Company Voluntary Arrangements: Evaluating Success and Failure

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Purpose of Project

- Consider the reasons for the ‘success’ or ‘failure’ of company voluntary arrangements (“CVAs”) and to investigate the outcomes where CVAs fail.

- Aims to identify key characteristics which will allow practical guidance to be provided to insolvency practitioners (“IPs”) and also inform policy recommendations to Government.
The project had three main avenues of enquiry:

1. Quantitative data gathering and analysis;
   - All 552 CVAs in England and Wales commenced in 2013 – analysis of records at Companies House
   - 100 pre-packs from 2016 – why not a CVA?

2. Qualitative data gathering and analysis; and
   - Survey of R3 members in Summer 2017
   - Stakeholder interviews in late 2017 / early 2018

3. Comparative analysis.
   - Review of national and international developments and consultations
Review of CVAs commenced in 2013

Initial review of all 552 CVAs commencing in 2013 looked at a number of key data points
- 514 (93%) were small or micro companies

Three key categories emerged:
1. CVA outcomes
2. Company profile and use of moratorium
3. IP firm involvement

Secondary data collection was undertaken to determine the outcomes of terminated CVAs in more detail
CVA Outcomes

- Implemented: 18.5%
- Terminated: 65.2%
- Ongoing: 16.3%
Length of CVAs (Quarters)
Use of Moratorium
Phase Two Analysis:
Terminated CVAs

Further analysis of the data in relation to terminated CVAs was carried out

Purpose: to determine whether dividends were being paid in terminated CVAs and so, although not fully implemented, whether such CVAs could be seen as a qualified success

- 244 CVAs were terminated after more than four full quarters
- The initial sample revealed no dividends being paid in those CVAs lasting four quarters and very few dividends paid in those CVAs lasting six quarters
- A sample was selected at random of 64 companies where the CVA had terminated between 6 and 18 quarters of commencement
Percentage of cases where unsecured dividend paid

Length of CVA (Quarters)
Findings

• Early termination of a CVA is not necessarily indicative of the CVA having failed

• Dividends are frequently paid in terminated CVAs – a better outcome than liquidation or pre-pack?

• The level of dividend is often lower than that proposed – even if the CVA is terminated near to the proposed completion date

• When the number of missed contributions is taken into account, 20 of the 22 CVAs where no dividend was paid had an effective length of less than six quarters

• Missed contributions undermine the funds available for unsecured creditors
R3 Membership Survey

- 156 R3 members responded
- 101 were insolvency appointment takers
- 117 had acted either in the capacity of advisor, nominee or supervisor in relation to a CVA in the previous three years.
- Based on 2013 CVA data, survey response encouraging:
  - 164 IP firms acting as supervisors
  - 79 IP firms taking only one appointment
Responses

Failure to proceed from formal proposal

• 60% - Lack of support from HMRC
• 40% - Lack of unsecured creditor support
• 34% - Lack of key supplier support

Reasons for approved CVAs failing

• 50%+ - Overly optimistic financial forecasts
• 50%+ - Company underestimated impact of CVA on working capital
• 29% - post-CVA creditors not paid
• 28% - Company failed to make changes
• 24% - Problems not fully identified and tackled in proposal
• 19% - Customers withdrew business
Responses

Most engaged creditor groups

- 55% - HMRC
- 45% - Trade Creditors
- 38% - Landlords
- 36% - Secured creditors
- 35% - Asset-based lenders

Creditor groups most likely to oppose CVA

- 71% - HMRC
- 35% - Landlords
- 20% - Secured creditors
Responses

What would increase the effectiveness of CVA process as a rescue tool?

- 60% - more support from HMRC
- 40% - a revised moratorium process
- 37% - a more realistic approach from directors
- 25% - more support from suppliers
- 25% - a better understanding of the CVA process
Stakeholder Interviews

- CVAs viewed as a good thing
- Flexible process and engaged creditors
- Different stakeholder groups felt their own interests were not always fully recognised
- Most, if not all, wanted to support CVAs even where not entirely convinced about the proposal
- Certain creditors would assess CVA proposals closely where appropriate
• Directors often:
  – act too late;
  – fail to understand what is needed; and
  – fail to make necessary changes to the business

• Concerns expressed as to the effectiveness of the Nominee’s assessment of CVA proposals

• No consensus as to what the role of the Supervisor is or should be

• Concerns were expressed about IP fees
Stakeholder Interviews

- 5 year duration for a CVA too long

- Possible introduction of a short term pre-insolvency moratorium received a lukewarm welcome

- HMRC was criticised by many stakeholders as:
  - behaving inconsistently;
  - imposing standard conditions;
  - often not engaging early; and
  - often being swayed by policy not commercial concerns
World Bank’s annual Doing Business Report, Resolving Insolvency:

- UK slipped to 14th
- Netherlands rose to 8th
World Bank Principles

• Directors’ obligations in the period approaching insolvency should promote responsible corporate behaviour

• Commencement of insolvency proceedings should prohibit the unauthorised disposition of the debtor’s assets and suspend actions by creditors

• Numerous other matters are also covered e.g. rescue financing and *ipso facto* clauses
EU Draft Directive

- Where insolvency is likely, directors have obligations to take immediate steps to minimise loss for stakeholders

- Excessive length of restructuring procedures a problem

- Need for a time-limited stay from enforcement actions to aid in achieving successful negotiations on a restructuring plan
• Addresses several of the World Bank principles

• Consistent with the EU Draft Directive

• Four key areas of focus
  – New pre-insolvency moratorium
  – Protection of ‘essential’ supplier contracts
  – New restructuring plan (including cram down)
  – Introduction of rescue finance mechanisms
International Reforms

Netherlands
- Process of corporate law reform, including the likely introduction of a new Scheme of Arrangement (“WHOA”)

South Africa
- Financial distress: company cannot pay its debts as they become due in the next 6 months
  - Directors must put the company into Business Rescue before it becomes insolvent
Main
Recommendations

• CVAs should last no longer than 3 years without good reason
• Directors’ duties in the shadow of insolvency should be articulated more clearly and fully to include a requirement to address financial distress early
• The roles and duties of nominees and supervisors should be articulated more clearly and fully in a revised SIP
Main Recommendations

• Public sector creditors should have to explain their decision fully if they refuse to support a CVA proposal
• A new form of pre-insolvency moratorium should be introduced
• Standard terms and conditions, at least for small company CVAs, should be made available and when adopted, certain classes of creditors should have to explain fully if they refuse to support the CVA
Main Recommendations

- The Insolvency Practitioner fee system used in other insolvency procedures could be adopted in CVAs.
- Documentation filed at Companies House in relation to CVAs should be more informative so as to improve transparency and encourage confidence.