Company Voluntary Arrangements (CVAs): Evaluating Success and Failure

Research report commissioned by R3, with the support of ICAEW
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Background

R3, the insolvency and restructuring trade body, has been considering ways to reform the UK's corporate insolvency and restructuring framework and, with support from ICAEW, commissioned the University of Wolverhampton to explore why Company Voluntary Arrangements (CVAs) – an important but relatively under-used business rescue tool – succeed or fail, and how they could be improved.

With growing economic pressures, particularly for the retail and leisure sectors, a number of high profile businesses have entered into or explored CVAs in 2018. This research identifies a number of possible policy changes to ensure that CVAs are more effective and used more widely to support business rescue in the UK economy.

The research is also published at a critical time for the UK's world class insolvency and restructuring framework, with other countries making concerted efforts to reform their own insolvency and restructuring frameworks. Brexit also risks creating barriers to resolving cross-border insolvencies and will require the UK's economy to be as attractive to international trade and investment as possible.

To ensure that its corporate insolvency and restructuring framework is up to date and competitive in the global market, the UK must start work now. Failure to do so would have a significant and detrimental impact on UK jobs, growth, investment and productivity.

In May 2016 the UK Government launched '*A Review of the Corporate Insolvency Framework: A consultation on options for reform'*. The consultation put forward a number of proposals to encourage rescue of viable businesses, including some which would have an impact on CVAs. R3 hopes that this research will be helpful as the Government looks to publish its response to the consultation – and that the possible reforms identified by this research can help to ensure the UK's insolvency and restructuring framework maintains its position as one of the best in the world.

What is a CVA?

CVAs see a viable company in financial difficulty agree with its creditors to repay a portion of its debts over a set period of time. A CVA is very flexible and may involve delayed or reduced payments of debt, capital restructuring or an orderly disposal of assets. The agreement requires the approval of at least 75% in value of the creditors, and, if approved, binds all unsecured creditors. The proposal and CVA are overseen by an insolvency practitioner acting either as a 'nominee' or, later, a 'supervisor'.

It has been argued that CVAs have many advantages. There is no requirement to prove insolvency, so action can be taken at the first signs of distress. CVAs are flexible and their terms are freely negotiated by a company and its creditors. CVAs allow time to reorganise and restructure a company, with minimal disruption to customers, and allow the core business to trade on and generate income. CVAs do not involve the Court, unless challenged, making the procedure cheaper than some alternatives

CVA Report – Findings and recommendations

The research involved the analysis of the 552 CVAs commenced in 2013 (to allow a sufficient period of time to have passed to permit a meaningful analysis of their outcomes) involving companies in England and Wales, along with other official data, surveys of insolvency practitioners, and interviews with creditor groups, government, and the insolvency and restructuring profession.

General conclusions

- The biggest strength of a CVA is its flexibility.

- The early termination of a CVA does not automatically mean failure: terminated CVAs may return more money to creditors – the ultimate goal of any insolvency procedure – or otherwise be more beneficial for creditors than an administration or liquidation.

- An analysis of the 552 CVAs commenced in 2013 involving companies in England and Wales showed:
    - 18.5% were fully implemented;
    - 16.5% were ongoing at the survey date;
    - 65% were terminated without achieving their intended aims;

- CVAs with the benefit of a moratorium – either from the existing 28-day pre-CVA moratorium available to small companies, or the moratorium provided by an administration – were terminated in only 20% of cases.

- Often directors do not implement necessary changes or fail to identify and tackle fully the problems identified in the CVA.

- HMRC is seen as the most engaged creditor but also the one most likely to vote against a CVA whether for policy or commercial reasons.

- The UK's insolvency and restructuring framework is slipping in the World Bank's 'Ease of Doing Business' rankings and lessons may be learnt from the World Bank principles and other international insolvency developments.

Main recommendations

- **CVAs should be capped at three years** – CVAs typically last five years, but, the research shows, long CVAs increase pressure on the struggling company, increase the risk of failure, and do not guarantee better creditor returns.

- **A pre-insolvency moratorium should be introduced** – Companies which used an existing, limited pre-CVA moratorium from creditor enforcement action, or which used the moratorium provided by administration, tended to have a higher chance of completing their CVA. The pre-CVA moratorium should be expanded to all sizes of companies, simplified and should be available for use ahead of any insolvency procedure. The moratorium would give companies more time to plan a CVA free from creditor pressure.

- **Directors' and insolvency practitioners' duties should be more clearly defined** – Directors should be required to address financial distress at an earlier stage than now, while the insolvency practitioner's role in a CVA should be clarified and reporting enhanced. Consideration should be given to extending the existing system of insolvency fee estimates to CVAs.

- **Public sector creditors should have to explain why they won't support a CVA** – The research found HMRC was the most likely creditor to oppose a CVA but that it provided little feedback on its reasons for doing so. This prevents an effective negotiation – and sometimes leads to a company's administration or liquidation, which can undermine returns to creditors, including the taxpayer.

- **Standard CVA terms and conditions should be introduced** – Standard terms would improve the consistency of CVAs, reduce costs, and help build knowledge among stakeholders about how the process works.