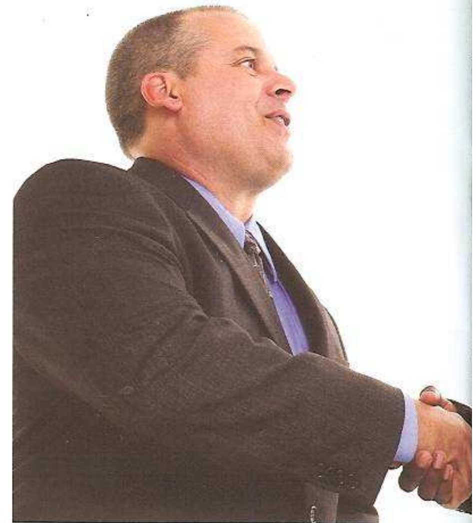
CVAs and you



Marc Fecher looks at an option for retaining control of a business even when the cash stream has dried up.

A Company Voluntary Arrangement (CVA) is a recognised legal procedure, introduced by the Insolvency Act 1986 (IA86), that enables a company to enter into a binding agreement with its creditors detailing how the company's debts and liabilities will be dealt with, and allows the directors to retain control of the company. A CVA is a flexible tool designed to have regard to the interests of the company, its creditors and any interested third parties.

what is the principal purpose?

In essence a CVA allows a company with historical cash flow problems to repay its liabilities, either in part or in full (including HMRC and VAT) over a period of time. A typical CVA looks to pay its creditors one pence in the pound dividend over the duration of the CVA.

typical time-spans

A CVA typically lasts five years but can, in theory, last as long or as short as the company desires. The duration is dictated by the proposal and how the company is going to generate funds for the CVA; i.e. if the CVA is based on the monthly contributions generated from future trading profits, the CVA may last up to five years – HMRC will usually insist on a five year term and a number of modifications. Conversely, if the CVA is reliant on the injection of a one-off third party payment, the CVA can last as little as six months.

Its main constituent is a proposal that draws up the terms of the CVA. The proposal, in essence, can be as varied and as flexible as desired and needed by the company.

However, for any CVA to be initiated, the proposal must be accepted by more than 75% of creditors voting at the meeting. There is a second vote which excludes associated creditors to ensure fair play. As long as this requisite majority is met, any creditors that voted against the CVA are still bound by its terms and are not entitled to pursue recovery of their debt.

key issues for director consideration

The ultimate questions that must be considered by the directors before embarking on a CVA are:

- What is going to change in the future that will enable the company to generate sufficient profits, not only to discharge its ongoing trading costs but also to enable it to pay a contribution into the CVA?
- Are there going to be wholesale reductions in overhead costs or a significant increase in revenue?
- Is the company going to get an injection of funding?
- Is a new large contract likely to be agreed?

If none of the answers to these questions is positive, then a CVA will not be viable. Essentially, will the company be able to generate profits in excess of what they had been making historically?

All creditors bound by the CVA do not need to be paid going forward – their account is frozen at the amount owed prior to the implementation of the CVA. They are only paid via a dividend out of the CVA.

declaration of insolvency

A company must make a declaration that it is insolvent before it can enter into a CVA. As such, the directors are declaring that the company could enter insolvent liquidation. This is the date which WT would define as the date at which the company had no reasonable prospect of avoiding insolvent liquidation.

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However, this is only significant should the CVA fail. Therefore, there is a worry for directors who enter into a CVA that is subsequently failed and the Company is placed into Insolvent Liquidation.

The duly appointed liquidator must investigate whether WT applies and on the basis of the declaration made by directors, it appears that this is prima facie evidence to pursue a WT action.

ongoing supplier support

A question frequently asked by directors is, will my suppliers continue to trade with me even though the company is in a CVA? The answer to that is unknown and can only be dealt with

on an individual basis. However, historically, the answer does tend to be positive, as all suppliers have it in their interest to continue to trade so long as their invoices are paid. The suppliers may well impose stricter credit terms which may impact on working capital post-CVA.

directors' duties under the agreement

The directors must be confident that the CVA is likely to achieve its purpose, be it 60 monthly contributions of £x over the course of a five year CVA or a third party contribution being made.

Indeed the nominee, who will be a responsible insolvency practitioner, has a duty to file his comments on the viability of the CVA in court.

Even though the directors retain control of the company on a day-to-day basis, they owe a duty to co-operate with the supervisor of the arrangement (also a qualified insolvency practitioner) and to abide by the terms of the CVA. If they fail to, the supervisor has a duty to fail the CVA and place it into insolvent liquidation.

insolvent liquidation

Opposite is a time-bar summary of the CVA process. 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.

The cost of an insolvency practitioner acting as nominee of a CVA can vary enormously from firm to firm and case to case.

However, for an SME company and a medium-sized insolvency practitioner firm, the cost will typically be £10,000 to £15,000.

The cost of an insolvency practitioner acting as supervisor of the approved CVA differs even more so than for the nominee. However, assuming the CVA is a typical five year contribution-based CVA, the fee is usually set at £5,000 per annum.

recommendations for companies suffering cash flow issues

It is common for directors to allow companies to trade wrongfully in the hope of a dramatic turnaround in the company's fortune.

Often this turnaround will not occur and the directors are therefore open to accusations of wrongful trading, with serious consequences for their personal finances, professional integrity and future directorships.

Where companies are experiencing financial difficulties, it is imperative that directors seek professional advice to ensure they act with integrity and in the interests of the creditors. This advice can come from an experienced insolvency practitioner who can review the situation and advise on the most suitable course of action. ■

Marc Fecher –
chair, Corporate Sector Network Panel