

Company voluntary arrangements: evaluating success and failure

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Company Voluntary Arrangements: Evaluating Success and Failure

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Executive Summary

- The biggest strength of a CVA is its flexibility.
- Assessing the success or failure of CVAs is not straightforward and depends on a number of variables.
- Early termination of a CVA is not necessarily indicative of the CVA having failed.
- An analysis of the 552 CVAs commenced in 2013 involving companies in England and Wales showed:
 - ▶ 18.5% were fully implemented;
 - ▶ 16.5% were ongoing at the survey date;
 - ▶ 65% were terminated without achieving their intended aims;
 - ▶ 7% were terminated within the first 2 quarters;
 - ▶ 24% were terminated between 4 and 6 quarters after commencement.
- 514 or 93% of companies entering CVA were small or micro companies:
 - ▶ 8 or 1.6% of small companies used the Sch. A1 moratorium;
 - ▶ 7 or 1.4% of small companies first entered administration.
- 38 or 7% of companies entering CVA were non-small companies, of which four first entered administration.
- CVAs with the benefit of a moratorium were terminated in only 20% of cases.
- 79 Insolvency Practitioner firms took one appointment with a further 25 taking two.
- Four insolvency practitioner firms acted in over 20 cases.
- The following issues with CVAs are noted:
 - ▶ There are situations where CVAs have been implemented but terminated quickly;
 - ▶ Some CVAs return very little to creditors over their lifetime; either because contribution payments are repeatedly missed or because contributions are only sufficient to cover the costs of the process;
 - ▶ The 'real' length of CVAs is often much shorter than its expected duration as a result of missed contributions;
 - ▶ There is often a significant gap between the expected level of dividends and the actual dividends;
 - ▶ There is not always a contingency plan for the costs of a subsequent winding up in the event the CVA terminates.
- Dividends to unsecured creditors were rare in CVAs which terminated within 6 quarters of commencement.
- Often directors do not implement necessary changes or fail to identify and tackle fully the problems identified in the CVA.
- HMRC is seen as the most engaged creditor and the one most likely to vote against a CVA whether for policy or commercial reasons.
- Different stakeholders have differing views of how effective CVAs are and how their interests might best be protected.
- The UK is slipping in the World Bank rankings and lessons may be learnt from the World Bank principles and other international insolvency developments.

Main Recommendations

- 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.

1. Purpose of the Research

The purpose of this report is to consider the reasons for the ‘success’ or ‘failure’ of company voluntary arrangements (“CVAs”) and to investigate the outcomes where CVAs fail. The frequency of CVAs is reasonably low when compared with alternative corporate Insolvency Act 1986 procedures¹ and it has been commented that CVAs have a high failure rate.² The research project aims to identify ‘successful’ and ‘failed’ CVAs and by doing so, identify key characteristics which will in turn allow practical guidance to be provided to insolvency practitioners (“IPs”) and also inform policy recommendations to Government.

We are conscious that the project is being carried out a time when national and international bodies are considering how best business rescue can be encouraged. In May 2016 the UK Government launched *A Review of the Corporate Insolvency Framework: A consultation on options for reform*. The consultation put forward four key proposals to encourage rescue of viable businesses including the introduction of a pre-insolvency restructuring moratorium; the protection of essential supplier contracts during restructuring; the ability to bind and cram down secured creditors in a restructuring; and the introduction of new options for rescue financing. Clearly, some or all of these matters may be factors which impact upon whether or not a CVA is deemed feasible in the first place, and subsequently, whether the CVA reaches a successful conclusion. Similar to the UK Government proposals, are those found in the draft EU Directive on preventive procedures³ from November 2016.⁴ In addition to conducting empirical research concentrating on CVAs in England and Wales, we have also considered national and international developments and consultations including some comparative analysis.

The findings from the empirical research build on those from the last comprehensive research on this issue by Sandra Frisby and Adrian Walters published in March 2011.⁵ That research was based on cases commenced in 2006 and is therefore relatively old and takes no account of any developments in law and practice since then. Evidence of current practice is required in order to identify the circumstances in which CVAs are used, are successful or unsuccessful and to identify factors which are favourable or unfavourable to CVA success. As part of this process it is important to take account of the views of the main stakeholders interested in CVAs. The views of insolvency practitioners, lawyers, landlords, secured and unsecured creditors⁶ have been canvassed and their respective positions and opinions have fed into our assessment of how CVAs operate currently and how that operation might be improved.

It is reasonably clear that although pre-packaged administration existed in 2006, pre-packs are more commonly encountered (as an alternative to CVAs) in 2018 than they were in 2006. It is now possible to identify companies which have entered a pre-pack and to consider the reasons those in control of those companies expressed for preferring a pre-pack over a CVA. The research also considers the reasons given by IPs for preferring a pre-pack over a possible CVA.

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

2. *A Review of the Corporate Insolvency Framework: A consultation on options for reform* found at: www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework (hereafter referred to as the “the Consultation”) identified that in 2014 there were 563 CVAs, of which 388 failed, equating to a failure rate of 60%.

3. *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))* (hereafter referred to as the “Draft Directive”).

4. In addition, the European Law Institute in its July 2017 *Rescue of Business in Insolvency Law* report looks at similar issues Found at: http://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf.

5. S. Frisby and A. Walters *Preliminary Report to the UK Insolvency Service into Outcomes in Company Voluntary Arrangements*, March 2011 found at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 (“Frisby and Walters Report”).

6. Although Her Majesty’s Revenue and Customs (“HMRC”) were approached they declined to be interviewed.

The report is presented in the following chapters:

2. CVA Mechanics
3. Research Methodology
4. An analysis of 2013 CVAs – Success or Failure?
5. 2016 Pre-pack Administrations – Reasons for not Pursuing a CVA
6. R3 Membership Survey
7. Stakeholder Views
8. National and International Reform Proposals
9. Summary of Findings
10. Conclusion
11. Annex

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.⁷

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.⁸ 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 2016⁹ 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"¹⁰ 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.¹¹ 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:

7. See e.g. L. Sealy, D. Milman and P. Bailey *Sealy and Milman Annotated Guide to the Insolvency Legislation 2017* (20th ed., Sweet & Maxwell) and A. Keay and P. Walton *Insolvency Law Corporate and Personal* (2017, 4th ed., LexisNexis).

8. *Insolvency Law and Practice* Cmnd 8558 (1982) ("Cork Committee") Chapter 7.

9. Insolvency (England and Wales) Rules 2016 (SI 2016/1024) ("Insolvency Rules 2016").

10. Insolvency Rules 2016, r.2.9(2).

11. Statement of Insolvency Practice 3.2 which deals with practice guidance for CVAs emphasises a number of principles including at para.3: "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."

The company may be placed into administration.¹² 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.¹³

It is possible for the directors of a small company¹⁴ 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,¹⁵ 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. Firstly, 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.

The Government's 2016 consultation 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.¹⁶ 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."¹⁷ 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.¹⁸

The above outline of the mechanics of a CVA is intended to provide a broad idea of the legal and procedural background to the research project.

12. It is also possible for a liquidator to propose a CVA but this rarely ever happens.

13. 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 Committee para.430).

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

15. Insolvency Act 1986, Sch. A1, paras. 7 and 8.

16. The Consultation.

17. The Consultation at para 7.7.

18. See the full account of such reform proposals explained in C.Umfreville "Mora' the same: reflecting on the latest attempts to salvage company rescue" (2017) 28 *International Company and Commercial Law Review* 385.

3. Research Methodology

The empirical part of the project has two main avenues of enquiry:

- Quantitative data gathering and analysis; and
- Qualitative data gathering and analysis.

With the kind assistance of the Insolvency Service, we have identified the 552 CVAs involving companies in England and Wales entered in 2013. The year of 2013 was chosen so as to allow a sufficient period of time to have passed to permit a meaningful analysis of the outcomes. The research considers a sample of over 500 CVAs commenced in a 12 month period, in order to have a solid sample size. This builds on feedback from previous work on pre-packs¹⁹ with Teresa Graham who required a large dataset to provide reassurance and comfort to Ministers. We collected between 20 and 25 data points²⁰ from the records held at Companies House for the 552 corporate CVAs. In addition to identifying CVAs which completed, terminated or are still ongoing, we also collected further data and carried out further analysis of those CVAs which terminated in order to assess whether, despite their termination, they were still a qualified success. We present and analyse the results below in Part 4.

In addition, we have identified randomly a sample of 100 companies which entered into a pre-packaged administration in 2016. We have again used the records at Companies House to record and analyse the reasons given by IPs as to why, in such cases, a CVA was not thought to be a better option than a pre-pack. The results are presented below in Part 5.

The third source of empirical data has been a survey of R3 members, carried out during the Summer of 2017, the results of which are analysed below in Part 6.²¹

In addition, towards the end of 2017 and the early part of 2018, we conducted a series of semi-structured interviews with representatives of various stakeholder groups including insolvency practitioners, lawyers, landlords, secured creditors and unsecured creditors. The results of this interview process are considered below in Part 7.

As the United Kingdom's position in the Resolving Insolvency section of the World Bank's Doing Business rankings continues slowly to slip as other jurisdictions catch up and overtake the UK, we have also considered any possible lessons to be learnt from looking abroad, especially taking account of the recent Draft Directive. This analysis may be found below in Part 8.

