure but will usually negotiate with the directors and their advisors.

5 During the CVA production or hiatus period, current assets such as WIP and debtors are collected, turned into cash and liquidity should improve. This should be used to fund the difficult period between appointment of CVA advisors and filing the document at court.

6 The CVA proposal is then filed at court only to ensure that the proposal is ratified and carries a legal originating number. Then it is printed and the proposal is distributed to all creditors. The court does not have an active part to play in this process but the CVA proposal sent to creditors must be a true signed copy of the document filed at court.

After the proposal is completed:

1 The proposal must then be sent to all creditors who then consider it for the minimum notice period as above before the creditors meeting can be held. This is usually held at an independent venue (theoretically at the convenience of creditors).We find that the HMRC team, called the Combined Voluntary Arrangement Service prefers to have up to 3 weeks to consider the proposals so we always allow more than the statutory 14 day minimum period for consideration.

2 The meeting will be chaired by the advisor or an Insolvency practitioner (IP). Creditors are often represented by technical professionals from other insolvency firms. The aim of the meeting is to allow the creditors to question the director's proposals; however it is not a place for settling disputes.

3 At the meeting the creditors vote on the proposal and the proposal will be approved if a majority vote of 75% by value of the total value of creditors at the meeting (whether in person or by proxy) vote in favour. A second vote excluding connected creditors is taken and provided that not more than 50% of creditors vote against the proposal it is approved.

4 **The voting at meetings is often an area that concerns directors.** The Combined Voluntary Arrangement Service, (CVAS) which represents the HM Revenue and Customs, will always support viable proposals that are well built and show proper care and attention to detail. Given that the CVAS often represents the largest votes, then we ensure that they are comfortable with the CVA process very early in the cycle of events.

5 The Chairman controls the ability to vote and provided creditors have been asked to consider a sensibly structured deal. Also the creditors may wish to modify the proposal - once again the modifications need to be approved by the majority votes above. This often done by the HM Revenue and Customs agencies to ensure future debts are paid on time and future filing of tax returns is done correctly. Occasionally other creditors may ask for a modification to the proposal.

6 At the same time as the creditors meeting, the members (shareholders) meeting is held. Members decide whether to accept the proposal as made or modified and a vote of 50% in favour is required.

7 If both meetings approve the proposal the meetings close. The chairman must then issue a chairman's report, within 4 days, to all creditors and the court, stating what happened, who voted and how they voted.

8 Once approved all notified and included creditors are legally bound for the debt "frozen" in the proposal. No further legal action (except by leave of court) can be taken against the debtor company and the creditors will receive dividends from the supervisor as described in the proposal.

9 After the approval the company must make the agreed contributions to the trust account administered by the supervisor. Failure to keep up with contributions is deemed a default and the company voluntary arrangement can be "aborted". This usually leads to liquidation or receivership.

10 To avoid this the best way to structure the CVA is on following basis. Prudent forecasts of directors should be further scaled back and modest forecast profits should be used as the basis for contributions but no more than 50% of profits after tax and debt repayments over the deal period should be contributed. Contributions should be stepped to match profits achieved. Any lump sum contributions during the currency of the CVA should be avoided where possible. The use of a profits ratchet allows higher repayments if modestly forecasts profits are exceeded.

Even if the approach outlined here leads to small repayment levels of 20-50% to unsecured creditors, the creditors usually prefer sensible contributions to hopelessly optimistic forecasts. Provided the company conforms to the CVA proposal and makes its contributions, then the CVA continues for the agreed period. The supervisor is generally not involved in the business (in our CVA's). **THE DIRECTORS REMAIN IN CONTROL**. What if things don't go well? If the company is not performing well and yet it would still appear to be viable, then it is theoretically possible to reconvene the creditors meeting at any time to ask the creditors to consider amendments. If the Supervisor has concerns, he can also ask the court for directions. In most cases the directors should inform the supervisor if there are any material changes to the company or its business.