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CVAs, COVID-19 and Rescue Culture

In the second of a series of articles on Company Voluntary Arrangements Hannah Fry gives an overview of how CVAs fit with the current approach of "rescue culture" for companies facing financial difficulties due to coronavirus and reviews the new standard form COVID-19 CVA for SMEs recently published by R3.

Businesses across the United Kingdom are facing treacherous times. The COVID-19 pandemic and its consequent restrictions have caused many businesses to suffer a pronounced drop in income, turnover and profits whilst still being liable to pay overhead costs such as rent to landlords. When businesses start to re-open, they will need to find a way to pay the overhead costs accrued during the COVID-19 pandemic, as well as ongoing costs.

Current Use of CVAs

Many high street retailers have recently entered into CVAs including Pizza Express, Jigsaw, Pizza Hut, Travelodge and New Look.

New Look's CVA was approved by creditors on 15 September 2020. The CVA proposal includes switching more than 400 of its UK stores to a turnover-based rent model and a three-year rent holiday on its 68 remaining stores.[1] Although, no store closures are featured in the CVA, New Look closed more than 60 outlets under a previous CVA launched in 2018.

This week nationwide bar operator Revolution Bar Groups has launched a CVA of its subsidiary Revolution Bars Limited. The CVA proposal includes reducing Revolution Bars Group's estate of Revolution branded bars from 50 to 44 and obtaining improved rental terms for seven others.[2] Further, as part of the proposals Revolution Bars Group will write-off half of the £30.9m debt owed by its subsidiary and if the proposals are

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[1] https://www.ft.com/content/46c7d5d2-7c17-4e10-ab07-b671af5372cd; https://www.ft.com/content/bf973ef2-c23f-46f6-8bed-19b2fb27bbca
[2] https://www.morningadvertiser.co.uk/Article/2020/10/27/Revolution-Bars-Group-CVA

accepted, the Group estimates its annual cash flow will improve by approximately £2m per annum over the next two years.

Analysis of CVAs

CVAs provide a useful restructuring tool which allows companies to restructure debt with creditors. A significant benefit of CVAs is their flexibility. The CVA proposal for Revolution Bar Groups demonstrates the ability of CVAs to allow businesses to keep open their best-performing sites whilst closing their worst-performing sites so that the remainder of their portfolio has a better prospect of success and profitability. Alternatively, recent CVAs such as the New Look CVA have also given businesses the benefit of a switch to turnover based rent.

CVAs can allow both parties to benefit provided there is a viable business model. Businesses can write off or re-schedule historical debt and return to profitability, whilst creditors benefit because the alternative to CVAs, namely liquidation, normally produces a reduced return on their debt.

However, the key consideration for businesses is whether they have a viable long-term business model. Otherwise, whilst a CVA may provide a business with a few more months or years of trading, it may simply be delaying the inevitable or even worsening its final position.

R3 Standard Form COVID-19 CVA for Small/Medium Enterprises

R3 has recently published a Standard Form Covid 19 CVA Proposal and accompanying Covid 19 Standard Conditions for Company Voluntary Arrangements which are intended for use by SME companies whose businesses have been affected by coronavirus. The Standard Form is not a panacea and should not override professional advice. The Explanatory Note for Insolvency Practitioners notes that the document's purpose is *"to save time and costs, and therefore make CVAs more accessible to the SME market."*

The Standard Form has four key features:

- (1) A directors' proposal – A CVA can be proposed by a company's director, an administrator or a liquidator. As the vast majority of CVAs are proposed by company's directors, the Standard Form is drafted for a director's proposal.

- (2) Breathing space period for the company – A breathing space period is provided for in order to allow the company time to restructure without fear of creditor action.

- (3) Delayed payment in full **–** The breathing space period is followed by a delayed period for full payment of the company's debts.

- (4) Trading costs from new income – Trading costs incurred during the CVA are to be paid out of new trading income.

The Standard Form has not set the proposed time period for the breathing space period or the delayed period for full payment; these are to be negotiated between the company and its creditors.

The terms of the Standard Form can be amended or varied to suit the individual circumstances of a particular case. For example, the Explanatory Note for Insolvency Practitioners states that a company may find it necessary to amend the Standard Form to allow debt composition from the outset and that under the Standard Form, directors are not able to take dividends during the CVA which may not be an appropriate restriction in all cases.

The R3 Standard Form COVID 19 CVA is to be welcomed in making CVAs more accessible to small and medium sized businesses facing financial difficulties as a result of the pandemic. Although the Standard Form will not be appropriate for all businesses, it is a foundation upon which an appropriate CVA for the particular company in question can be based.

The Future for CVAs

From 1 December 2020, HMRC will become a secondary preferential creditor in insolvencies for certain debts, e.g. VAT, PAYE and employee National Insurance Contributions upon restoration of the Crown Preference as set out in the Finance Act 2020. Such debts therefore will not be able to be compromised in a CVA unless HMRC specifically consents.

Whilst the overall number of company insolvencies in England and Wales fell in Q2 2020 by nearly one-quarter when compared with Q1 2020 and CVAs decreased by

32% from Q1 2020, it is acknowledged that such reduction was likely to be at least partly driven by Government measures put in place in response to the COVID-19 pandemic.[3] The popularity of CVAs is predicted to increase as Government measures in response to the pandemic are withdrawn or cut back.

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[3] Company Insolvency Statistics April to June 2020, the Insolvency Service, p.5-6