International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

The Future of CVAs – Not Just for Leases ...

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The Company Voluntary Arrangement ('CVA') was introduced into English insolvency law by the Insolvency Act 1986 (the 'IA 1986'), as a result of recommendations made in the Cork Report[1] in 1982. Commensurate with its position at section 1 of the IA 1986, it was expected that the CVA would become a key restructuring tool available to companies under English law, in particular in allowing a debtor and its unsecured creditors to implement a restructuring solution efficiently and outside of formal insolvency proceedings.[2] However, in the intervening years the CVA has become more of a niche restructuring tool than a 'mainstream' regime (arguably with the exception of its use by smaller companies who can avail of a moratorium as part of the CVA process[3]). The CVA has, to a large degree, been limited to compromising lease and other property liabilities in the retail and casual dining sector (2018 alone has seen CVAs from a number of companies in the sector, including New Look, House of Fraser, Prezzo, Byron, Mothercare and the ultimately unsuccessful Toys 'R' Us CVA). A key drawback of the CVA, when compared with the English law scheme of arrangement under the Companies Act 2006 is the inability to bind secured creditors (see further below). This has undeniably limited the utility of the CVA in complex secured capital structures.

There are, however, certain significant examples of CVAs being used in a broader context, and these demonstrate that CVAs should remain at the forefront of the minds of directors of, and advisors to, companies in financial distress – even outside the retail and casual dining context where they have become ubiquitous in 2018.

We discuss some examples of the use of CVAs below and some of the key advantages and disadvantages of the CVA. We also set out what we consider to be some other scenarios where the CVA could, whether alone or in conjunction with broader measures, prove an extremely useful restructuring tool.

Run-off CVAs

One of the more interesting uses of CVAs in recent years was the CVA proposed by the special administrators of spread-betting firm *MF Global*[4] in November 2017. MF Global entered special administration, a version of administration tailored for use in cases of failures of certain financial institutions, in 2011. The special administrators proceeded to make a number of interim distributions to unsecured creditors in the subsequent years. However, a point was reached where, due to certain provisions of the special administration regime, no further distributions could be made to creditors for a number of years (with final distributions potentially not being available for a period of eight to nine years).

What is a CVA?

- Compromise or arrangement between a company and its unsecured creditors, proposed by directors or an administrator / liquidator
- No moratorium (except for 'small companies')
- Binds all unsecured creditors of a company – *but* cannot bind secured creditors without their consent
- No class concept – but different groups of creditors can be treated differently
- Involves (and grants a vote to) all unsecured creditors – even if not affected by CVA
- Approved by a majority in number and 75% by value of the creditors (and 50% by value of 'unconnected' creditors) present and voting
- Can be challenged on the basis of 'unfair prejudice' or 'material irregularity'

Notes

1 *Insolvency Law and Practice: Report of the Review Committee* (Cmnd. 8558) (HMSO, 1982).

2 It should be noted that a CVA is technically an 'insolvency proceeding' – however, CVAs are usually rehabilitative in nature and should be distinguished from the often terminal insolvency proceedings of liquidation and administration.

3 Certain 'small businesses' are able to avail of a moratorium in connection with their filing and implementation of a CVA. In broad terms, a 'small business' is one which satisfies two out of the following three criteria: (i) turnover no greater than £10.2m, (ii) balance sheet assets no greater than £5.1m and (iii) no more than 50 employees.

4 MF Global UK Limited (in special administration), 2017.

In order to facilitate an earlier return for unsecured creditors, the special administrators proposed a CVA whereby (in simple terms) such creditors could elect either to receive an immediate discounted return on their claim, or to retain a claim in the special administration with the possibility of receiving a potentially larger (and indeed possibly above-par) return upon the making of final distributions (though it should be noted that creditors 'staying in' also took on the risk of potentially receiving a smaller return than the 'exiting' creditors).[5]

Note that it appears (at the time of writing) that the MF Global CVA will not in fact be implemented, after the Court of Appeal held[6] that an intervening, and substantial, indemnity claim against the company (which was unforeseen when the CVA was approved) had upset the commercial bargain underlying the CVA and accordingly the CVA coming into effect would present a potential risk of unfairness to the relevant creditors.

CVAs to avoid insolvent liquidation

A CVA has also been used simply to avoid the prospect of an insolvent liquidation, the aim being to compromise the unsecured liabilities of the relevant company in order to ensure that all such liabilities could then be paid out in full and that accordingly the company could be wound up via a solvent liquidation.