In Part 9 below we attempt to synthesise the results of each different strand of the report in order to make suggested amendments to the CVA regime. Our conclusions are found in Part 10.

19. <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>.

20. The number varied depending upon what happened to the company in question following the CVA. Where it had entered subsequent insolvency procedures, the number of data points necessarily increased.

21. With the survey questions being replicated as Annex A to this report.

4. An analysis of CVAs from 2013

Data collection and analysis was carried out in relation to all the CVAs entered by companies in England and Wales in 2013. This data collection and analysis involved two phases. Phase One looks at the entire sample of 552 CVAs. Amongst other things, it records whether the CVA completed, was terminated or is ongoing. Phase One findings are set out in Part 4.1 below. Phase Two concentrates on those CVAs which terminated to enquire whether some of them, despite their termination, may still be considered a qualified success. Phase Two findings are set out in Part 4.2 below.

4.1. Phase One Analysis

The initial data provided by the Insolvency Service included the company name, company registration number, SIC07 categorisation (1, 2 and 3 digit) and the CVA commencement date. This information was supplemented with information in company records filed at Companies House to populate a database with information on:

The characteristics of companies entering into CVAs;

- Information about the Insolvency Practitioner (and firm) carrying out the procedure;
- Details of the outcome of the CVA;
- Details of any subsequent insolvency process and the Insolvency Practitioner (and firm) carrying out such a process;
- In the event of termination of a CVA, information, where available, as to the reason for termination of the CVA.

On completion of the data collection, all entries were updated to reflect Companies House records as filed and recorded by 5 November 2017.

There were a number of instances where a CVA appeared to have been terminated, with the company moving into, for example, administration, liquidation or strike off, but where a notice of termination did not appear to have been filed (or at least not properly recorded)²² at Companies House. This meant that no end date for the CVA was recorded or readily ascertainable from the available records. Where it was apparent that the CVA had indeed terminated (for example, there were no further supervisor's abstracts of receipts and payments), the start date of the subsequent process was substituted for the end date of the CVA.

The following data were collected in relation to the 552 CVAs commencing in 2013:

1. Characteristics of company entering CVA

- i) Name and registered number of company
- ii) Sector (SIC 2007 1, 2 and 3 digit codes)
- iii) Size of company – small (including micro) or not
- iv) Length of time company had existed prior to insolvency

2. Details of the CVA

- i) Nature of any process leading up to CVA
- ii) Status of CVA – i.e. completed, terminated or ongoing
- iii) End date of CVA
- iv) Length of CVA
- v) Ultimate outcome (e.g. survival, dissolution following administration)

22. For example, where a Certificate of Termination was filed, but recorded at Companies House together with another document apparently filed at the same time.

3. Information about the Insolvency Practitioner carrying out the procedure

- i) Name of Insolvency Practitioner(s)
- ii) Name of Insolvency Practitioner firm

4. Insolvency process immediately following CVA

- i) Nature of insolvency process (e.g. administration, creditors' voluntary liquidation)
- ii) Name of Insolvency Practitioner(s)
- iii) Name of Insolvency Practitioner firm
- iv) Whether any change in Insolvency Practitioner firm
- v) Start and End Date of follow up insolvency process
- vi) Details of any subsequent process
(e.g. creditors' voluntary liquidation following administration), participants and length

The headline findings from this initial data collection can be categorised into three areas:

- 4.1.1 CVA Outcome;
- 4.1.2 Company Profile;
- 4.1.3 Insolvency Practitioner ("IP") Firm involvement.

These findings are set out immediately below.

4.1.1 CVA Outcome

Of the 552 CVAs which commenced during the calendar year 2013, 102 have been implemented (that is, they have been implemented in accordance with the proposal, as originally proposed or modified). This represents 18.5% of all CVAs for that year. A further 90 CVAs were still ongoing as at 5 November 2017. In light of information gleaned from the R3 Member Survey,²³ the relatively large number of ongoing CVAs is not surprising. Given that a high proportion of CVAs are typically proposed to run for five years, as our sample is from CVAs which commenced in 2013, we would expect to see an end date during 2018. As these CVAs have continued for in excess of four years, it is not unreasonable to expect a good number of these ultimately to be implemented, which could increase the overall implementation rate, potentially to as high as 34.8% of all cases. This would represent a marked increase.

²³. See below at Part 6.

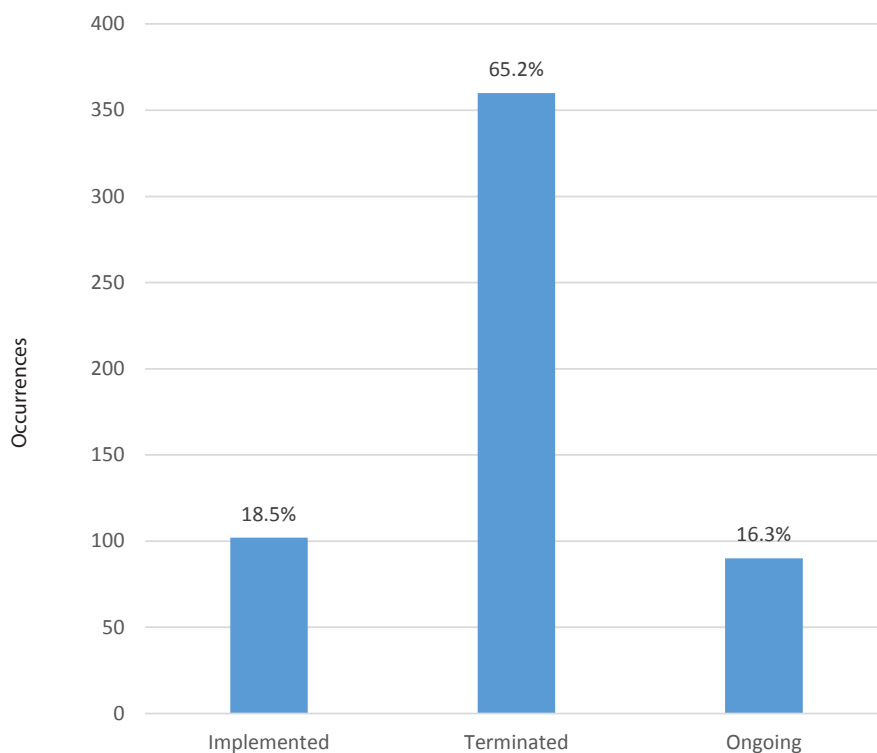


Chart 1: CVA Outcomes

A significant number of CVAs, 360 (or 65.2%), have been terminated without achieving the intended aims. A variety of reasons are given for this, but common themes across a number of CVAs include:

- failure to make the required contributions;
- difficulty in trading post-CVA;
- failure to pay post-CVA creditors; and
- failure to meet HMRC liabilities, both pre- and post-CVA.

The reasons, variously put, all suggest a common theme of difficulty in trading once a CVA has been put in place. This is set out expressly in some Final Reports of supervisors filed at Companies House. For example, a company which was reported to have lost key contracts because of a lack of confidence due to it being in an insolvency process.

Further investigation of successful completions reveals that not all of these resulted in company rescue, as revealed in Chart 2. Of the 102 CVAs fully implemented, 20 (or 19.6% of those implemented, and 3.6% of all cases) moved into an insolvency process²⁴ immediately following completion of the CVA. This gives an implementation and survival rate of 82 out of 552 CVAs (or 14.9%). In these cases, it appears that the CVA was used as a distribution mechanism rather than as a company rescue process. Although this may appear surprising, this aspect of the utility of CVAs is also reflected in the Stakeholder Interviews in Part 7 below.

A further 14 cases (13.7% of those implemented or 2.5% of all cases) have the company subsequently entering an insolvency process at a later point, and prior to 5 November 2017 (4 rescue and 10 terminal). This results in an immediate survival rate of 82 (14.9% of all cases) and an ultimate survival rate of 68 (12.3% of all cases) of the 552 companies entering into CVAs in 2013.

24. For the purposes of this report, a subsequent insolvency process includes compulsory and voluntary strike off.

It is important to note that these later insolvency rates do not appear to be directly related to the CVA process, and could be linked to a later event which triggered further insolvency proceedings. It is interesting to note that where a CVA is fully implemented and not followed by immediate insolvency (i.e. the CVA is not being used simply as a distribution mechanism), the company appears to be relatively robust, with 68 of 82 of cases (or 83%) ultimately surviving to the end of the survey period. This robustness was also highlighted by various stakeholders during the interviews (see Part 7 below). Later insolvency will not be considered in the remainder of this Part.

