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RESEARCH ARTICLE

A snapshot of company voluntary arrangements: Success, failure and proposals for reform

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Abstract

Company Voluntary Arrangements (CVAs) are designed to be used in the UK to rescue a company as a going concern. They are under used in practice and have a reputation for high failure rates. This article, based upon a longer report funded by the UK insolvency profession, considers the nature of success or failure of CVAs. It considers empirical evidence to identify the weak points of CVAs in practice. It looks at quantitative data as well as taking into account views of practitioners and other stakeholders. Key elements of the CVA procedure are considered in light of recent national reform proposals and approaches and reforms internationally. Domestic reforms in the Netherlands and South Africa are considered to determine whether any lessons might be learnt from other jurisdictions. Recommendations are made including changes to the suggested amendments to the legal framework and to professional practice guidance.

1 | INTRODUCTION

The Company Voluntary Arrangement ("CVA"), introduced by the Insolvency Act 1986, was born out of the Cork Committee, which in 1982 identified the need for a simple procedure where the will of the majority of creditors in agreeing to a debt arrangement could be made binding on an unwilling minority.[1] Despite the availability of this flexible restructuring tool for over three decades, the frequency of CVAs is reasonably low when compared with alternative corporate Insolvency Act 1986 procedures and it has been commented that CVAs have a high failure rate.[2] The CVA has risen to prominence recently with a number of high-profile cases drawing media attention and, at times, creditor criticism.[3]

It is in this context that the authors were commissioned by R3, the Association of Business Recovery Professionals, and the ICAEW, to consider the reasons for the "success" or "failure" of CVAs and investigate the outcomes where CVAs fail. The aim of the project was to identify key characteristics which will allow practical guidance to be provided to insolvency practitioners ("IPs") and also inform policy recommendations to Government. This led to the publication in May 2018 of *Company Voluntary Arrangements*: *Evaluating Success and Failure* ("the Report").[4] This article represents a summary of the key findings of the Report as presented at the INSOL International Academic Colloquium in July 2018. The findings and recommendations of the Report are of continuing importance in light of the continued negative publicity surrounding CVAs, developments in judicial interpretation and the reform proposals subsequently published by the Government in August 2018 (discussed below in Section 7.3) but yet to be implemented at time of writing.

2 | CVA MECHANICS

In order to consider how effective or otherwise CVAs are in practice, it is necessary to understand the legal and procedural rules which govern them. The following is designed to provide only an outline guide. For more detailed consideration of the law relating to CVAs, readers are directed to more specialist publications.[5]

The Cork Committee identified in 1982 a need for a simple procedure to be introduced, where the will of the majority of creditors in agreeing to a debt arrangement could be made binding on an unwilling minority.[6] This gave rise to the CVA. Sections 1–7B of the Insolvency Act 1986 contain the primary legislation governing CVAs. Part 2 of the Insolvency Rules 2016[7] contains most of the relevant secondary legislation.

It is most commonly the directors of a company who propose a CVA. Where the directors propose a CVA they must approach an insolvency practitioner to act as nominee. The nominee's role is to opine on the proposal (and will frequently assist with its drafting in the role of adviser as distinct from nominee). If the nominee's opinion is that the proposal has "a reasonable prospect of being approved and implemented"[8] that opinion will be filed at court and the proposal will be put to the members and creditors of the company. If the unsecured creditors agree to it by a majority of at least 75% in value of those creditors voting, the CVA becomes binding upon the company and all the unsecured creditors (even those who voted against the proposal). Secured creditors are only bound if they agree to be bound. Creditors may apply to the court if the CVA's terms are unfairly prejudicial or if there was some material irregularity in the procedure leading up to its approval.

Once approved, the CVA is given effect to under the supervision usually of the nominee who becomes the supervisor upon the CVA being approved.[9] Its terms are then carried out in much the same way as any other commercial contract. If all creditors are paid what the CVA has promised, the CVA will complete. If the company does not satisfy the terms of the CVA, for example, if it is unable to keep up with monthly payments, the CVA's terms will often have provisions for how to deal with its termination. A CVA which terminates will often lead to the company entering a subsequent insolvency procedure such as a liquidation.

The CVA procedure suffers from an apparent weakness. There is no moratorium on actions against the company whilst the CVA proposal is prepared and considered. Creditors may therefore frustrate a possible CVA by enforcing their rights prior to the decision-making procedures convened to approve the proposal. In cases where a moratorium would be helpful in allowing time to permit the CVA to be put to the creditors, two main possibilities exist.

First, the company may be placed into administration.[10] Administration brings with it a wide-ranging moratorium or stay on creditor enforcement action. It permits an administrator, who will have taken over the directors' management role, some respite from creditor harassment whilst he or she attempts to achieve one of the statutory purposes of administration. The preparation and approval of a CVA would usually be intended as a way of achieving the primary purpose of administration, that is, to rescue the company.[11]

Alternatively, it is possible for the directors of a small company[12] to remain in post and acquire the benefit of a CVA-specific moratorium under Schedule A1 to the Insolvency Act 1986. The procedure requires an insolvency practitioner nominee once again to opine on the proposed CVA. If the nominee is of the opinion that the proposal has a reasonable prospect of being approved and implemented and that the company is likely to have sufficient funds available during the moratorium period to enable it to carry on its business, the directors may file that opinion (together with other documents) at court. The filing at court automatically creates a 28-day moratorium,[13] which allows the company's members and creditors to vote on the proposal.

It should be noted that the moratorium provided by administration permits time for the administrator both to prepare *and* seek approval of the CVA. There is no requirement for the CVA proposal to be in existence prior to the appointment of the administrator. From the directors' viewpoint, putting the company into administration so as to ensure a stay on creditor action, has the marked weakness that the administrator controls the company and the process, not the directors. It may also prove to be expensive due to the administrator's fees.