It is worth asking what value a CVA would add compared to simply placing the company into creditors' voluntary (i.e. insolvent) liquidation, given the economic effect for unsecured creditors is likely to be substantially identical. The answer in the most significant example of this type of CVA, *Southern Cross*,[7] was to avoid the potential non-economic negative effects of an insolvent liquidation. In this case, given the public sector involvement as a result of Southern Cross's care home business, there was a strong desire to avoid the negative stigma of a formal insolvency.

Other examples might include where the company and its directors wish to avoid prolonged investigation by the liquidator into transactions or conduct in the lead up to the liquidation (for example of reviewable transactions under the IA 1986). A solvent liquidation would ensure that certain such claims may not be as readily available (though it would not eliminate the risk of a liquidator seeking to pursue claims against directors or to unwind certain transaction).

Of course, this solution would rely upon the company's creditors, who are being asked to compromise their claims and who could stand to gain from a successful action against the company's directors (for example), consenting to the CVA.

Unsecured liabilities generally

Some of the most significant and broad-ranging uses of the CVA were seen in respect of two distressed North Sea oil & gas businesses – *ATP Oil & Gas*[8] and *Iona Energy.*[9]

In ATP Oil & Gas, a CVA was used in order to compromise, as a single class, a broad range of legacy unsecured liabilities and so achieve a sale of the shares in the company. Without such a compromise a sale of the shares (and accordingly a rescue of the business) would have likely proven impossible (a previous auction of the UK entity's shares, as part of ATP's parent's US chapter 11 proceedings, having failed).

Similarly, in Iona Energy the administrators of the company again achieved a sale of the business as a result of the restructuring of its unsecured liabilities pursuant to a CVA. An even broader range of existing unsecured debts were compromised, including among other things decommissioning liabilities, trade liabilities, accruals and debts owed to a former director.

Each of these cases demonstrate the wide-ranging power of a CVA to compromise, at once and as a single class, unsecured liabilities. This is a key advantage over schemes of arrangement, in which creditors with disparate interests are typically entitled to vote in their own class, thereby essentially giving greater scope for a veto or 'hold-out' right to each category of creditors.

CVAs as a broader restructuring tool

With creditors of the European arm of Steinhoff recently reported as potentially considering a CVA in order to compromise up to €4.8 billion of unsecured debts, it is worth considering some of the potential additional uses, and advantages over schemes of arrangements, offered by the CVA.

Restructuring of unsecured bonds

England has, in recent years, become a high-profile and popular jurisdiction for bond restructurings (whether

Notes

5 A similar structure had previously been indicated as a potential option by the administrators of Lehman Brothers. In the end, the administrators opted for a scheme of arrangement, launched earlier in 2018, as certain creditors were not receptive to the terms of the proposed CVA.

6 *Heis and Others v Financial Services Compensation Scheme Limited and Another* [2018] EWCA 1327.

7 Southern Cross Healthcare Group PLC, 2012.

8 ATP Oil & Gas UK Limited, 2014.

9 Iona Energy Company (UK) Limited, 2016.

issued by English entities or not, and whether or not governed by English law), in particular by way of schemes of arrangement. While the restructuring of secured bonds in England will need to continue to rely upon schemes of arrangement to bind dissenting / non-voting minorities, a CVA would potentially be available to restructure unsecured bonds. The key advantage would manifest itself where a company is seeking to restructure several series of unsecured bonds at once, as a CVA would potentially allow for the 'cramming down' of a dissenting group of bondholders.

A CVA might also be of assistance in situations where a restructuring is seeking to compromise an unsecured bond along with an overdraft facility (which would usually be unsecured) and/or significant trade or unsecured guarantee liabilities (e.g. as in the case of Steinhoff and Iona Energy).

Challenges to a CVA vs challenges to a scheme

More broadly, it can be argued that a restructuring by way of a CVA, which is not strictly a court-driven process, has advantages as against the scheme's hearings in open court. While creditors are able to apply to court in order to challenge a CVA, it does not offer up the multiple court hearings involved in a scheme that allow (and indeed essentially invite) creditors to come to court if they have concerns as to fairness, for example. Further, the strict 28 day window for challenge gives quick certainty for stakeholders involved in a CVA.

With respect to the grounds for challenge themselves, it is worth noting that the jurisprudence with respect to substantive CVA challenges as to unfair prejudice[10] is very well established and, importantly, limited to certain relatively narrow categories of unfairness.

Essentially, the court will undertake an assessment as to the treatment of the challenging creditor as against (a) the treatment of other CVA creditors (the 'horizontal comparison') and (b) their return in an insolvent liquidation (the 'vertical comparison'). To the extent a company is able to present robust valuation evidence and genuine commercial reasons for a creditor's treatment, a challenge is unlikely to be successful.

