



Company Voluntary Arrangements: a Primer

A company voluntary arrangement (“CVA”) is a tool under English insolvency law which allows a company to restructure its financial obligations and is typically used in the context of unsecured debt. CVAs have come to the fore recently as increasing number of retailers and casual dining restaurants are turning to CVAs to restructure their rental obligations. This is not surprising given that a CVA is a relatively flexible process and usually cheaper to implement than a scheme of arrangement. Neither a CVA nor a scheme of arrangement will fix a fundamentally flawed business, but companies looking at restructuring should be aware of the capabilities of these English law mechanisms.

WHAT IS A CVA?

- (1) A CVA may be proposed by the directors of the company, or an administrator or a liquidator if the company is in an insolvency process.
- (2) A company’s unsecured creditors vote on a proposed arrangement, which may be a straightforward “haircut” or other more complex arrangements (*see “Who uses CVAs?” below*).
- (3) The CVA will pass if approved by:
 - a. **more than 75% of creditors by value**; and
 - b. **50% or more creditors by value who are “unconnected”** to the company.
- (4) All creditors vote together and there is no requirement to divide creditors into classes. If approved, the CVA will **bind all unsecured creditors of a company**, including those who voted against and those who did not vote. The CVA cannot bind secured or preferential creditors, unless such creditors agree to the proposals.
- (5) CVAs are **supervised by a nominee**, who must be a licensed insolvency practitioner.
- (6) There is **no statutory moratorium**, except for very small companies with a turnover of less than £6.5 million per annum, with less than 50 employees, or with a balance sheet total that did not exceed £3.26 million. A CVA could be combined with an administration in order to take advantage of the moratorium under an administration but this will increase the costs substantially.

WHO USES CVAS?

CVAs have been often used in the retail sector where companies have large lease portfolios. Landlords are usually unsecured creditors of their tenants and therefore fall into the category of creditors who could be bound by a CVA.

CVAs are relatively flexible and allow debtors to propose different arrangements depending on the circumstances. For example, companies may reduce amounts payable, modify rent payment dates, agree top-up or performance based payments, add or remove guarantees, introduce new security or include new break or termination rights, all with the intention of improving their financial position.

Recent CVAs have shown that leases are typically divided into three different categories: profitable stores (leases left untouched), borderline stores (leases will be amended including rent reduction) and unprofitable stores (leases terminated). The ability of CVAs to bind non-consenting landlords is one of the key advantages of the CVA.

Other debtors with a significant real estate footprint, such as casual dining restaurants, care homes and serviced offices, could potentially use CVAs to restructure their lease obligations.



HOW CAN CVAS BE CHALLENGED?

There are two grounds on which a CVA can be challenged:

- (1) **unfair prejudice** – the arrangement is prejudicial to certain unsecured creditors. To ascertain fairness, the courts will consider two comparisons: **horizontal prejudice** is where a creditor is treated less favourably than others in a similar position without justification (e.g., different property location can justify different treatments) and **vertical prejudice** is where a creditor is in a worse position after the CVA than they would be upon administration or liquidation; or
- (2) **material irregularity** – there has been a material

irregularity with regard to the process used to consider the arrangement. For example, certain landlords of House of Fraser filed a challenge to the CVA, arguing that the company did not list all of the relevant costs applicable to the CVA when compared to an insolvency.

Any challenges must be brought within 28 days from either the date of the arrangement's approval or the first day a creditor becomes aware. Such legal challenges can be expensive and may eventually lead to the debtor filing for insolvency if it is unable to effect a CVA.

CVAS AND SCHEMES COMPARED

Schemes of arrangement provide another mechanism under English law to restructure debt. There are a number of differences between CVAs and schemes including:

- (1) There is no court process for CVAs, unless they are challenged.
- (2) For schemes, the courts require that creditors with rights sufficiently similar are treated distinctly as a "class." There is no requirement to divide creditors into separate classes under CVAs.
- (3) A majority by number of creditors in a class is required to sanction a scheme (in addition to 75% by value). No such "numerosity" test is needed for CVAs.
- (4) Schemes can restructure secured indebtedness subject to the class composition requirement, but CVAs may not

compromise the rights of secured creditors without their consent.

In recent years, businesses have used CVAs in conjunction with schemes to achieve different aims, sometimes with the CVA as the first step in the restructuring process. In *New Look* and *House of Fraser*, the CVAs were used first to close stores and reduce rent obligations, and schemes were used subsequently to restructure the groups' financial debt more comprehensively.

CVAs can also be used in combination with restructuring proceedings in other jurisdictions. The *Abengoa* restructuring used CVAs in conjunction with a Spanish procedure (*homologación*) and U.S. Chapter 11 and Chapter 15. We expect to see more interlocking procedures used for large multinational companies with complex balance sheets.

OUR TEAM



David Billington
Partner, London
+44 20 7614 2263
dbillington@cgsh.com



Jim Ho
Partner, London
+44 20 7614 2284
jho@cgsh.com



Polina Lyadnova
Partner, London
+44 20 7614 2355
plyadnova@cgsh.com



Andrew Shutter
Partner, London
+44 20 7614 2273
ashutter@cgsh.com



© 2019 Cleary Gottlieb Steen & Hamilton LLP

Under the rules of certain jurisdictions, this may constitute Attorney Advertising.

Throughout this brochure, "Cleary Gottlieb," "Cleary" and the "firm" refer to Cleary Gottlieb Steen & Hamilton LLP and its affiliated entities in certain jurisdictions, and the term "offices" includes offices of those affiliated entities.

clearygottlieb.com