The Schedule A1 moratorium does permit the directors to remain in control of the company but suffers from two main weaknesses. First, the moratorium is only available if the proposal is already in existence and is one upon which the nominee has expressed a positive opinion. Secondly, nominees are in practice reluctant to provide an opinion that the company is likely to have sufficient funds available during the moratorium period to enable it to carry on its business. Nominees consider that they are not usually in a position to provide such a positive opinion on what may turn out to be unreliable financial evidence. Their concern that they may incur personal liability for providing a defective opinion appears to be one of the main reasons why the Schedule A1 moratorium is rare in practice.[14]

The Government's 2016 consultation, which informed the Government's reform proposals announced in 2018, suggested a new form of statutory moratorium where the directors would be able to remain in effective control whilst attempting to put together some form of rescue package such as the preparation of a CVA proposal.[15] Such a "pre-insolvency" moratorium would cover:

> both initial negotiations, aimed at developing a proposal, and, if needed, the time required for creditor approval of a statutory proposal.[16]

It is interesting to note that similar reforms have been proposed in the past, by Governments of all persuasions, but none has been put into effect.[17]

The 2018 reform proposals also include the proposed introduction of a new restructuring plan which, amongst other things, requires court approval for any rescue plan approved by a 75% majority of different classes of creditor. The above outline of the mechanics of a CVA and reform proposals is intended to provide a broad idea of the legal and procedural background to the research project.

3 | STRUCTURE OF THE REPORT

The project had three main avenues of enquiry: quantitative data gathering and analysis; qualitative data gathering and analysis; and comparative analysis.

The Report first considers the outcome of all 552 CVAs involving companies in England and Wales which commenced in 2013.[18] This year was chosen to allow a sufficient period of time to have passed to permit a meaningful analysis of the outcomes, and what may constitute a "successful" CVA. The headline findings of this analysis are set out in Section 4 below.[19] Further data was gathered through a survey of R3 members in the summer of 2017 and then a series of semi-structured interviews with representatives of various stakeholder groups including IPs, lawyers, landlords, secured creditors and unsecured creditors in late 2017 and early 2018. The findings are summarised in Sections 5 and 6 below, respectively.

Finally, the Report considers approaches at national and international level to encourage business rescue. The proposals in the UK Government's 2016 Consultation "A Review of the Corporate Insolvency Framework: A consultation on options for reform" are considered,[20] together with the draft EU Directive on preventive procedures from November 2016.[21] Domestic reforms in the Netherlands and South Africa are also considered, to determine if there are lessons to be learnt from other jurisdictions. A summary of this detailed analysis is set out in Section 7 below. Based on the findings from this broad approach, the Report makes a number of recommendations to enhance the success, and perception, of CVAs and in turn improve the prospects of business rescue. These are set out in Section 8 below.

4 | REVIEW OF CVAS COMMENCED IN 2013

Data collection and analysis was carried out in relation to all 552 of the CVAs entered into by companies in England and Wales in 2013. The initial review recorded key information including the start and end date of each CVA, the outcome, the size of the company involved and whether a form of moratorium was used (Phase One). Data were collected based on filings at Companies House up to November 5, 2017. Three key categories emerged from the data collected: CVA outcome; company profile and use of a moratorium; and the involvement of IP firms. Following this initial analysis, secondary data collection was carried out to look more closely at those CVAs which were terminated early to determine the impact of these terminated CVAs (Phase Two).

This article will focus on CVA outcomes, lengths and use of an available moratorium, highlighting the key findings of the Report. It will then go on to consider some of the headline findings in respect of those CVAs which were terminated early. More detailed discussion and analysis of these, and the wider findings, can be found in the Report.

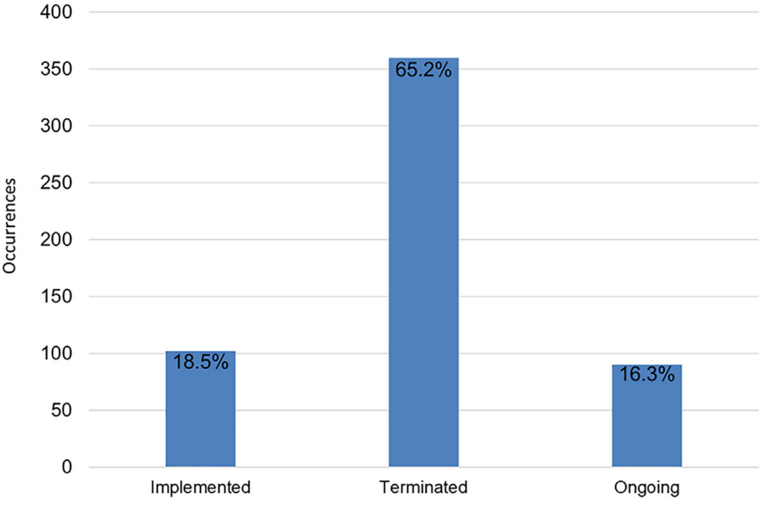


CHART 1 CVA outcomes. Source: Survey Data Collection. CVA, Company Voluntary Arrangement [Color figure can be viewed at wileyonlinelibrary.com]

4.1 | CVA outcomes

There were three possible outcomes for the CVAs under review at the end of the survey period. They had either been implemented (in accordance with the original or modified proposals), had been terminated early, or were still ongoing at the survey period cut off. These findings revealed some interesting statistics. Of the 552 CVAs commenced in 2013, 102 (18.5%) had been implemented, 90 (16.3%) were ongoing, with 360 (65.2%) having been terminated early, as shown in Chart 1 (below).

The high number of terminations stands out here. Around two-thirds of all CVAs commenced in 2013 did not achieve what, with the consent of creditors, they set out to do. This can, and has,[22] been viewed as a high rate of failure, though whether this is an appropriate interpretation will be considered in more detail in Section 4.4 below. An alternative view is that around a third of all CVAs were either implemented or ongoing by the end of the survey period. On the basis that over 16% of CVAs have continued for more than 4 years, there would appear to be a reasonable prospect of these progressing to implementation, raising the overall implementation rate to over one third. This assumption appears to be reasonable in the context of the length of completed CVAs, considered at Section 4.2 below, and that CVAs are typically proposed for a 5-year period, as revealed by the R3 Member Survey discussed at Section 5 below.

4.2 | Length of CVAs

A number of interesting themes emerged from the CVAs which were either implemented or terminated. As can be seen from Chart 2 below, the majority of all CVAs saw some form of outcome within 3 years of commencement.