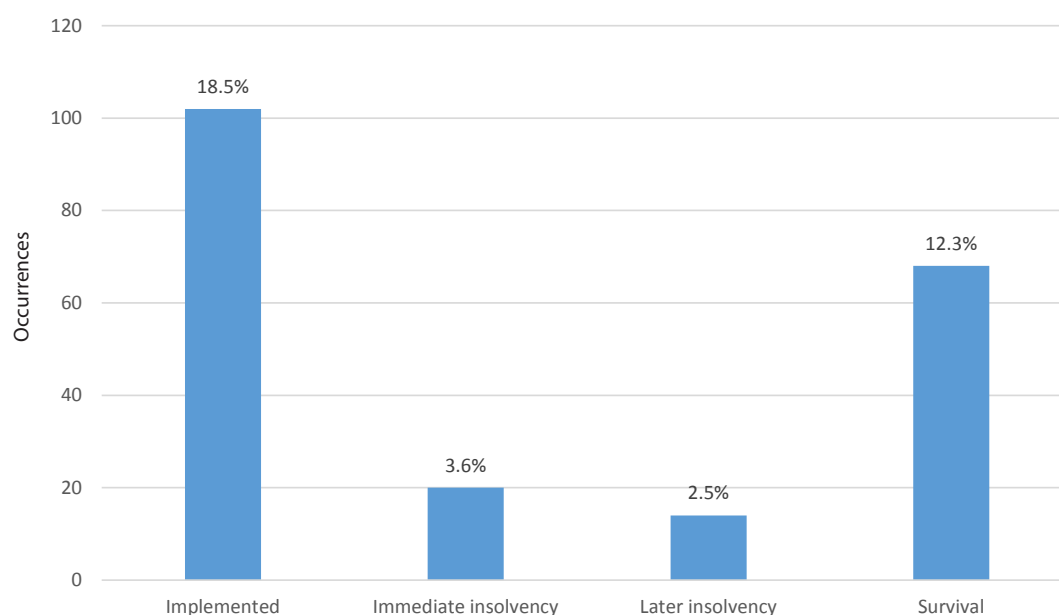


Chart 2: Outcomes of implemented CVAs

Of the CVAs which were terminated, a majority moved into a terminal proceeding (including strike off) immediately (Chart 3). The vast majority of those which moved into administration subsequently entered liquidation or were dissolved, with only 5 administrations following a CVA still ongoing at the date of review (and none having exited administration solvent).²⁵ Perhaps most surprising is the number of companies struck off the register following termination of a CVA. There is also one instance of a CVA being terminated, yet two and a half years later no follow up procedure has been entered into. This apparent abandonment of the insolvent company raises concerns whether the wider interests of creditors (and indeed society) are being looked after. This is an aspect picked up in the Frisby and Walters Report.²⁶ The Stakeholder Interviews discussed in Part 7 below suggest that in some cases, modifications to CVA proposals have required supervisors to put aside sufficient funds to petition for the compulsory winding up of the company should the CVA fail. This would appear a sensible solution to this issue.

25. We have not considered the outcomes of these administrations (e.g. whether there was a pre-pack leading to the business being sold, in whole or part, as a going concern) for the purposes of this report.

26. Frisby and Walters Report, p.8 (18% of all CVAs resulted in dissolution without any further procedure).

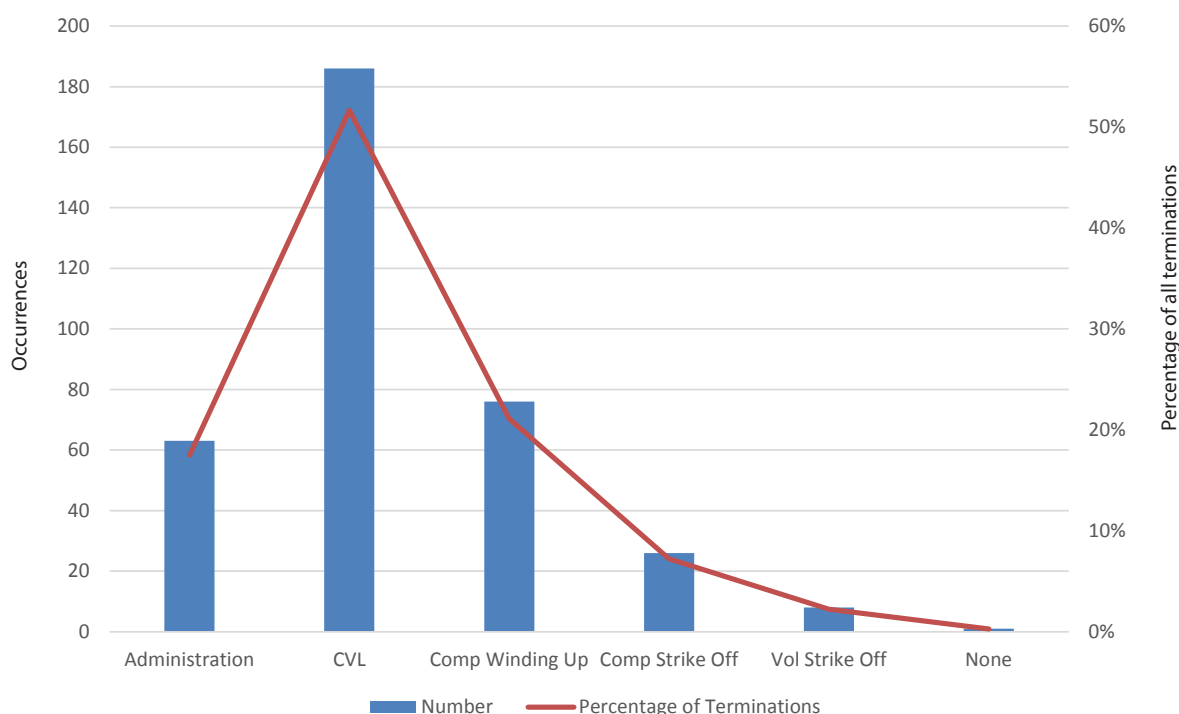


Chart 3: Subsequent insolvency processes where CVA terminated

There is no clear pattern as to the length of a CVA where it ‘successfully’ completed, with a fairly even distribution across the entire survey period (Chart 4). The numbers do begin to drop off towards the later dates, certainly from Quarter 13, though there is a small spike at Quarter 16. This is perhaps not surprising, given the high number of terminations by this time.

It can be seen that most CVAs appear to terminate within 4 to 9 quarters of commencement, with a heavier weighting towards Quarters 4 to 7. There is a spike in terminations up to 2 quarters from commencement, suggesting that these CVAs were essentially failing from the start. There were 133 CVAs which terminated in quarters 4 to 6 which represents 24% of all the CVAs surveyed.

Supervisors are obliged to terminate CVAs on occurrence of specified events, which in the 2013 sample commonly included failure to make three consecutive contributions. It was observed on a number of occasions that there was a delay between such a termination trigger event occurring and the CVA being terminated. There were numerous reasons for this, including the company seeking variation of the terms or making assurances to the supervisor that the issues would be addressed, only to fail to do so. On this basis, a number of CVAs which were terminated within 4 to 6 Quarters of commencement may well have effectively failed some time before termination, making little or no contributions to the CVA.

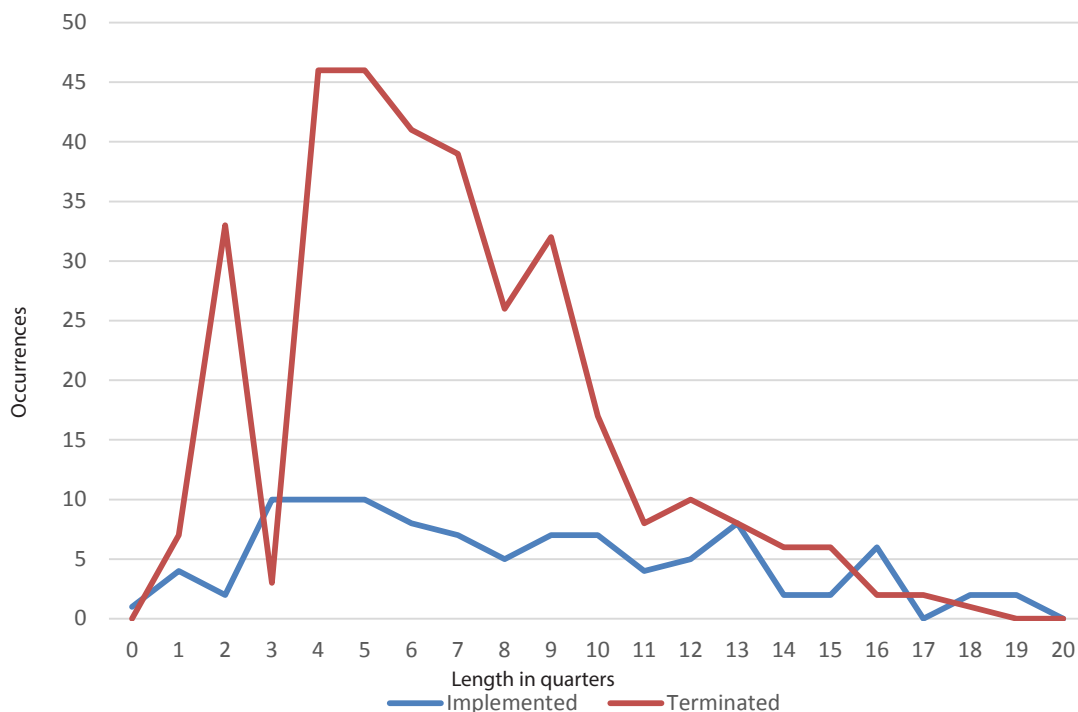


Chart 4: Length of Implemented and Terminated CVAs by quarter

It stands out that 40 CVAs were terminated within 2 quarters of commencement. This represents 11% of all terminated CVAs (and 7% of all CVAs). Whilst it is conceivable that some companies will experience catastrophic events soon after agreeing a CVA with creditors, it is highly doubtful that such a fate befalls such a large number. This calls into question whether a CVA was in fact the appropriate tool for these companies, or whether administration or even liquidation should have been pursued. If these CVAs were excluded, the overall implementation rate would rise to 19.9%, whilst the overall termination rate would drop to 62.5%. Consistently with some of the views expressed in our Stakeholder interviews explained in Part 7 below, this is supportive of the suggestion that some further thought may need to be given to the preparation and approval processes for CVAs.

