



RECOVERY UPDATE

The Company Voluntary Arrangement: A true win - win solution?

Even though HM Revenue & Customs' time-to-pay agreement has now been extended for the lifetime of the next parliament, many businesses may still find themselves struggling to manage their cashflow.

The total amount of finance provided by HM Revenue & Customs ("HMRC") during the economic crisis has been estimated to be in excess of £5bn. This figure represents financial assistance to approximately 300,000 businesses and individuals.

The problem is that there are a large number of businesses that, notwithstanding the government's financial assistance, are still struggling. When the economy starts to improve the need for working capital is likely to increase and cash is likely to become an even scarcer commodity.

A solution for some companies maybe to put forward proposals for a Company Voluntary Arrangement ("CVA").

What is a CVA?

At its most basic level, a CVA is no more than a contract with creditors where they agree terms by which they are repaid in full or in part over a period of time.

The directors, working with an insolvency practitioner, will put forward a proposed agreement along with supporting information setting out what the company intends to do.

The insolvency practitioner will also submit a report to the court confirming that the offer the company has put forward is fair and has a reasonable prospect of successful implementation, and should therefore be considered by creditors.

These two documents are sent to creditors for their consideration. Creditors then have three options. They can vote in favour of the proposal, vote against it or vote in favour of it but subject to some form of modification to what has been proposed.

Provided more than 75% (by the value of their debts) of those creditors who vote do so in favour of the proposals, they will be approved and the CVA is then binding on all creditors irrespective of how they voted.

The 75% voting limit is a key advantage to the CVA as in most cases this effectively means that the agreement can be approved by only a handful (in number) of a company's creditors.

Once it is approved, all that is required of the company is that it does whatever it offered to do under the proposals. It continues to trade under the control of its directors and none of the creditors are able to take legal action to recover their debts.

What should the company offer?

Firstly, it is important to appreciate that there is no need for a company to offer creditors payment in full. Secondly, whilst many CVAs are based on fixed monthly contributions, this is not a requirement.

At Milsted Langdon we have been assisting companies to put forward CVA proposals since they were introduced in the late eighties and experience has shown that the structure of any offer can be crucial.

The company must take care not to offer more than it can afford. Equally it needs to ensure that it offers enough to win sufficient support from creditors for the proposals.

A CVA should never be used to prolong the inevitable demise of an unsound business. Instead it is a mechanism by which profitable businesses with arrears of debt can be rescued and the return to creditors maximised.

Unlike pre-pack administrations, a CVA seldom requires directors to invest new money into a business and allows directors to retain day-to-day managerial control.

The role of the insolvency practitioner is limited to ensuring the company complies with the proposals.

For many companies, having to pay a fixed sum each month can put a great deal of financial pressure on an already cash-constrained business. We have therefore helped companies to put forward offers that are tailored to their specific financial circumstances.

Such bespoke offerings can provide for contributions into a CVA to be adjusted to reflect seasonality of a business (with more paid in the busier months of the year and less at the quieter times) or its anticipated growth (with more paid in later years than sooner ones). Contributions to the CVA fund can be calculated as a percentage of profit or even turnover. Alternatively they can represent the realisation of non-core assets.

This flexible approach minimises the chance of the company being unable to honour its obligations under the terms of its proposals and the consequence which would be the failure of the CVA.

What about HM Revenue and Customs?

HMRC views CVAs completely differently from time-to-pay agreements. Before supporting a CVA, it will still want to ensure that the underlying business is sound and that it has a reasonable prospect of meeting ongoing tax liabilities. However, it will not require payment in full and typically companies pay between 40% and 100% of their debts over a period of five to seven years.

Often companies that have been declined a time-to-pay agreement by HMRC or which are in default of an existing agreement may still be able to obtain HMRC's approval for a CVA.

That is not to say that HMRC will approve any offer but we have worked with its specialist voluntary arrangement unit for many years and have an almost unbroken record of obtaining its approval.

Example

We were invited by the invoice financing arm of one of the high street banks to meet with the directors of a manufacturing business.

The directors had explained to the bank that they could no longer continue to trade as the company was insolvent. They wanted advice on closing down the business.

After talking to the directors, it quickly became clear that the core business was profitable. Although the directors had taken a number of steps to reduce overheads, their cost-saving measures were only just beginning to bear fruit. Unfortunately the company was in default on a time-to-pay agreement and believed that it was only a matter of time before HMRC petitioned for the company's liquidation.

We took a more detailed look at the company and its financial position and made some further recommendations, including reducing staff levels and renegotiating terms with suppliers.

We then recommended a CVA to deal with the outstanding liabilities. The government will underwrite redundancy costs when a company enters a CVA. For that reason we were able to advise on a redundancy program whereby employee numbers were reduced and those staff that were made redundant were paid their entitlement by the government. The government then submitted a claim in the CVA and was paid under the terms of the proposals.

We assisted the directors to draft CVA proposals whereby the company offered to make contributions equivalent to 2% of turnover over a period of five years, providing a return to creditors of approximately 40%.

60% of the company's total liabilities were due to one large supplier and HMRC. We assisted with negotiations with both parties so that by the time the CVA came to a vote, their support had already been secured.

We also worked with the invoice discounter to ensure that its exposure was limited without leaving the company short of working capital during the hiatus period whilst creditors considered the proposals.

Creditors unanimously approved the CVA and the company is now trading successfully without the burden of its historic debts. It has a flexible repayment plan tailored to its business.

Strategy

A CVA is not the right solution for every insolvent business. Only those that are essentially profitable should consider it as a means of financial rescue. That said, for many directors who recognise insolvency at an early enough stage and are willing to work to turn the company around, a CVA can be an effective and flexible tool for dealing with historic financial difficulties.

Long-term secured investors/stakeholders are unaffected by a CVA and can continue to rely on their security. Creditors get a better result than they could otherwise expect in a liquidation and the directors are left in control to steer the company to a profitable future.

We have considerable expertise in implementing CVAs and have experience of working with a company's existing advisors to ensure a successful outcome for all concerned.

For further information on our Business Recovery Solutions contact Simon Rowe or your usual Milsted Langdon contact.

TAUNTON OFFICE

Winchester House,
Deane Gate Avenue,
Taunton, TA1 2UH
Tel: 01823 445566
Fax: 01823 445555

BRISTOL OFFICE

One Redcliff Street,
Bristol,
BS1 6NP
Tel: 0117 945 2500
Fax: 0117 945 2545

YEOVIL OFFICE

Motivo House,
Yeovil,
BA20 2FG
Tel: 01935 383500
Fax: 01935 383511

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