It appears that when a CVA terminates, it tends to terminate reasonably early. Around a quarter of all CVAs commenced in 2013 (24%) were terminated within 12–18 months of commencement. In all, nearly a third of all CVAs were terminated within 18 months of proposals being approved by creditors. Supervisors are required to terminate CVAs in a number of specified circumstances, which frequently include failure to make three consecutive (usually

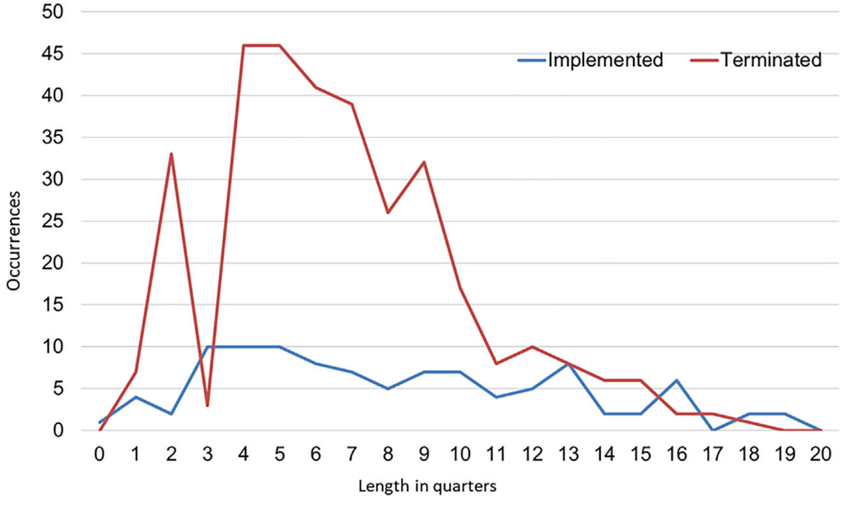


CHART 2 Length of CVA. Source: Survey Data Collection. CVA, Company Voluntary Arrangement [Color figure can be viewed at wileyonlinelibrary.com]

monthly) contributions. Furthermore, it was observed that there was often a delay between such a trigger event and the CVA being terminated.

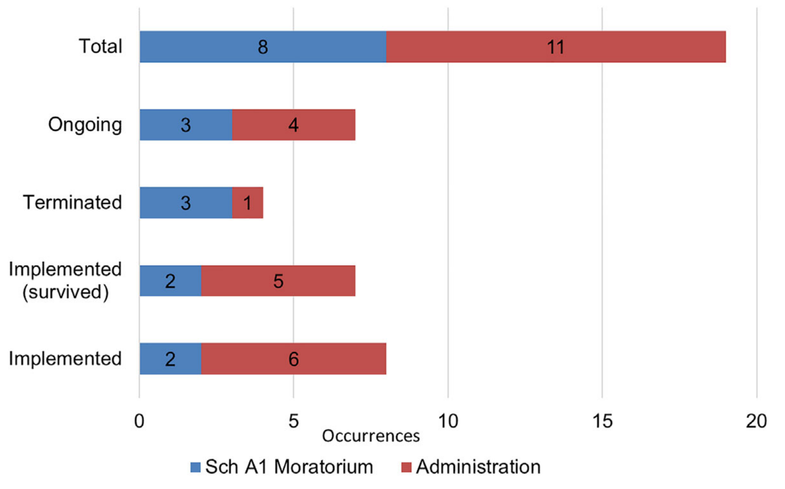
On this basis, it is likely that these early terminations may have ceased being effective some time before termination, making little or no contribution to the CVA. In particular, there is also a surprising spike of very early terminations, with 40 CVAs (7% of all CVAs commenced in 2013) terminating within 6 months of commencement. This high proportion of early terminations raises doubts about the viability of these CVAs from the outset. Whilst it is conceivable that some companies will experience catastrophic events soon after approval of a CVA, it is highly unlikely that such a fate befalls such large numbers of companies. If these 40 cases are excluded, the overall implementation rate rises to 19.9% and the termination rate drops to 62.5%. This supports the suggestion, consistent with some of the stakeholder interviews discussed in Section 6 below, that further thought may need to be given to the preparation and approval processes for CVAs.

It is also noticeable that a number of CVAs are implemented relatively early (over 40 within 18 months of commencement), especially in the context of the perceived norm of the 5-year CVA. It was observed that a number of CVAs were implemented early following a variation, which then allowed the company to operate free from the constraints of the CVA. The relatively shallow tail, and in particular the drop-off in the number of terminations from 36 months onwards, supports the prospect of the 90 ongoing CVAs being fully implemented in the fullness of time. Such a late spike in implementations would provide interesting food for thought with regard to the outcomes of CVAs which are able to go full term.

4.3 | Use of a moratorium

Of the 552 companies entering into a CVA in 2013, 514 were small or micro companies.[23] As such, 93.1% of CVA users in 2013 qualified for the Schedule A1 moratorium introduced by the Insolvency Act 2000. Despite this, uptake of this safe harbour is incredibly low. Only eight companies made use of the Schedule A1 moratorium in 2013 (1.6% of those eligible), whilst a

CHART 3 Use of a moratorium. Source: Survey Data Collection [Color figure can be viewed at wileyonlinelibrary.com]



further seven companies entered into a CVA having first been in administration, thus having benefited from the associated moratorium.[24] A further four "non-small" companies entered into a CVA having first been in administration.[25]

The outcomes of those CVAs which followed some form of moratorium varies noticeably from the general trend considered in Section 4.1 above, as Chart 3 illustrates. Whereas only 18.5% of all CVAs were implemented, the implementation rate jumps to 42.8% when preceded by a moratorium. A further 36.8% were ongoing, compared to 16.3% of the general population. Strikingly, only 21% of these CVAs were terminated, compared with the overall figure of 65.2%.

Whilst the sample is too small to draw any firm conclusions on the efficacy of a moratorium leading into a CVA, the divergence from the general trend is striking. Since publication of the Report, the Government has proposed, following consultation, the introduction of a pre-insolvency moratorium available to companies of all sizes as a gateway to a number of possible outcomes, including a CVA.[26] This would in turn lead to the repeal of the little used moratorium for small companies available under Schedule A1 of the Insolvency Act 1986. On the basis of the albeit limited evidence in the Report, an accessible and user-friendly moratorium could prove beneficial to the outcomes and efficacy of CVAs.

