



Restructuring and insolvency

Company voluntary arrangements

Summary and implications

A company voluntary arrangement (CVA) is one of the insolvency procedures available to companies that are in financial difficulty. This briefing provides a short summary of a CVA and answers some frequently asked questions. Each CVA is different and specific advice should be taken on an individual basis.

Aim of the CVA procedure

The CVA procedure was introduced by Part 1 of the Insolvency Act 1986 (IA 1986) to enable a company to agree a binding compromise or arrangement with its creditors by a relatively simple procedure and with minimum court involvement. The procedure is largely an out of court process limited to filing various documents. The CVA can stand alone or supplement other insolvency procedures. There is no requirement that the company be insolvent.

Proposing a CVA

The directors of a company may make a proposal under Part I of the IA 1986, to be voted on at meetings of the company's shareholders and creditors, seeking a "composition in satisfaction of its debts" or a "scheme of arrangement of its affairs".

Where a company is in administration or liquidation, only the administrator or liquidator may propose a CVA.

Save for the fact that the CVA must amount to a "composition in satisfaction" of the company debts or "a scheme of arrangement of its affairs", there is little in the Act or governing secondary legislation as to the form the CVA must take. Furthermore, it is possible for a CVA to deal with unsecured creditors in different ways. However, the CVA must not unfairly prejudice the interests of any creditor (a point discussed in greater detail below) and cannot affect the rights of secured creditors to enforce on their security nor affect the priority of payment of preferential creditors without their consent.

Ask a question

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Overseeing the CVA

The CVA proposal must nominate an individual to act either as trustee of the CVA or otherwise for the purpose of supervising its implementation. This individual is known as the nominee when the CVA is still at the proposal stage and is known as the supervisor once the CVA has been approved and she has been appointed.

Optional moratorium

Prior to the enactment of the Insolvency Act 2000 (IA 2000), a company proposing a CVA did not enjoy a moratorium shielding it from actions against it by its creditors. The IA 2000 introduced a CVA moratorium for companies during the proposal stage prior to the meetings. The moratorium is optional and only available to small companies which meet the specific size requirements set out in the Act. The moratorium commences when the directors file at court documentation setting out, inter alia, the terms of the proposed CVA. It lasts until both meetings have been held, which meetings must be summoned for a date not more than 28 days from the date the moratorium takes effect. However, a meeting commenced but adjourned within the 28 day period may resolve to extend the moratorium for a further period of up to two months from the meeting date.

Whilst the moratorium is in force, the company is shielded from action by its creditors, for example, no petition may be presented for the winding up of the company and an administrator cannot be appointed.

The process by which a CVA is approved

Nominee's consideration of the proposal and report to court

If the nominee is not the administrator or liquidator the nominee must consider the proposal and prepare a statement to be submitted to the court stating, inter alia, whether the CVA has a reasonable prospect of being approved and implemented.

Though the nominee's statement must be submitted to the court, the court's role is principally administrative and it will likely only be involved judicially where there are contentious issues.

Where the nominee's report is negative, the company is not barred from seeking a second opinion from another nominee.

Where an administrator or liquidator is the nominee, meetings of the company and of the company's creditors can be called without the need to report to the court.

The time and date of the meetings of the company and of the creditors

Where the nominee's report on the proposal is positive, she must summon meetings of the company and of the creditors for a date not more than 28 days from the date the moratorium takes effect. If there is no moratorium, the meetings must be held no more than 28 days after the nominee files her report to the court. There is no time limit set out in the applicable legislation beyond which the meetings cannot be held where the nominee is the administrator or liquidator.

What constitutes approval at the meetings

Approval by the shareholders requires a simple majority in value of those present and voting; approval by the creditors requires 75 per cent in value of those present and voting. If the meetings disagree, the decision of the

creditors' meeting prevails but a shareholder has a right to apply to court within 28 days to challenge the creditors' decision.

