Focus on Company Voluntary Arrangements

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On 28 September 2009 it was reported that Blacks Leisure Group intended to go through a company voluntary arrangement (CVA) and close 80 of its 400 stores, which include the Blacks, Millets and Free Spirit chains. If it goes ahead, it will be the third high profile CVA this year, as more companies seek to secure survival by offloading unprofitable stores.

In August it was announced that Focus, the national DIY retailer, had successfully entered into a CVA, avoiding administration and safeguarding nearly 5,000 jobs. This in turn followed on from JJB Sports' CVA in May. But what is a CVA, and will there be more in the business pages in coming months?

What is a CVA?

A Company Voluntary Arrangement, also known as Creditors' Voluntary Arrangement, is an alternative to administration or liquidation for companies in financial difficulty, although it can also be used for solvent companies. The Board of Directors can suggest a CVA to creditors and shareholders, under part 1 of the Insolvency Act 1986. Notice of a meeting must be given to creditors and shareholders, to discuss the CVA. Proposals can include rescheduling the debt, or a debt for equity swap.

There must be a consensus in excess of 75 percent (by value) of creditors present and voting at a properly convened meeting to make the CVA binding. However the vote will be invalid if those voting against the CVA include more than 50 percent in value of the notified creditors who are not connected with the company. (This prevents the company's directors and other connected creditors from forcing a CVA through.) It also requires the approval of more than 50 percent in value of the company's members. If the members' decision differs to the creditors', however, the creditors' vote will be adhered to, with the option of appeal for the members.

The CVA is not binding on any secured or preferential creditors unless they agree to it. However, the CVA will bind all other creditors that were entitled to be notified of the meeting, even if they did not vote for it or did not attend the meeting. This avoids problems with creditors who cannot be traced.
Since January 2003, small companies also have the option of a moratorium, akin to that applying to a company in administration, before the CVA is put into place. However, in practice this is dependent on obtaining the consent of secured creditors.

Creditors can challenge a CVA in the 28 day period following the report of the meeting being filed at court. A creditor can challenge a CVA on grounds of unfair prejudice or material irregularity.
How often is it used?

Until recently there have been relatively few successful CVAs. Many directors are unaware that they exist and so do not explore the possibility. The CVA must be suggested by the directors, not the shareholders or creditors. Also, a CVA does not have the same advantage of an automatic moratorium as an administration.

Anecdotal evidence suggests that companies that have considered CVAs have generally been unsuccessful. Earlier this year Stylo, the shoe retailer, was unable take this route when the creditors voted against it, with landlords in particular objecting to a proposed rent reduction.

Creditors are usually averse towards CVAs because the compensation CVAs offer is often a fraction of the debt that it is owed them. Companies typically turn to CVAs as a last resort, when they have no money to offer their creditors, and as a result the creditors will not vote in favour of it. Two success stories show how a CVA can be done differently.

Success story number 1: JJB Sports

In May 2009 JJB Sports was successful in obtaining a CVA. There are a number of reasons why JJB Sports was successful where other companies were not.
First they focused on a specific group of creditors, while the others were left untouched by the CVA. It was aimed at the commercial landlords to whom they owed a great deal of rent. JJB Sport was forced to close a lot of stores in 2007-8 but was still contracted to pay rent on them.

Secondly, they offered compensation that was better than the alternative. They made a deal with the landlords of the closed stores allowing them to renege on the rent, and as compensation they would pay them, collectively, £10 million in two instalments. This compensation was substantially more than they would receive if the company went into liquidation; the only alternative if the CVA was refused.

They also agreed to pay the landlords of their open stores on a monthly, rather than a quarterly basis, for the next twelve months.

Success story number 2: Focus

The Focus CVA was in some ways similar to JJB Sport's. Focus had 38 'dark' or non-trading stores, which sucked cash out of the group without generating profit. The CVA worked to rid Focus of this drain on its cash flow, enabling it to concentrate on building its business up again. In return for getting out of the rent and service charge, landlords of the 'dark' stores are to receive a dividend, expected to be worth an average of 6 months' rent, to be paid next year.

Why might a company choose CVA?

CVA can be a beneficial solution for many companies. It allows them to pay only a proportion of their debt and to come to an arrangement over payment. This gives them time to restructure their company and possibly bring it to profit in the future. CVAs can terminate contracts, leases and employment contracts for no cash outlay. They only need to hand employees their P45s. And finally managers and directors can be terminated if necessary.

The employees may not be comforted by these benefits, but the shareholders and usually the existing board can remain in control of the company. A CVA is cheaper than other insolvency procedures, especially since there is only a limited amount of court involvement. It can also avoid the large fees paid to insolvency practitioners. Both can result in more money for creditors.

Finally, in some circumstances it may be possible to combine a CVA with an administration, which has its own moratorium.

Conclusion

It remains to be seen if CVAs will continue to hit the headlines — although, if this means the concept will avoid the bad publicity surrounding some other insolvency procedures, such as the pre-pack administration, its supporters will say this is no bad thing. A CVA will be an important option for many companies and, as the examples show, one that troubled companies should consider sooner rather than later.

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