4.4 | Terminated CVAs: A closer look

At face value, if a CVA has been terminated prematurely, it will not have achieved its aims, and therefore will not have been successful. This is a rather arbitrary distinction that potentially overlooks positive outcomes in CVAs which are ultimately terminated. In Section 4.2 above, it was identified that the 360 terminated CVAs were brought to a close from anything between 1 and 18 quarters after commencement. This provides considerable scope for what could have happened in such timeframes. In particular, a level of contributions should have accrued, especially in those cases terminated after more than 1 year, that would allow for some form of distribution to unsecured creditors, given such funds are usually held on trust for CVA creditors.[27] Phase Two of the data collection therefore looked more closely at these terminated CVAs, to determine whether dividends were being paid and, if so, whether such CVAs could be considered a qualified success, even though not fully implemented.

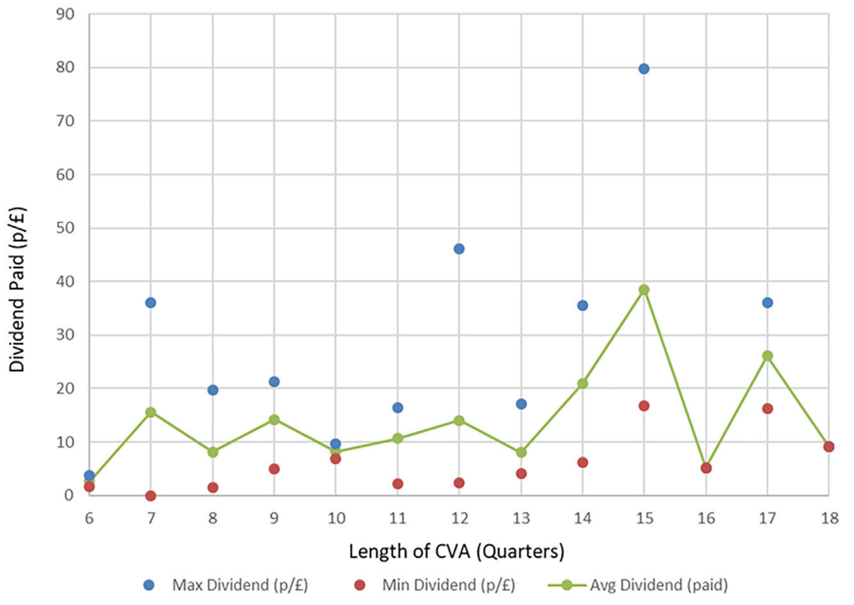


CHART 4 Dividends in terminated CVAs. Source: Survey Data Collection. CVA, Company Voluntary Arrangement [Color figure can be viewed at wileyonlinelibrary.com]

A total of 244 CVAs were terminated after more than four full quarters. Initial sampling revealed no dividends being paid in CVAs lasting four quarters and very few in CVAs lasting six quarters. Phase Two therefore focused on CVAs terminated between 6 and 18 quarters post-commencement, with a random sample of 64 companies investigated. This revealed that the longer the CVA went on, the greater the chance of a dividend being paid. This is particularly the case where the CVA terminated after 12 or more quarters, though there were still examples of long-running CVAs where no dividend was paid.[28]

Whilst a dividend was being paid in many of these CVAs, this was often not substantial. As Chart 4 below illustrates, the average dividend is typically between 10 and 20 pence in the pound. Thus, whilst dividend payments are more likely the longer a CVA runs for before being terminated, this outcome is not certain and there is no apparent consistency in terms of the level of dividend being paid.

Whilst the level of dividend, when paid, appears to be low, a clearer picture emerges when the payment is considered in the context of both how close the CVA is to its proposed end date and also what level of dividend was accepted by creditors in the CVA proposals. There was some evidence that the closer a CVA gets to its proposed length, the closer the dividend actually paid was to the level of dividend proposed. There was, however, still considerable shortfall in most cases. This brings into question whether there would have been sufficient contributions to pay a full dividend had the CVA run its course.[29]

The Report found that early termination of a CVA is not necessarily indicative of the CVA having failed. Whilst the CVA may not have achieved the intended purpose, unsecured creditors regularly receive dividends in terminated CVAs, often in excess of what might be expected in the alternative procedures of a pre-packaged administration or insolvent liquidation.[30] The level of these dividends was, however, found to be lower than that proposed, even where a CVA terminated near to its proposed completion date. This problem was exacerbated in cases where there were a number of missed contributions, which undermine the accumulated funds available to unsecured creditors. Additional contributing factors appear to be whether the proposed dividend levels were realistic for the company to achieve when trading within a CVA, and the suitability of the management team to trade the company and make these contributions.

5 | R3 MEMBERSHIP SURVEY

In the summer of 2017, an online survey of R3 members was carried out.[31] The survey asked 28 substantive questions of practitioners. The survey was answered by 156 R3 members of whom 101 were insolvency appointment takers. Of the respondents, 117 had acted either in the capacity of advisor, nominee or supervisor in relation to a CVA in the previous 3 years. This was an encouraging response rate, based on the findings of the 2013 CVA data collection, which revealed 164 different IP firms acting as CVA supervisors.

The survey sought to establish the reasons for CVAs failing, both at the proposal stage and after approval. As there are no official records of CVA proposals which fail to gain creditor approval (and so do not form part of the analysis above based upon records held at Companies House), the survey sought the views of respondents as to the reasons why formal proposals were not approved by creditors. The responses showed that formal proposals failed to proceed largely due to a lack of support from HMRC (60%), unsecured creditors generally (40%) and key suppliers (34%). Where the proposals are approved, but the CVA subsequently fails, over half of the respondents suggested that this was a result of overly optimistic financial forecasts or underestimating the impact of the CVA on working capital. Further factors included failure to pay post-CVA creditors (29%), directors not implementing the necessary changes (28%) and the proposal failing to identify and address all of the company's problems (24%).

Additionally, the survey sought to identify the engagement and impact of creditors in the CVA process. Respondents reported that HMRC was the creditor most engaged in the CVA process (55% of responses), followed by trade creditors (45%), landlords (38%) and secured creditors (36%). Perhaps not surprisingly, HMRC (71%) and landlords (35%) were considered the creditor groups most likely to oppose a CVA.

Finally, the survey sought to identify what could be done to improve the effectiveness of the CVA process as a rescue tool. Over 60% of respondents consider CVAs to be a very effective or fairly effective rescue tool, and nearly 70% believe that with some changes CVAs have the potential to be used more than at present. The two most important reforms identified were more support from HMRC (60%) and the introduction of a revised moratorium process (40%). Other key changes relate to education in the use of CVAs, with a more realistic approach by directors (37%), a better understanding of the CVA process (25%) and more support from suppliers (25%) raised as areas for improvement.