4.1.2 Company Profile

4.1.2.1 Size of Company

Utilisation of CVAs is dominated by small companies, with 514 of the 552 companies reviewed classified as small (or micro)²⁷ based on Companies House records. This represents 93.1% of all companies surveyed. Whilst these companies qualify for the Schedule A1 moratorium introduced by the Insolvency Act 2000, uptake of this safe harbour is very low, with just 8 instances (or 1.6% of eligible companies). Interestingly, the Schedule A1 Moratorium was used largely by older companies. Six of the 8 users were incorporated pre-2000, whilst the remaining 2 were incorporated in 2003 and 2005. A further 7 small (or micro) companies entered into a CVA having first been in administration (or 1.4% of companies eligible for the Schedule A1 Moratorium), thus having enjoyed the benefit of an administration moratorium prior to approval (Chart 5A).²⁸

27. In accordance with the definition in Companies Act 2006, ss.382 and 384A.

28. We attempted to contact the IPs who utilised the Schedule A1 Moratorium to understand the rationale for its use, but unfortunately did not receive any responses.

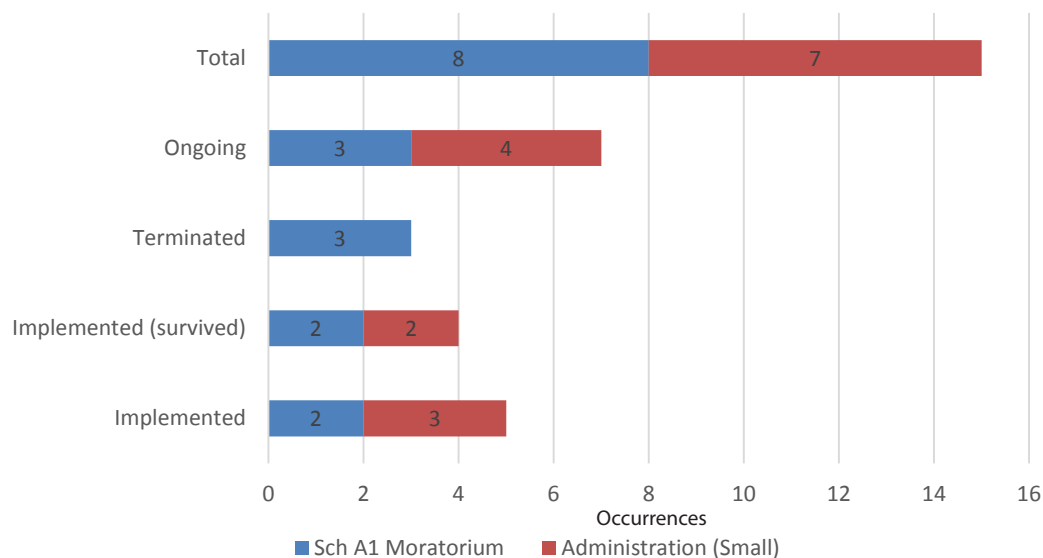


Chart 5A: Use of a moratorium by small companies prior to CVA approval²⁹

There is no publicly available data which clearly states the proportion of small (and micro) companies registered in the UK. At the end of 2013 there were 1,395,505 active businesses utilising the corporate form, of which 1,359,775 (or 97.4%) had fewer than 50 employees (suggesting these were small or micro businesses).³⁰ Importantly this only records active companies, with a total of 3,250,325 companies on the Register as at 31 March 2014,³¹ so does not capture all of the companies which could make use of a CVA. Based on this limited available data, whilst small (and micro) companies dominate the use of CVAs, the use is not directly proportionate to the total number of these companies. It can be seen that non-small companies are using the CVA process disproportionately, making up 6.7% of the 2013 CVAs, compared with less than 2.6% of the total population of non-small companies.³²

Four non-small companies entered into a CVA having first been in administration. This represents 10.5% of all non-small companies using the CVA process in 2013.

29. "Implemented (survived)" is a subset of "implemented" and any reference hereafter to "implemented (survived)" should be interpreted accordingly.

30. Department for Business, Innovation and Skills *Business Population Estimates For The UK and Regions 2013* available at <https://www.gov.uk/government/statistics/business-population-estimates-2013>. NB This figure includes LLPs.

31. Companies House *Statistical release: Companies Register Activities 2013-2014* (July 2014) p.8.

32. Department for Business, Innovation and Skills *Business Population Estimates For The UK and Regions 2013* available at <https://www.gov.uk/government/statistics/business-population-estimates-2013>. NB This figure includes LLPs.

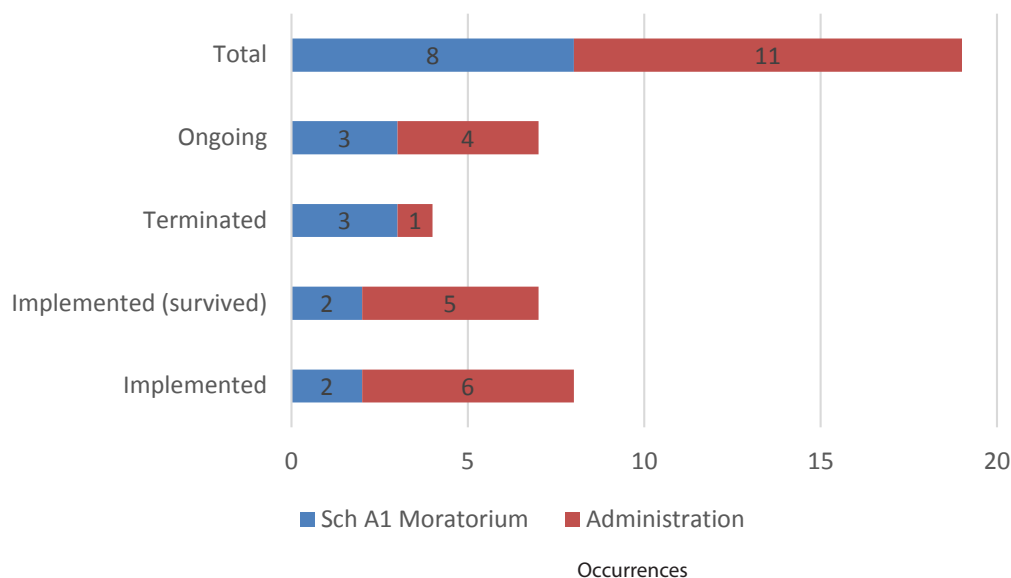


Chart 5B: Use of a moratorium by all companies prior to CVA approval

The outcomes following use of some form of moratorium is mixed. It is worth noting that both forms of moratorium (whatever the size of user) enjoy a higher implementation rate compared to both the overall statistics and where no moratorium is used. The Schedule A1 Moratorium has an implementation and survival rate of 25% with a further 32.5% ongoing, whilst the use of Administration by small (or micro) companies sees a 42.8% implementation (and 28.6% survival) rate with 57.1% ongoing and none terminated. The use of the administration moratorium by non-small companies is particularly noteworthy, with the CVA being fully implemented in three of the four cases and the companies surviving. 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 of implementation and survival is striking. Companies entering a CVA in 2013 with the benefit of some form of moratorium had a termination rate of only 20% (4 of the 19 companies).

The low rate of uptake of either form of moratorium is not a new phenomenon. The Frisby and Walters Report found that, where sufficient information was available, the Schedule A1 moratorium was only used by 1% of the sample group. A CVA used in conjunction with administration occurred in just 6% of all cases in the Frisby and Walters Report, all of which were small companies.³³ This suggests that use of an available moratorium had become even less common by 2013 than it was in 2006 (when both were relatively new options following the Insolvency Act 2000 and Enterprise Act 2002 reforms).

Whilst use of these formal moratoria procedures prior to a CVA appears to have waned, this is not to say that companies have not benefited from a form of moratorium. The interim moratorium triggered by filing a Notice of Intention to Appoint Administrators by a company or its directors appears to have been used to enable companies to explore restructuring options, including CVAs.³⁴ Unfortunately there are no records of the use of the interim moratorium to be able to consider this issue further. With this avenue ruled out by the courts in 2017, the need for a formal moratorium may be more pressing.

33. Frisby and Walters Report pp.10-11.

34. See for example *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 C. Umfrville 'Curtailling the use of multiple Notices of Intention to Appoint Administrators: the case for a moratorium?' (2017) 395 *Company Law Newsletter* 1-4.

The vast majority of small companies did not make use of a statutory moratorium (either Schedule A1 or Administration). Unsurprisingly, given the positive effect of the moratorium considered above, the rate of implementation where there is no moratorium does decrease when compared with the overall outcomes (as observed in Chart 1), from 18.5% to 14.98% of CVAs being implemented (see Chart 6). There is a similar decrease in the number of implemented CVAs in which the company survives, from 14.9% in the whole population to 11.87% in this sample. The impact of not using a moratorium on termination is less pronounced, with a small increase from 65.2% of CVAs from the whole population being terminated, to 66.54% in this sample.