Typically, challenges arising under the 'horizontal comparison' will arise where an unsecured creditor is able to argue that the company's valuation evidence does not adequately justify their differing treatment under the CVA. The classic example of such a challenge arises in a CVA of lease liabilities where landlords of poorly performing locations are given commensurately worse treatment in the CVA than other landlords of comparable properties – a landlord may seek to challenge the assertion that the location is 'poorly performing' enough to justify the level of differing treatment proposed (which may of course sometimes include terminating the lease with minimal compensation).

Challenges with respect to the 'vertical comparison' arise most commonly where the company asserts that a creditor is partly or entirely 'out-of-the-money' and accordingly seeks to compromise all or substantially all of their claim. A creditor may argue that they would receive a return in insolvent liquidation and are accordingly not 'out-of-the-money' on that basis – this argument most commonly occurs where a CVA seeks to release a parent guarantee of the company's liabilities to such creditor. Such a guarantee would not usually be released upon an insolvent liquidation, leaving the creditor therefore with a potentially lucrative claim against a possibly solvent parent. The parent guarantee would accordingly constitute a valuable asset the CVA is attempting to strip, in certain circumstances unfairly, from such creditor.

With robust valuation evidence, a company is often able to minimise with relative certainty the risks of such challenges to a CVA. In contrast, a scheme arguably offers up more avenues for challenge by creditors, including challenges to the composition of classes, challenges on fairness grounds and arguments as to the scheme being non-effective to bind foreign creditors (especially in the EU, given the scheme of arrangement falls outside of the Recast EU Insolvency Regulation).

The CVA as an international restructuring tool

The vast majority of high-profile CVAs have concerned English companies, or companies with their centre of main interests (COMI) quite clearly in England. However, there is no reason why, if conditions are otherwise suitable, a CVA could not be used to restructure the liabilities of a company originally domiciled abroad, following a shift of such company's COMI to the UK. COMI shifts have regularly been used in the context of schemes of arrangements in order to establish a 'sufficient connection' to England in order to allow courts to assert jurisdiction over the scheme creditors.

In addition, as noted above, unlike the scheme of arrangement the CVA is technically an insolvency proceeding falling within the Recast EU Insolvency Regulation. The upshot of this is automatic recognition of the CVA across the EU (save for Denmark) and potentially easier recognition globally under the UNCITRAL Model Law, and under applicable local insolvency and private international law. It should, however, be noted that using an insolvency proceeding is not always an advantage, as CVAs may trigger insolvency-related cross-defaults in counterparty contracts in circumstances where a scheme of arrangement would not.

Notes

10 There is also a separate ground for challenge on the basis of material procedural irregularity.

The future of CVAs

Far from being a niche restructuring tool confined to dealing with retail landlord liabilities, CVAs can be a powerful tool for compromising a broad range of unsecured liabilities. In addition, CVAs offer certain (perhaps sometimes overlooked) advantages over the other principal restructuring tool in English law – the scheme of arrangement – when seeking to compromise multiple classes of unsecured debt.

In particular, it is worth noting the advantages against schemes of arrangements discussed in the previous section, especially in circumstances where the relevant debt is unsecured, or unsecured debt could potentially be restructured in parallel with (and potentially on an inter-conditional basis with) a scheme restructuring the secured debt. There is precedent for this type of restructuring in the CVAs of both *Travelodge*[11] and *Fitness First.*[12] In each of those cases a scheme of arrangement of secured financial debt was accompanied by a CVA of lease liabilities.

There is no reason, however, why a similar approach could not be taken to restructure secured financial debt (by way of a scheme) together with a CVA for unsecured financial liabilities, such as unsecured bonds and overdrafts, which might otherwise constitute separate classes with 'blocking' positions in a scheme. With the recent resurrection of the CVA as a key restructuring tool for retail and casual dining businesses, debtors may well now see its advantages in a broader context in order to restructure a range of unsecured financial debt.

Companies in financial distress, along with their creditors (and their respective advisors), would accordingly benefit from keeping the CVA in mind as a potentially valuable part of their restructuring arsenal.

	CVA	*Scheme*
Creditor classes	No (single class of unsecured creditors)	Yes
Creditor composition	All unsecured creditors	Selected creditors (including secured creditors)
Binds secured creditors	No	Yes
Court hearings	Only in the event of a challenge	Convening hearing and sanction hearing
Insolvency proceeding	Yes (supervisor appointed)	No
Automatic EU recognition	Yes	No
Jurisdictional requirement	COMI in England & Wales	Sufficient connection to England & Wales

Notes

11 Travelodge Hotels Ltd, 2012.
12 Fitness First Clubs Limited, 2012.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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