6 | STAKEHOLDER INTERVIEWS

In addition to looking at a large number of CVAs and surveying the profession, it was important to interview a broad cross section of stakeholders to elicit their views on current CVA practice and to identify where improvements might be made. A number of semi-structured interviews were conducted in late 2017 and early 2018 with IPs, insolvency lawyers, secured creditors, landlords and unsecured creditors.

The main topics covered in the interviews included a number of suggestions made by the Government in the Consultation. The main points discussed were:

- the reasons for early termination of CVAs;
- the possible need for a pre-insolvency moratorium[32];
- the introduction of a provision preventing executory contracts being terminated by a company entering a CVA[33];
- the possibility of a standard form of CVA terms and conditions;
- the possibility of legislating for the priority of new rescue funding[34]; and
- the duration of CVAs.

Full discussion of these interviews and the response of each stakeholder group is set out in Part 7 of the Report. This article will consider the general themes which arose from these interviews.

All stakeholder groups viewed CVAs as essentially a beneficial restructuring tool. The flexibility of the process and engagement of creditors were considered to be two of its prime facets, and stakeholders on the whole showed a willingness to support a CVA, even when not entirely convinced about the proposal. The proposals were subjected to closer scrutiny by certain creditor groups, including secured lenders and landlords, particularly in the case of high value debts. There was only lukewarm support for the introduction of a pre-insolvency moratorium, however, with concerns over abuse and diminution in the value of security.

Whilst generally seen in a positive light, a number of concerns about the use and operation of CVAs were raised by various stakeholder groups. A particular concern was the role of a company's directors, who are perceived as slow to act, and then fail properly to understand what is needed or to implement the necessary changes to the business. Success was more likely where there was open and honest dialogue and changes were made. A further impediment to success was the excessive length of many CVAs, with 5 years seemingly becoming a default option. A 2- to 3-year duration was generally seen as more sensible, though this presented difficulties in being able to offer creditors enough to back proposals. Inevitably, a long CVA will often result in “a slow death by a thousand cuts” for the company.

The role of IPs in the CVA also raised concerns from the interviewees, including from IPs themselves. There was some confusion over the nature of the role of both nominee and supervisor. It was suggested that nominees' assessment of proposals could be more effective. These were often overly optimistic, for example setting out ambitious cash flow or collectibles predictions. Some considered there to be an element of self-interest in IPs recommending a CVA, which would lead to their appointment as supervisor. In turn, there was no consensus as to what the role of the supervisor is or should be.

Some respondents reported a lack of confidence in the multiple roles adopted by an IP in the CVA process, and it was suggested that a turnaround professional may be better suited to overseeing the process once approved. There was also some concern expressed as to the extent of fees extracted by IPs during the CVA process. Perhaps unsurprisingly, different stakeholder groups also revealed concerns that their interests were not always fully recognised.

A number of landlords felt that their interests were not fully protected under the current CVA regime. Along with other types of creditors, landlords wanted fair treatment. They generally accepted that different leases will be treated differently in a CVA as some are more profitable to the company than others, with some unprofitable.[35] It is therefore common, at least in large retail CVAs, to have perhaps three (or more) categories of lease identified with more profitable leases treated more favourably than the less profitable leases under the terms of the CVA. Rent under leases in the top category will often continue to be paid in full during the CVA. Landlords whose leases fall within the second category may have to accept a compromise on the full rent for the duration of the CVA but the landlord will usually have the option to break the lease if it is able to re-let it to a new tenant at a higher rent. Leases which fall within the final category are usually handed back to the landlord under the terms of the CVA. Although there may be variations on this theme, such a structure is often the basis for dealing with rent payable during the CVA. Although some landlords viewed the differential treatment of different leases as potentially actionable as “unfairly prejudicial” under section 6 of the Insolvency Act 1986, the court has recently effectively held that such CVAs are fair, as long as any rental payments under the CVA's terms are not below market value.[36]

The final theme to emerge from the stakeholder interviews was the role of HMRC.[37] Interviewees criticised the approach of HMRC, which was reported as failing properly to engage early in the CVA process, instead imposing standard terms not necessarily suited to the CVA. There was also a general belief that HMRC votes on policy grounds rather than purely commercial reasons, in that HMRC often votes down a CVA if the debtor has a poor taxation compliance record even where the CVA is likely to lead to a better return to HMRC than under any alternative process (usually a liquidation). A concern was raised that HMRC was inconsistent in its approach, with a suggestion that HMRC institutes an internal procedure to respond in a timely manner.

7 | NATIONAL AND INTERNATIONAL REFORM PROPOSALS

The Report considered international trends, best-practice guidelines and reforms being introduced in individual jurisdictions. This was to identify developments that the UK may find useful in considering possible reforms. In doing so, the Report considered the Netherlands, where significant reform is working its way through parliament, and South Africa, where wide-reaching reforms were introduced in 2008.[38]

7.1 | World Bank Doing Business Report and Principles

The World Bank's annual Doing Business Report plays an important role in law reform, as is evidenced by the reference to it in the 2015 Conservative Party election manifesto. The Conservative Party (which subsequently won the election to form the Government) committed itself to being in the top five in the world and number one in Europe in the Doing Business Report. To this end, as mentioned earlier, the Government consulted on possible improvements to the existing corporate insolvency regime, with proposals for reform published in August 2018.[39]

The UK held an overall ranking of 7th in the 2018 Doing Business rankings with a drop to 8th in the 2020 rankings.[40] It is, however, important to note that although this is not an undesirable ranking, it seems that other jurisdictions have improved more in their distance to the frontier points than the UK, currently on 83.5 in the Doing Business Report of 2020.[41] One obvious indicator of the UK's worsening overall performance is the Resolving Insolvency indicator, where the UK is ranked 14th, with a drop of 1.74 percentage points from 82.04 in 2017 to 80.3 in 2020.[42]

The movements on the UK rankings can be contrasted with that of the Netherlands. The Netherlands currently ranks 42nd overall; although they have slipped in the overall rankings in previous years, they continue to improve on the Resolving Insolvency indicator. Here the Netherlands is ranked 7th, with 84.4 percentage points.[43] The Netherlands also outranks the UK on the Strength of Insolvency framework index, where the UK holds an 11 against the 11.5 of the Netherlands. As part of the continued strengthening of their position the Netherlands is currently in the process of corporate law reform, including the introduction of a new Bill for a Scheme of Arrangement which seeks to amend the Dutch Bankruptcy Act.