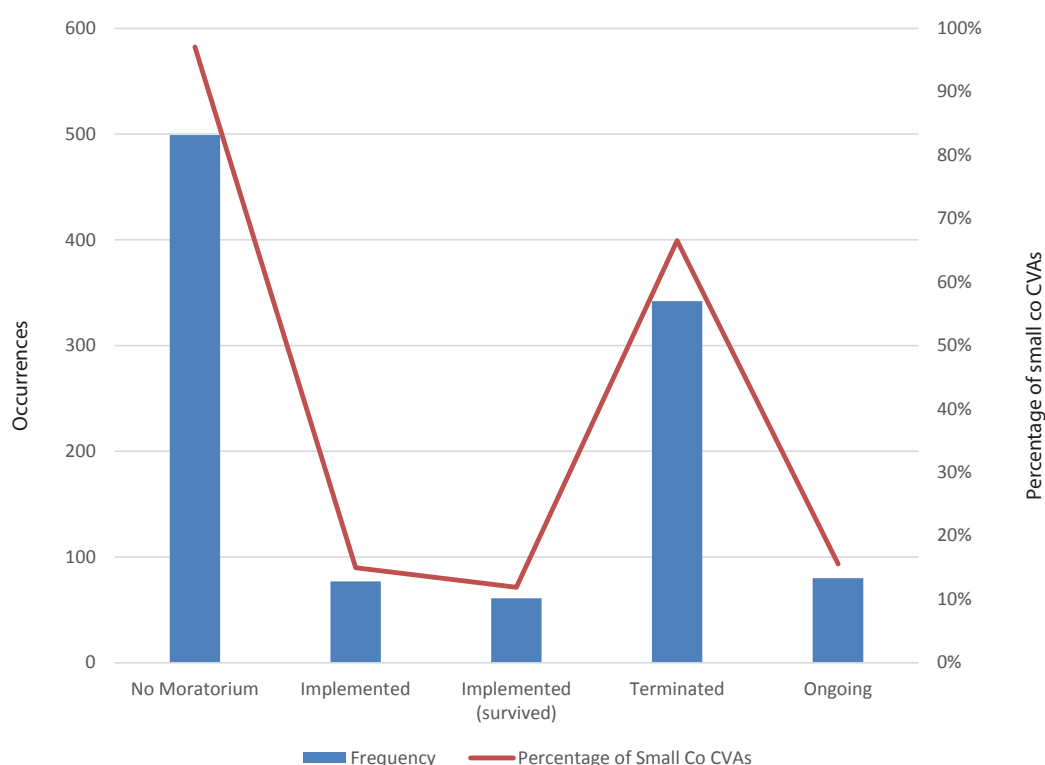


Chart 6: Outcomes of small company CVAs where no moratorium used

Perhaps unsurprisingly based on the commentary above, where users of CVAs are not classified as small companies, the implementation rate is far higher. This is based on a relatively small sample of 37 ‘non-small’ companies³⁵ entering into CVAs in 2013. Of these 37 companies, 19 CVAs were fully implemented (or 51.4% compared to 18.5% in the whole population), of which 17 were implemented and survived (or 45.9% compared to 14.9% in the whole population). Only 15 of these CVAs were terminated during the sample period, representing 40.5% compared to 65.2% of the whole population. This is in sharp contrast with the findings in relation to small companies considered above, and illustrated in Charts 5A, 5B and 6.

35. That is, those companies not categorised as small or micro in accordance with Companies Act 2006, ss.382 and 384A based on filings at Companies House. There was one further company whose size could not be identified from the filings at Companies House. The company had been restored to the register after a lapse of 20 years.

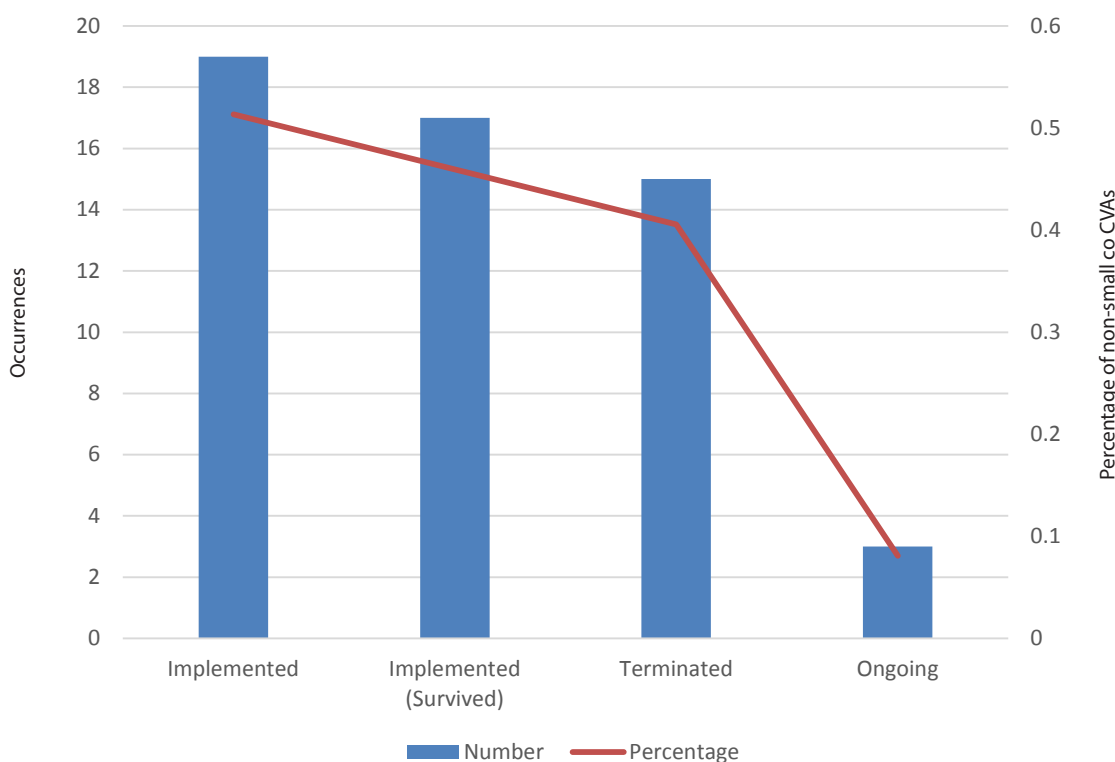


Chart 7: Outcomes of non-small company CVAs

4.1.2.2 Age of company

In 2013 CVAs were most popular with companies which had been incorporated for between 2 and 4 years at the date of commencement, with 19.57% of all users falling within this age range. The mean age of companies using a CVA in 2013 was 11.1 years. This compares interestingly with the average age of live companies in 2013-14 of 8.6 years,³⁶ suggesting that companies are more established when using a CVA. This is not surprising, perhaps, given that a company using a CVA would be expected to have some trading history, as well as prospects for survival, in order to justify a rescue process being chosen over a terminal insolvency process.

The mean age is arguably distorted by thirteen companies with a mean age of 74 years at CVA commencement. The modal age of companies using a CVA in 2013, on the other hand, was 4 years (rounded up to the next whole year). This figure bears interesting comparison with the findings in the 2014 Report *Growing Pains: How the UK became a nation of micropreneurs* which found that 55% of new businesses fail to last beyond five years,³⁷ a figure apparent more widely in Europe.³⁸ On this basis, it is perhaps not surprising that there is a large group of users within this age range.

36. Companies House *Statistical release: Companies Register Activities 2013 – 2014* p.9.

37. RSA *'Growing Pains: How the UK became a nation of micropreneurs'* (October 2014) available at www.rsabroker.com/growing-pains-white-paper.

