Restructuring Trends

Company voluntary arrangements – friend or foe?

Company Voluntary Arrangements (CVA) have attracted considerable negative press coverage, particularly in the retail sector where landlords often feel disadvantaged by the process. The CVA has been described as an 'unfair' process, which is presented as a 'fait accompli' and gives creditors 'no time to react'. These are all terms that previously have been used in relation to pre-packs, although comparisons with other processes such as administration are seldom fully understood. This article examines why so many CVAs fail.

It's about the business not the CVA

A successful restructuring requires careful analysis of the business, its financial position and its prospects. A CVA is not a panacea for a business' lack of funding, weak product offering, poor quality management etc.

The closure of underperforming stores is often used in the restructuring of retail and other multi-site business, but it is important to understand that this is only part of the solution. JJB Sports, for example, went through two CVAs, but still ended up in administration, when only a small percentage of its stores were sold and for a fraction of book values. Customers had lost interest in the product offering and nothing was achieved by the CVAs. In comparison, Travelodge and Fitness First have thrived after a CVA, because both have a clearly defined and funded customer proposition.

Often, there is not enough independent scrutiny of the overall business and its operational plan when a CVA is proposed and boards may take a narrow view of the impact of the CVA. The advice given by some insolvency practitioners does not help this process.

Collective process and communication

The CVA process was not designed to target a particular group of creditors, such as landlords. The CVA was introduced as part of the 1986 Insolvency Act and is a collective process, as borne out by the fact that all unsecured creditors vote on it. Unsurprisingly, if disadvantaged parties see their losses being ratified by a vote, which includes creditors who are not affected, they take umbrage and feel disenfranchised. This does not enhance the company's relationships with these key stakeholders and a sense of mistrust continues, often until the business fails.

In this respect, a consultation period needs to be considered. The CVA allows for a 21-day notice period, although creditors often feel that, in practice, they have very little time to react. A good CVA needs some market testing, which is not always easy to accomplish, but is in keeping with the original intentions behind the introduction of the process.

Consideration of other processes

Any CVA proposal has to demonstrate that it is the best process available. If it is not, creditors might prefer an alternative. The calculations in CVA proposals comparing CVA outcomes with other processes can be too simplistic. They often compare the continuity of the business post CVA – even if the process does not have solutions to all of the company's issues – with an effective liquidation, ignoring the spectrum of outcomes in between.

Assuming some form of insolvency is necessary, landlords like the individual interaction they have with the insolvency tenant in, for example, an administration. This is because the insolvent tenant has to deal with each site (dealing with surrender, assignment, continuation and sub-letting). As a result, landlords often feel that they are less likely to be misled into agreeing to a deal where they have had very little dialogue and instead each site can be considered on its individual merits.

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Shareholder contribution

The CVA process was introduced into insolvency legislation with a strong hint in the wording that a proposal might involve new money coming in from shareholders to match the compromises and concessions made by creditors. In other words, the CVA was envisaged as being a deal. The successful Mamas and Papas CVA included this feature, which is also one of the few successful examples of the process.

In conclusion, achieving a successful CVA is not easy. If you, or your clients are being advised to consider a CVA it is important to remember:

- The underlying business has to be viable and the CVA is just one part of the solution, not the whole solution;
- If you have to change contractual terms with your creditors, engage with them as early as possible, so that they trust you and trust the process;
- Creditors will feel that a process in which shareholders also contribute to the solution has a better chance of succeeding; and
- A CVA is not the only process to consider – it has been touted as a quick process, with management remaining in control. However it has been proven empirically that larger restructurings involving consensual solutions, or using administration have a better survival rate.

If you would like to learn more about the CVA process please get in contact using the details below.

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