Several of the World Bank principles are relevant to this discussion, but beyond the scope of this article. These principles, most notably the principles regarding the governing of directors' obligations, the moratorium or stay provisions and the powers of insolvency representatives to deal with contracts, are discussed in more detail in the Report.[44]

7.2 | European Union

In 2016, the European Commission published the Draft Directive, to increase the efficiency of restructuring, insolvency and discharge procedures.[45] The explanatory memorandum to the proposal highlighted the importance of efficient rescue and restructuring mechanisms to increase investment and job opportunities. The Directive was adopted on March 28, 2019 and came into force in June 2019.[46] The focus of the Directive is on harmonising the principles of restructuring proceedings and second chance frameworks in the Member States. Above all, however, the Directive aims to enhance the rescue culture in the European Union. The relevance of the Directive for the UK in the wake of Brexit might be disputed but the international best-practice guidelines provided therein may be of importance for productive international trade relations between the UK and other Member States within the European Union.

The Directive places an emphasis on early intervention mechanisms. It proposes rules to ensure that, where the likelihood of insolvency exists, directors have obligations to take immediate steps to minimise loss for stakeholders and to take reasonable steps to avoid insolvency. The importance of early intervention is emphasised throughout the preamble, and it is stated that the probability of avoiding impending insolvency significantly increases the sooner the debtor can detect its financial difficulties. It therefore suggests that early warning mechanisms to incentivise debtors to take early action and tools, such as accounting and monitoring duties for the debtor's management, should be available.

The excessive length of restructuring procedures in many Member States leads to low rates of recovery and deters investors from doing business in jurisdictions where proceedings take too long.[47] Various provisions aimed at reducing the length of restructuring procedures, most notably the limits placed on the length of the stay, are incorporated in the Directive.

Articles 6 and 7 of the Directive provide for the rules pertaining to the time-limited stay of individual enforcement actions. This should also include a suspension of the obligation to file for the opening of insolvency procedures where such actions may adversely affect negotiations and hamper the prospects of a restructuring of the debtor's business. The stay is to be applicable in respect of all types of creditors, including secured and preferential creditors. It may be general covering all creditors, or limited, covering one or more individual creditors. In a nutshell, it proposes that a stay can initially be no longer than 4 months, but that it can be extended under certain conditions.

7.3 | UK Government 2016 Consultation and 2018 Response

In May 2016, the UK Government launched the Consultation, which sought views on four proposed areas for reform of the UK's corporate insolvency framework:

- The creation of a new moratorium period for financially distressed (but ultimately viable) companies. In terms of this moratorium creditors would not be able to take action against the company in this period, during which it would be making preparations to restructure;
- A provision that would require essential suppliers to continue to supply to a financially distressed company on existing terms and not use termination clauses or demand “ransom” payments;
- The creation of a “new restructuring plan”—a company rescue vehicle that would enable (for the first time in the UK) a “cram down” of classes of dissenting creditors; and
- Measures to encourage “rescue finance” (money lent to a company in an insolvency procedure to assist in its survival).[48]

The Government published a response to the Consultation in August 2018.[49] In this, the Government undertook to implement measures in line with those proposed in the Consultation, subject to some revisions, as soon as parliamentary time permits. The response mentions the creation of a 28-day moratorium,[50] available to all companies (with some exceptions) providing eligibility criteria are met; during which time the directors would remain in control of the company and creditors' interests be protected by an authorised supervisor.

The Government noted that the moratorium would be modelled on the same parameters as the administration moratorium. In responding to the overwhelming concerns regarding the designation of certain suppliers as essential, the Government stated that is no longer intends to require the designation of essential suppliers by a debtor company. However, it intends on introducing legislation to prohibit the enforcement of “termination clauses” by a supplier. The Government also intends on proposing a restructuring plan which would allow the cross-class cram down of the company's restructuring proposals onto both secured and unsecured creditors. The identification of new forms of rescue finance is something the Government no longer intends to pursue.

It is clear that the proposals for reform as contained in the Consultation and Response are reflective of the World Bank principles and the EU Directive making it a move in the right direction as far as international best practice is concerned.

7.4 | International examples

7.4.1 | The Netherlands

The Dutch Bill on the confirmation of a private restructuring plan in order to prevent bankruptcy closely follows and incorporates the World Bank principles, as well as the proposals put forward in the Directive.[51] The Bill, known as WHOA (Wet homologatie onderhands akkoord ter voorkoming van faillissement), bears similarities with the UK Scheme of Arrangement and US Chapter 11 Bankruptcy proceedings.[52] The consideration given to the World Bank principles and the Directive will reflect positively on the resolving insolvency indicator of the Doing Business report.[53]

WHOA aims to respect the rights of creditors as much as possible, whilst providing for provisions to limit their rights in order to encourage successful corporate rescues.[54] WHOA provides for an out of court composition with creditors by way of a restructuring plan that may be initiated by either the debtor[55] or a creditor[56] which may be confirmed by the court to be binding on all creditors. A discussion of the most relevant aspects of WHOA is set out below.

A key proposal of WHOA is a stay of enforcement. The stay will, however not happen automatically but has to be requested from the court.[57] During this period, the duration of which may not exceed 2 months, any right of a third party to enforce their claims against the property of the debtor (or property under the debtor's control) may not be exercised, save with the court's permission. The stay is also extendable once, upon request, but by no more than 2 months. This means the total duration of the stay may not exceed 4 months. The granting of the stay may also be challenged by a creditor or third party.[58] The stay may also be general in nature or targeted to specific claims and creditors.