38. Explanatory Memorandum to the Draft Directive.

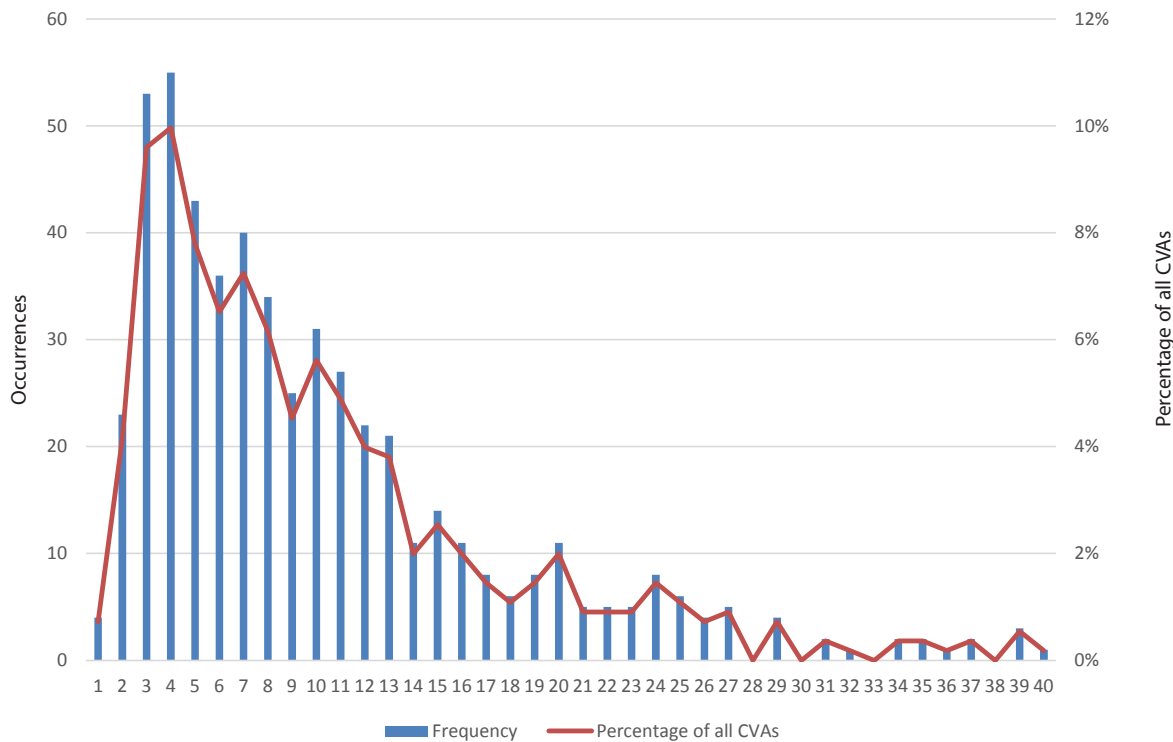


Chart 8: Age of company in years at date of CVA commencement

There does not appear to be a discernible pattern as to the outcome of a CVA based on the age of the company at date of commencement. As can be seen in Chart 9, a higher proportion of CVAs of companies aged between 2 and 5 years at date of the CVA, are terminated when compared with the overall figure (65.2%). The implementation statistics for companies in these age ranges are lower than the overall figure (18.5%), but not remarkably so. This raises the question of the viability of a CVA for companies in this age range, although there is evidence of successful outcomes.

There is no similar pattern between age of company and CVAs being implemented. There are increases at ages 6, and then 9-14, with a particular spike at age 13. There is a vague suggestion that companies in this age range are more likely to survive, though the rate of CVA terminations broadly aligns with the overall figure. Again there are not a significant number of companies in any of these groups to draw firm conclusions.

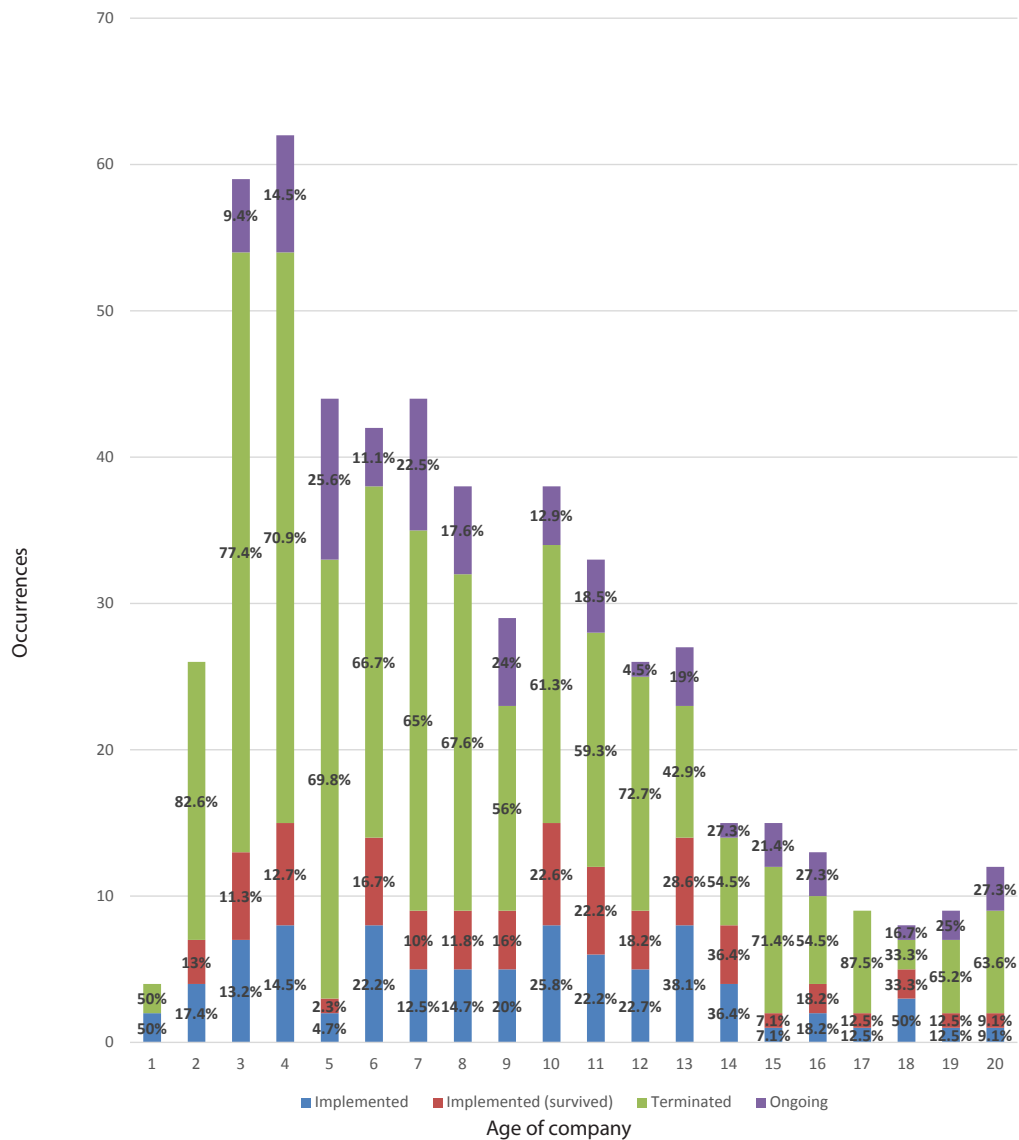


Chart 9: CVA outcome by age of company at commencement of CVA

It is also interesting to consider the age of non-small companies using CVAs. These companies range from an age of 3 to 140 years when entering CVA, with a mean age of 19 years. With lower and upper quartiles of 7 and 16 years, the larger (i.e. non-small) companies using CVAs appear to be more established when entering into a CVA. This is perhaps not surprising, given that longevity will have assisted attainment of medium or large company status, but is of interest when the outcomes are considered (see Chart 7 above).

4.1.2.3 Business Sector

Companies from a wide spread of industries are making use of the CVA process, though there is a higher proportion of companies from Construction (F, 23.2%), Repair of motor vehicles (G, 13%), Manufacturing (C, 11.8%), Administrative and Support Services (N, 11.1%) and Accommodation and Food Services (I, 10.0%). This use by sector bears interesting comparison with that in 2006 set out in the Frisby and Walters Report. Generally, usage in 2006 appears to have been more evenly spread. Whilst Construction (first) and Other Manufacturing (joint third) were prevalent, the rates were 16% and 6% respectively, which is much lower than comparator categories in 2013.³⁹

39. Frisby and Walters Report, p.18 (N.B. This would have relied on SIC03 categorisation or earlier).

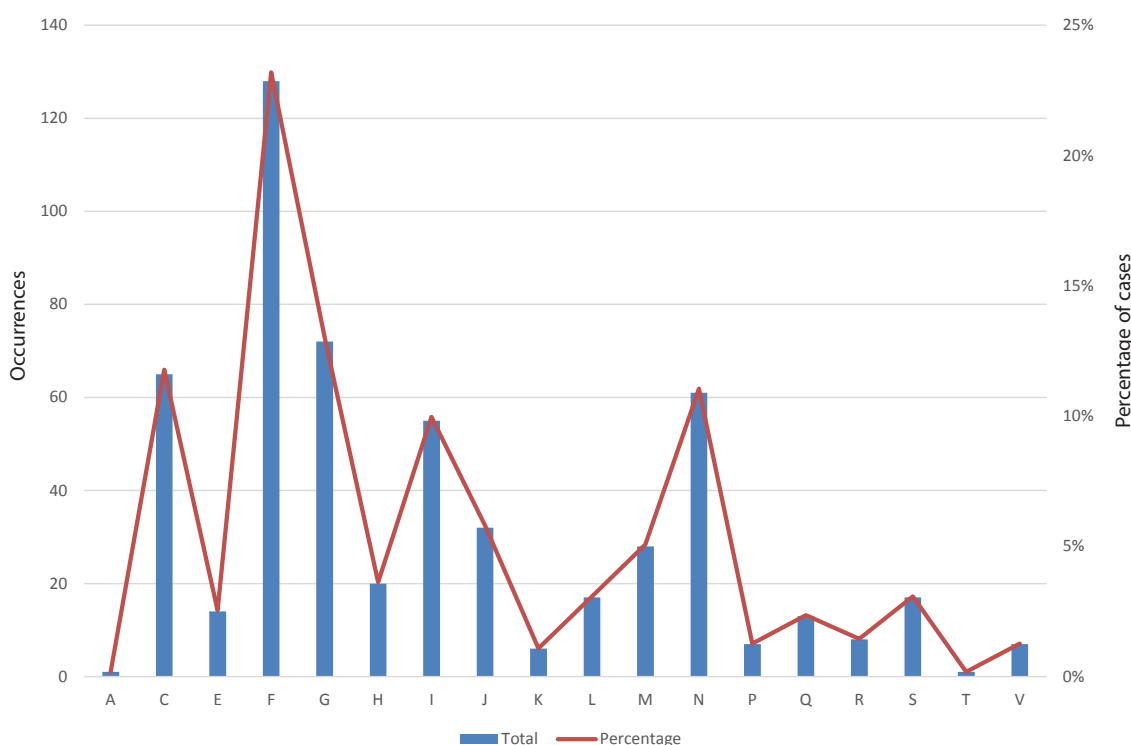


Chart 10: Use of CVA by business sector (SIC07 1 Digit⁴⁰)

It is interesting to look at the distribution of these companies across the implemented, terminated and ongoing CVAs. Here we see some patterns emerging of sectors where CVAs appear more likely to succeed (or at least to be fully implemented rather than being terminated). There are also some interesting patterns with ongoing CVAs, which may go on to be implemented, which their current longevity suggests is more than a mere possibility.