Which creditors are bound by the CVA

Prior to the IA 2000 coming into force, a CVA bound only those creditors who had notice of the proposal and were entitled to vote at the creditors' meeting. This caused problems where creditors could not be traced or subsequently came to light.

By the amendments introduced by the IA 2000, the CVA now binds not only creditors who had notice of and were entitled to vote at the creditors' meeting but also creditors who would have been entitled to vote had they received such notice. Accordingly, CVAs bind both known and unknown creditors of the company.

Challenging the CVA

By section 6 of the IA 1986, a creditor, a shareholder, the nominee and the administrator/liquidator all have standing to apply to the court on the grounds either:

- that the CVA unfairly prejudices the interests of a creditor or shareholder of the company; or
- that there has been a material irregularity at or in relation to either of the meetings.

The application must be brought within 28 days of the results of the meetings being reported to the court save in the case of a creditor who was not given notice of the meeting where the application must be made within 28 days of the creditor's becoming aware that the meeting had taken place. Where the court is satisfied on such an application that either there has been unfair prejudice or material irregularity, it may, *inter alia*, revoke or suspend any decision approving the CVA.

Material irregularity

There is case-law to the effect that to constitute a material irregularity, the irregularity must be such as to possibly have affected the outcome of the meeting.

Unfair prejudice

Case-law is to the effect that there is no universal test for judging unfairness. In assessing unfairness, a number of techniques are used, including "vertical" and "horizontal" comparisons. A vertical comparison is a comparison between the creditor's entitlement in the CVA and in a hypothetical liquidation. The importance of this comparison is that it generally identifies the minimum below which the return in the CVA cannot go. A horizontal comparison is a comparison between the position of the applicant and other creditors. The fact that a CVA involves differential treatment of creditors is a relevant factor, although it will not automatically render a CVA unfairly prejudicial, in particular the differential treatment may be justified by the need to secure the continuation of the company's business by paying essential suppliers.

In *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] Bus LR 1771 the court found that there had been unfair prejudice where, by the terms

of the CVA, guarantees enjoyed by certain creditors against the parent company of the company in CVA were made ineffective without anything in return such that these creditors were in no better position than similar creditors who enjoyed no guarantee. This case is also notable for the court's holding that it was at least possible in principle for a CVA to render a guarantee enjoyed by a creditor ineffective against a third party.

Mourant & Co Trustees Ltd v Sixty UK Ltd (In Administration) [2010] EWHC 1890 (Ch) involved similar facts save that some compensation was offered to the creditors under the terms of the CVA. Despite the compensation, the court found that there had been unfair prejudice on the ground, inter alia, that, in the circumstances of that case and at a time of such market uncertainty, it was difficult if not impossible to determine what sum would compensate the landlord for the loss of the guarantee and, in the absence of compelling justification, the landlord should not be forced to accept the sum offered in the CVA which was based on numerous assumptions which may or may not have been well founded.

The supervisor's powers

The power of the supervisor derives from the terms of the CVA (which can be individual to each case).

By its terms, the CVA may create a trust over some or all of the company's assets and the possible existence of a trust should be considered by any party when purchasing from a company subject to a CVA.

By section 7 of the IA 1986, a creditor or any other person dissatisfied with an act, omission or decision of the supervisor has standing to apply to the court for an order reversing the decision.

Completion or termination of the CVA

Whether the CVA is successfully implemented or is unsuccessful and is terminated, the supervisor must send a report on the implementation of the proposal to all members and creditors who are bound by the CVA within 28 days of its completion or termination. A successful CVA typically results in the company being able to trade uninterrupted throughout the CVA process and ultimately being relieved of its entire pre-CVA debts. An unsuccessful CVA typically ends in the company's liquidation.

Depending on the terms of the CVA, it is possible for a trust over the company's assets created by the CVA to survive the CVA's termination and the company's entry into liquidation and this is a point that should be considered by any party when purchasing from a company in liquidation that was formerly subject to a CVA.

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