Although WHOA does not provide for the retention of essential supply contracts specifically, it does offer some flexibility to amend contracts or to reject contracts that are too onerous for the debtor.[59] To this end WHOA provides that a debtor may make a proposal to a counterparty with whom it has concluded an executory contract seeking to modify that contract.[60] If the counterparty does not agree to the proposal, the debtor may terminate the contract at a time at which it would usually terminate (and the agreed notice period was observed). Upon modification or termination, the counterparty obtains a claim for damages against the debtor.[61]

WHOA provides for creditors and enfranchised shareholders to be placed in different classes.[62] Creditors will vote in their respective classes and a plan will have been approved if at least two-thirds of the number of votes cast by that class voted for the plan.[63] If at least one class voted in favour of the plan the debtor may file a request with the court for confirmation of the restructuring plan. Such confirmation will have the effect that the restructuring plan and will become binding on all enfranchised creditors and shareholders.[64] This will bring about a cross-class cram down, although the absolute priority rule will still apply.[65]

7.4.2 | South Africa

The South African Business Rescue procedure was considered with specific reference to the widening of the scope of the term "financial distress" as a requirement for entering a rescue procedure and how this encourages early intervention. If a company cannot pay its debts as they become due in the next 6 months, then the directors must either put the company into Business Rescue before it becomes insolvent, or explain to creditors why they have not done so.[66]

The South African Business Rescue regime, therefore, places an emphasis on early intervention and as such has given the term "financial distress" a very wide definition by introducing a 6-month time period. Section 128(1)(f) of the Companies Act 2008 states that a company will be deemed to be financially distressed if it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing 6 months,[67] or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing 6 months.[68] The adding of the 6-month time period was to encourage the early commencement of Business Rescue which in turn maximises the chance of a successful rescue.

The formulation of the concept of financial distress in the Act also refers to commercial and factual insolvency at a future date implying that Business Rescue should not be utilised by companies that are already insolvent. South African courts agree with this and have at numerous occasions denied applications for the initiation of Business Rescue where the companies were insolvent and not in financial distress.[69] This will likely be of interest to the formulation of the pre-insolvency moratorium being proposed in the UK, which will not be available to insolvent companies.

8 | CONCLUSION—RECOMMENDATIONS FOR REFORM OF CVAS

It is clear from the findings considered above, and in more detail in the Report, that the CVA is a flexible tool that takes many forms with varying aims. The outcomes are also incredibly varied, with even terminated CVAs offering potentially improved outcomes compared to the next best alternative. As such, it is not straightforward to categorise a CVA as a success or failure. Nonetheless, it can be seen that the CVA is not perfect, and with reform both the outcomes and perceptions of CVAs could be improved. In this light, the Report makes the following recommendations for reform of the CVA process:

- CVAs should last no longer than 3 years without good reason.
- Directors' duties 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.
- 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.
- There could be consideration of whether the insolvency practitioner fee system used in other insolvency procedures should 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.

It is clear from developments overseas that the UK is fast being caught up and overtaken by other jurisdictions. With the uncertainties of the next few years clear for all to see, improving the UK's systems for resolving insolvency, in a way which shows informed incremental development appropriate to our jurisdiction, seems both sensible and necessary. Not all distressed companies can or ought to be saved. Where a company can be saved the law needs to encourage that process.

ENDNOTES

[1]Cork Committee, *Insolvency Law and Practice* (Cmnd 8558) (1982) ("Cork Report"), Chapter 7.

[2]There were 17,243 total company insolvencies in 2017 in England and Wales, of which only 292 were CVAs.

[3]See, for example, Judith Evans and Jonathan Eley, "Landlords file challenge to House of Fraser CVA" (*Financial Times*, 20 July 2018), available at: <https://www.ft.com/content/cdef6350-8c31-11e8-bf9e-8771d5404543>.

[4]Peter Walton, Chris Umfreville and Lézelle Jacobs. *Company Voluntary Arrangements*: *Evaluating Success and Failure* (2018), available at: <https://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/R3_ICAEW_CVA_Report_May_2018.pdf>.

[5]See, for example, Len Sealy, David Milman and Peter Bailey. *Sealy and Milman Annotated Guide to the Insolvency Legislation 2019* (22nd edn) (Sweet & Maxwell, 2019); Andrew Keay and Peter Walton. *Insolvency Law Corporate and Personal* (4th edn) (LexisNexis, 2017).

[6]Cork Report (above Note 1), Chapter 7.

[7]Insolvency (England and Wales) Rules 2016 (SI 2016/1024) ("Insolvency Rules 2016").

[8]Ibid., Rule 2.9(2).

[9]Statement of Insolvency Practice 3.2 which deals with practice guidance for CVAs emphasises a number of principles including: "An insolvency practitioner should differentiate clearly between the stages and roles that are associated with a CVA (these being, the provision of initial advice, assisting in the preparation of the proposal, acting as the nominee, and acting as the supervisor) and ensure that they are explained to the company's directors (where they are making the proposal), shareholders and creditors." (Paragraph 3).

[10]It is also possible for a liquidator to propose a CVA, but this rarely ever happens.

[11]It is interesting to note that the Cork Committee's view was that a CVA proposed by directors would be only likely, where for some reason it was not appropriate to appoint an administrator and where the CVA was a simple one and would prove of value to small companies: Cork Report (above Note 1), Paragraph 430.

[12]Under Paragraph 3, Schedule A1, Insolvency Act 1986, a company is eligible for the small companies' moratorium if it satisfies at least two of the three requirements laid down in Section 382(3), Companies Act 2006, namely: its turnover is not more than GBP 10.2 million; its balance sheet total is not more than GBP 5.1 million; and it has not more than 50 employees.

[13]Paragraphs 7 and 8, Schedule A1, Insolvency Act 1986.

[14]See, for example, the Government's response to the consultation of the Department for Business, Energy and Industrial Strategy, *Insolvency and Corporate Governance*: *Government Response* (BEIS, 2018) ("BEIS Response"), Paragraph 5.69, available at <https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>, where it is suggested that there is a need to legislate for a limited immunity from action for insolvency practitioners monitoring a moratorium.

[15]*A Review of the Corporate Insolvency Framework*: *A Consultation on Options for Reform* ("Consultation"), available at: <www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework>.

[16]Ibid., Paragraph 7.7.

[17]See the full account of such reform proposals explained in Chris Umfreville, "'Mora' the same: Reflecting on the Latest Attempts to salvage Company Rescue" (2017) 28 *International Company and Commercial Law Review* 385. The Covid-19 pandemic has become the catalyst for the Government to bring into force its longstanding reform proposals.

[18]The authors would like to thank the Insolvency Service who assisted in the identification of these CVAs.