Overall, only 18.5% of all CVAs in 2013 were fully implemented, and with a number moving straight into another insolvency process only 14.9% of CVAs can be considered to have survived. It can be seen in Charts 11A and 11B that a number of sectors buck this trend, particularly Financial and Insurance Services (K, 66.6% and 33.3%), Real Estate (L, 88.2% and 82.4%) and Household employers (T, 100% for both). However, only Real Estate has a significant number of occurrences (15).

40. A complete list of current Standard Industrial Classification ("SIC") codes may be found at: <http://resources.companieshouse.gov.uk/sic/>.

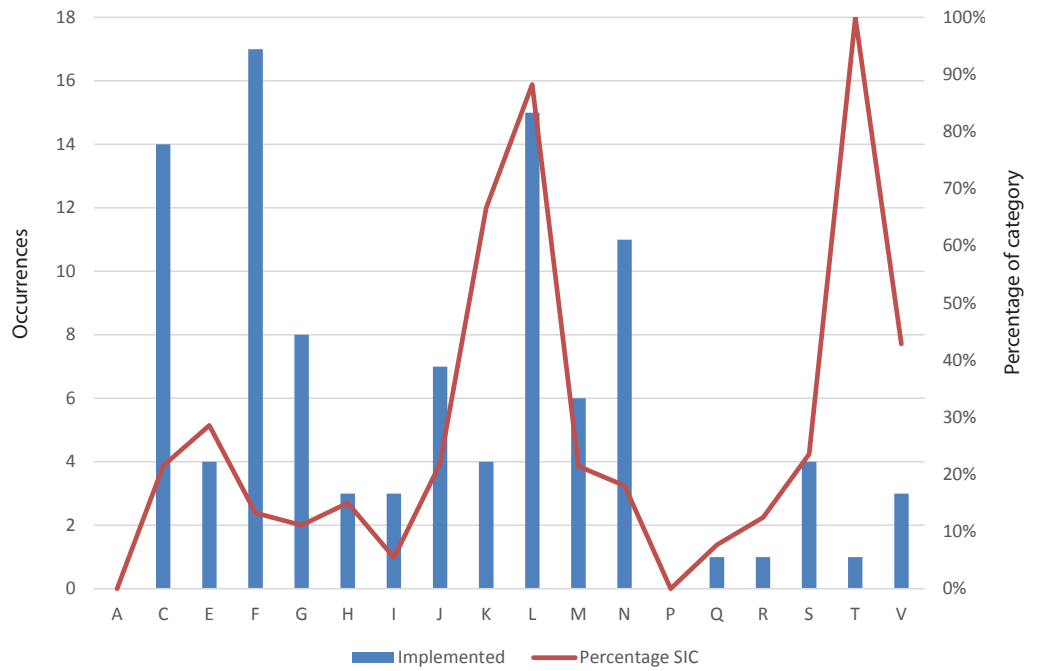


Chart 11A: Implemented CVAs by business sector (SIC07 1 Digit)

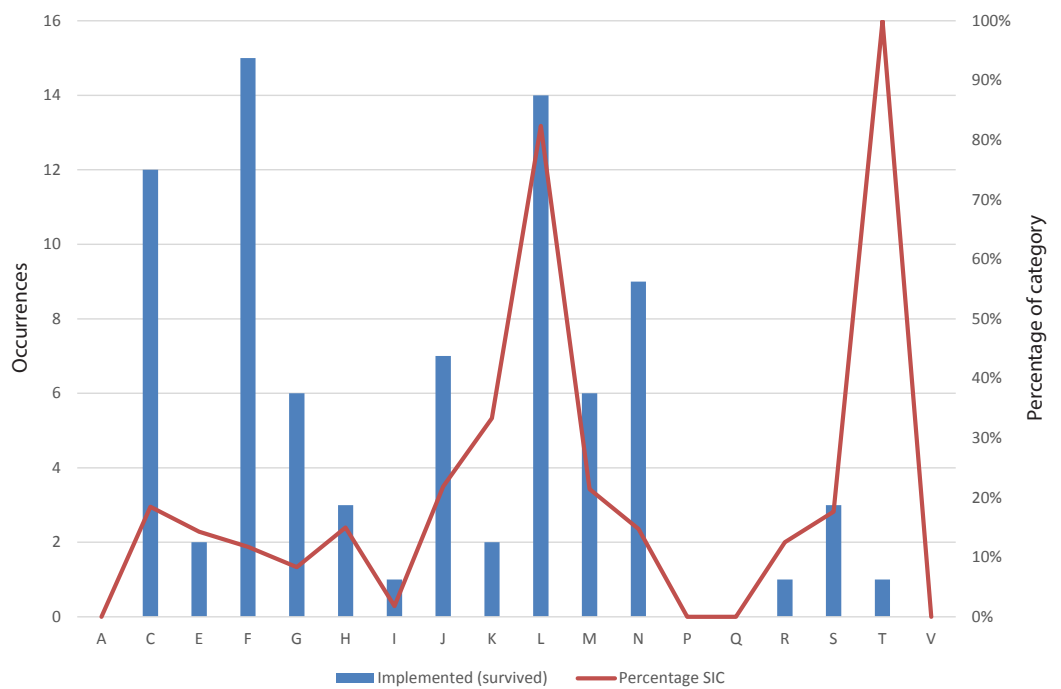


Chart 11B: Implemented CVAs which survived by business sector (SIC07 1 Digit)

Chart 11C shows that the termination rate of the most popular sectors, Construction (F, 64.8%), Repair of motor vehicles (G, 73.6%), Manufacturing (C, 66.2%) and Administrative and Support Services (N, 70.5%) is broadly in line with, if not a little higher than, the general population, which stands at 65.2%.

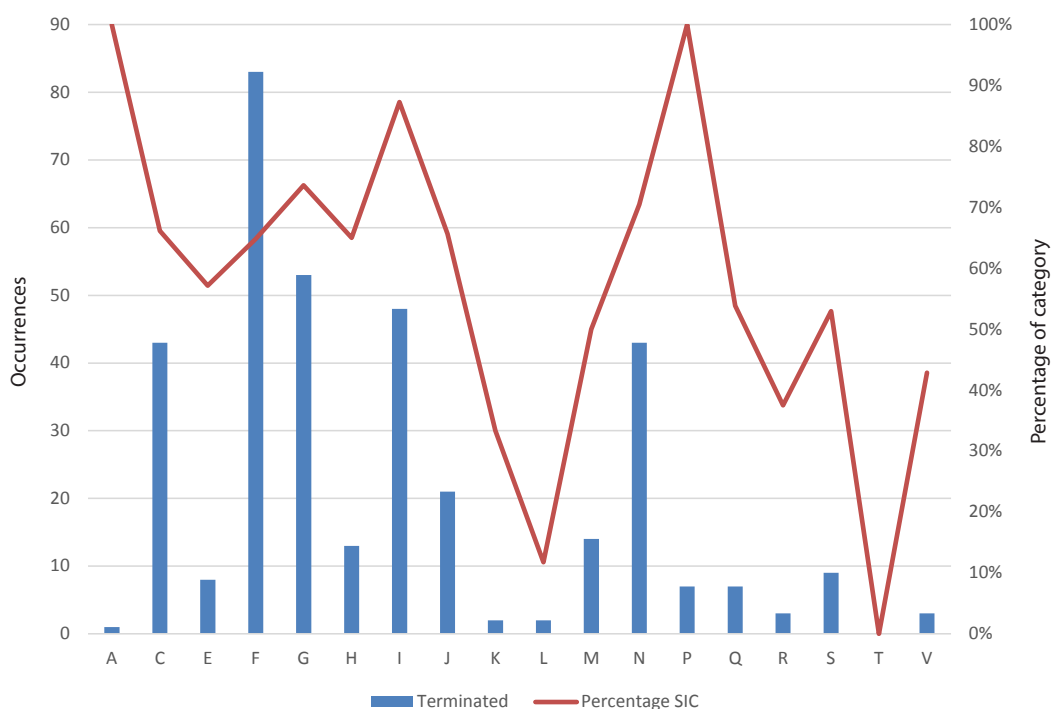


Chart 11C: Terminated CVAs by business sector (SIC07 1 Digit)

It was also observed that 16.3% of all CVAs commenced in 2013 were still ongoing as at 5 November 2017. It can be seen in Chart 11D that those in Construction (F, 21.9%), Transportation and Storage (H, 20%), Professional, scientific and technical (M, 28.6%) and particularly Arts, entertainment and recreation (R, 50%) have a higher proportion of ongoing CVAs. With all bar Professional, scientific and technical (M) below the average for implemented and implemented and survived CVAs, should these CVAs be implemented (and survive), it will have a significant impact on the overall picture. Construction (F) is of particular interest in this regard, being the most popular category for which the termination rate is on par with the figure for the overall population. It will also be of interest whether these ongoing CVAs, if implemented, result in the companies surviving, or whether the companies will move immediately into a subsequent process, suggesting that the CVA was used as a distribution mechanism rather than a rescue process (as observed in at Part 4.1.1 above).