[19]The Report also considered a random sample of 100 companies, which entered into a pre-packaged administration in 2016, to identify the reasons given by IPs as to why a CVA was not thought to be a better option than a pre-pack. This is not considered in this paper.

[20]Consultation (above Note 15).

[21]*Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU* (2016/0359(COD)) ("Draft Directive"). In addition, the report of the European Law Institute, *Rescue of Business in Insolvency Law* (July 2017) looks at similar issues. It is available at: <http://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf>.

[22]*A Review of the Corporate Insolvency Framework*: *Consultation Stage Impact Assessment*, Paragraph 1.58, available at: <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525529/Consultation_stage_corporate_insolvency_consultation_Impact_Assessment_-_Mar_2016.pdf>.

[23]In accordance with the definition in Sections 382 and 384A, Companies Act 2006 (based on Companies House filings).

[24]Paragraphs 42–43, Schedule B1, Insolvency Act 1986.

[25]It is important to note that further companies may have utilised the interim moratorium pursuant to Paragraph 44, Schedule B1, Insolvency Act 1986, triggered by filing a Notice of Intention to Appoint Administrators by a company or its directors. This appears to have been common practice prior to the ruling in *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* [2018] 1 WLR 24. For a discussion of the impact of this case, see Chris Umfreville, "Curtailing the use of multiple Notices of Intention to Appoint Administrators: the case for a moratorium?" (2017) 395 *Company Law Newsletter* 1–4.

[26]BEIS Response (above Note 14).

[27]*Re NT Gallagher & Sone Ltd* [2002] BCLC 133.

[28]Dividends were paid in all CVAs terminated after between 12 and 18 quarters, save for one-third of cases terminated after 14 quarters and half of cases terminated after 16 quarters.

[29]See Paragraph 4.2.4 of the Report for a detailed discussion of the level of dividends compared to the level of dividend proposed.

[30]For a comparison of the outcomes of CVAs and pre-packaged administrations, including returns to creditors, see Chris Umfreville, "Pre-Packaged Administrations and Company Voluntary Arrangements: The Case for a Holistic Approach to Reform" (2019) 30(11) *International Company and Commercial Law Review* 581.

[31]The authors are most grateful to the R3 members who kindly responded to the survey and are particularly grateful to Nick Cosgrove of R3 who was instrumental in the creation and operation of the survey.

[32]See Consultation (above Note 15), Part 7.

[33]Ibid., Part 8. Such a provision would be wider than the current provisions dealing with essential suppliers in Sections 233-233A, Insolvency Act 1986, such that suppliers identified as essential would be required to continue to supply goods or services during any moratorium.

[34]Ibid., Part 10.

[35]See the discussion in *Discovery (Northampton) Ltd and others v Debenhams Retail Ltd and others* [2019] EWHC 2441 (Ch), [17].

[36]Idem.

[37]HMRC was invited to take part in the interviewing process, but was unable to do so due to the concern that sharing its observations from an operational perspective risked straying into areas of policy that were proper to another government department.

[38]See Paragraph 8 of the Report for a detailed discussion on the jurisdictions and the reform initiatives introduced there.

[39]See BEIS response (above Note 14).

[40]The Doing Business Reports of the World Bank are available at: <https://www.doingbusiness.org/>.

[41]An economy is measured by its distance to the frontier which represents the best performance observed on each of the indicators across all economies. The distance to the frontier score or "DTF score" of an economy is reflected on a scale of 1 to a 100, where 0 represents the lowest performance and 100 represents the frontier. Each indicator used to measure the DTF score of an economy is based on a set of best practice principles developed by the World Bank and UNCITRAL in conjunction with other governing bodies and stakeholder organisations.

[42]The UK has ranked 14th on the Insolvency Indicator for a number of years, despite the fluctuation in percentage points.

[43]Above Note 40.

[44]See Part 8.2 of the Report.

[45]A copy of the initial proposal is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0723>.

[46]Directive of the European Union and of the Council on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (2019/1023 EU).

[47]Ibid., Preamble Paragraph 6.

[48]BEIS Response (above Note 14).

[49]Idem.

[50]Allowing for an extension of a further 28 days when necessary.

[51]The Dutch Ministry of Justice has submitted the Bill to parliament (second chamber). For more information on the process, see: <https://www.eerstekamer.nl/wetsvoorstel/35249_wet_homologatie_onderhands>.

[52]For an unofficial translation of the Bill, see: <http://www.resor.nl/>.

[53]For a more detailed exposition of the Dutch reforms, see Part 8.5 of the Report.

[54]Clifford Chance, "Revised Draft 'Dutch Scheme (WCO II)'" (11 September 2017), available at: <https://www.cliffordchance.com/briefings/2017/09/revised_draft_dutchschemewcoii.html>.

[55]Article 370, WHOA.

[56]Ibid., Article 371(1). The creditor is to approach the debtor with a request to propose a restructuring plan. Should the debtor fail to propose a restructuring plan within 1 month of having been asked to do so, the creditor may approach the court to request it to appoint an expert to propose a restructuring plan.

[57]Ibid., Article 376.

[58]Ibid., Article 377.

[59]Ibid., Article 373.

[60]Ibid., Article 373(1).

[61]Ibid., Article 373(2).

[62]Ibid., Articles 374 and 381(3). Creditors and shareholders with voting rights are the creditors and shareholders whose rights are amended under the plan.

[63]Ibid., Article 381(7).

[64]Ibid., Article 385.

[65]Above Note 54.

[66]For a more detailed exposition of the South African approach, see Part 8.6 of the Report.

[67]Section 128(1)(f)(i), Companies Act 71/2008, referring to the so-called cash flow test for insolvency.

[68]Ibid., Section 128(1)(f)(ii), referring to the so-called balance sheet test for insolvency.

[69]*Gormley v West City Precinct Properties (Pty) Ltd* (Unreported case); see also *Wellman v Marcelle Props* 193 2012 JDR 0408 GSJ: 12: "In my view, Business Rescue proceedings are not for the terminally ill close corporation." *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 2 SA 423 (WCC); *African Banking Corporation of Botswana v Kariba Furniture Manufacturers* (228/2014) [2015] ZASCA 69. "Suffice it to say that the company was clearly hopelessly insolvent and effectively dormant in that it had not traded for years and had no business contacts in place."

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