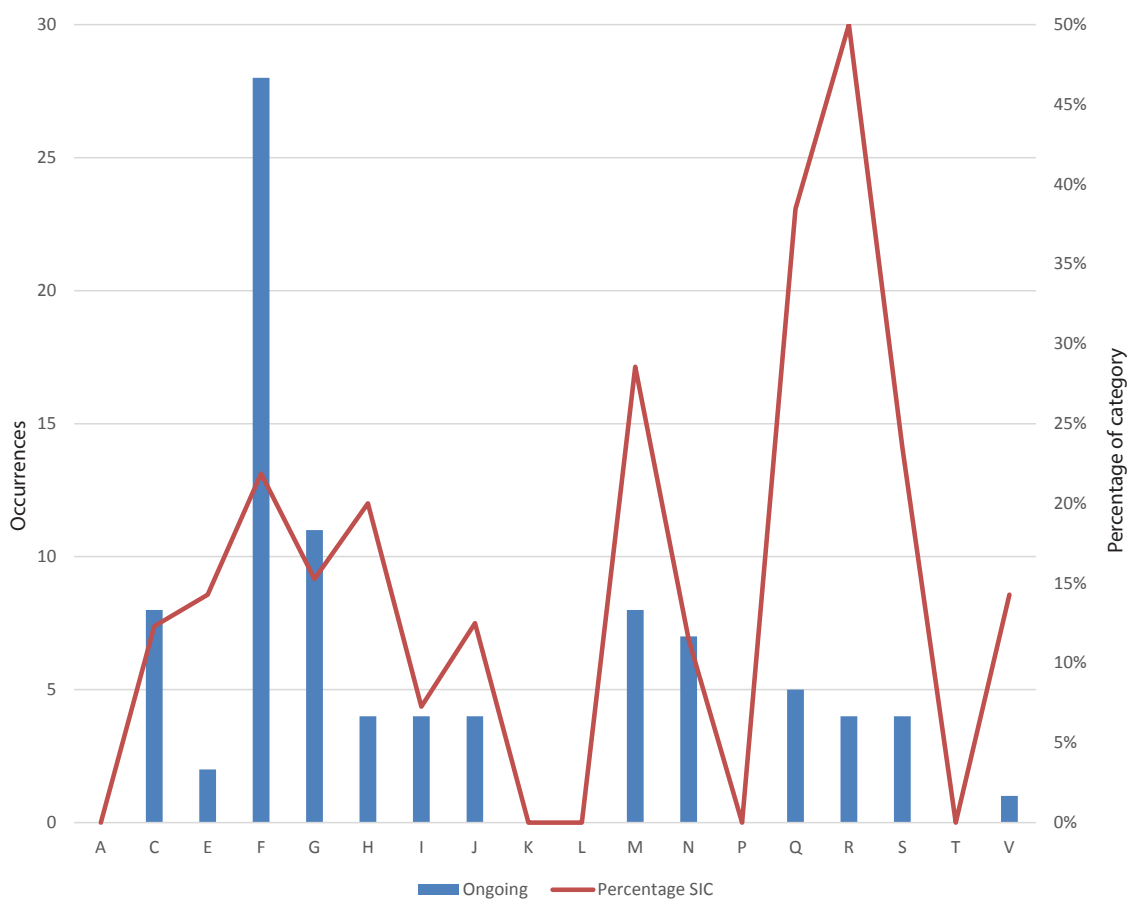


Chart 11D: Ongoing CVAs by business sector (SIC07 1 Digit)

The data shows that CVAs appear to be used more frequently in certain sectors, but also that there are relatively high termination rates for these CVAs, either in line with or higher than the overall average. This raises the question as to whether CVAs are an appropriate restructuring tool for some sectors. It may be that there are sector specific issues which hinder CVA performance, such as the reaction of key creditor groups, or perhaps simply that the terminations observed are due to localised issues or perhaps the individual company or operation of its CVA. The fact that some CVAs are being implemented, or continuing for at least four years, suggests it is a viable tool. However, the societal impacts of failures of companies in certain industries, such as construction and repair of motor vehicles, need to be borne in mind, with customers and end users relying on warranties and quality of workmanship from these companies. Perhaps more careful scrutiny needs to be given to CVA proposals for companies in these sectors, given the apparent high termination rate and wider ramifications of company failure. When the SIC07 Data is broken down further and 2 Digit codes considered, the most popular sectors generally appear to follow the overall trend (i.e. 18.5% Implemented and 65.2% Terminated). Chart 12 details those sectors with at least 17 occurrences (i.e. over 3% of all cases), with only one sector, Real Estate Activities (68), bucking the general trend with 16 of 17 cases being fully implemented, and all bar one of these surviving the CVA. This represents a range of operations, largely involving the ownership of real estate. Ownership of such assets may explain the link with successful implementation.

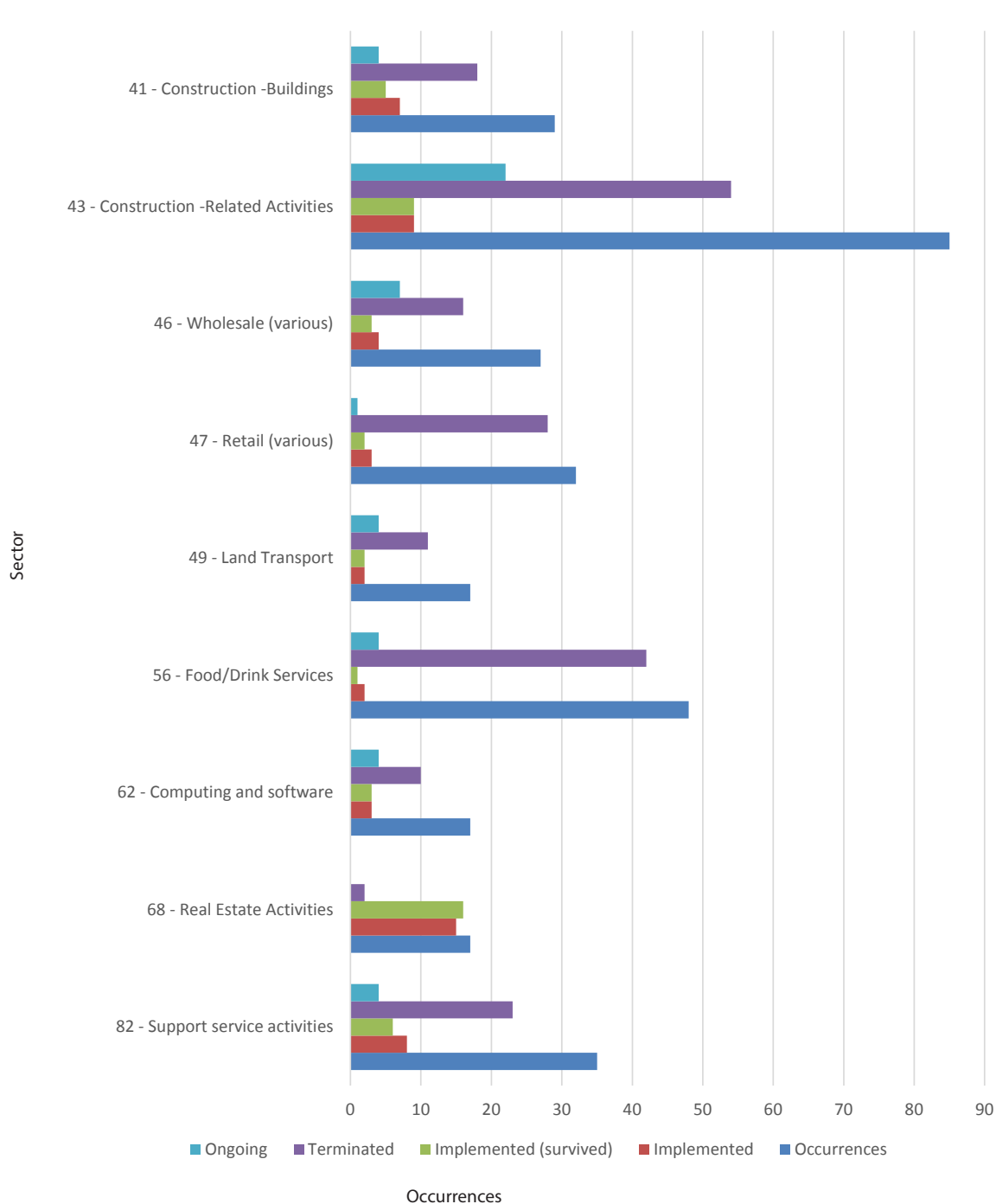


Chart 12: Use of CVA and outcomes by business sector (SIC07 2 Digit)

4.1.3 Insolvency Practitioner (“IP”) Firm involvement

It is notable that there were a significant number of IP firms (164) taking supervisory appointments in the CVAs reviewed. Of this total, IPs from 79 firms took just one appointment, whilst a further 25 took two appointments. As shown in Chart 13, where firms were taking multiple appointments, these were usually fewer than 5 and rarely exceeded 10.

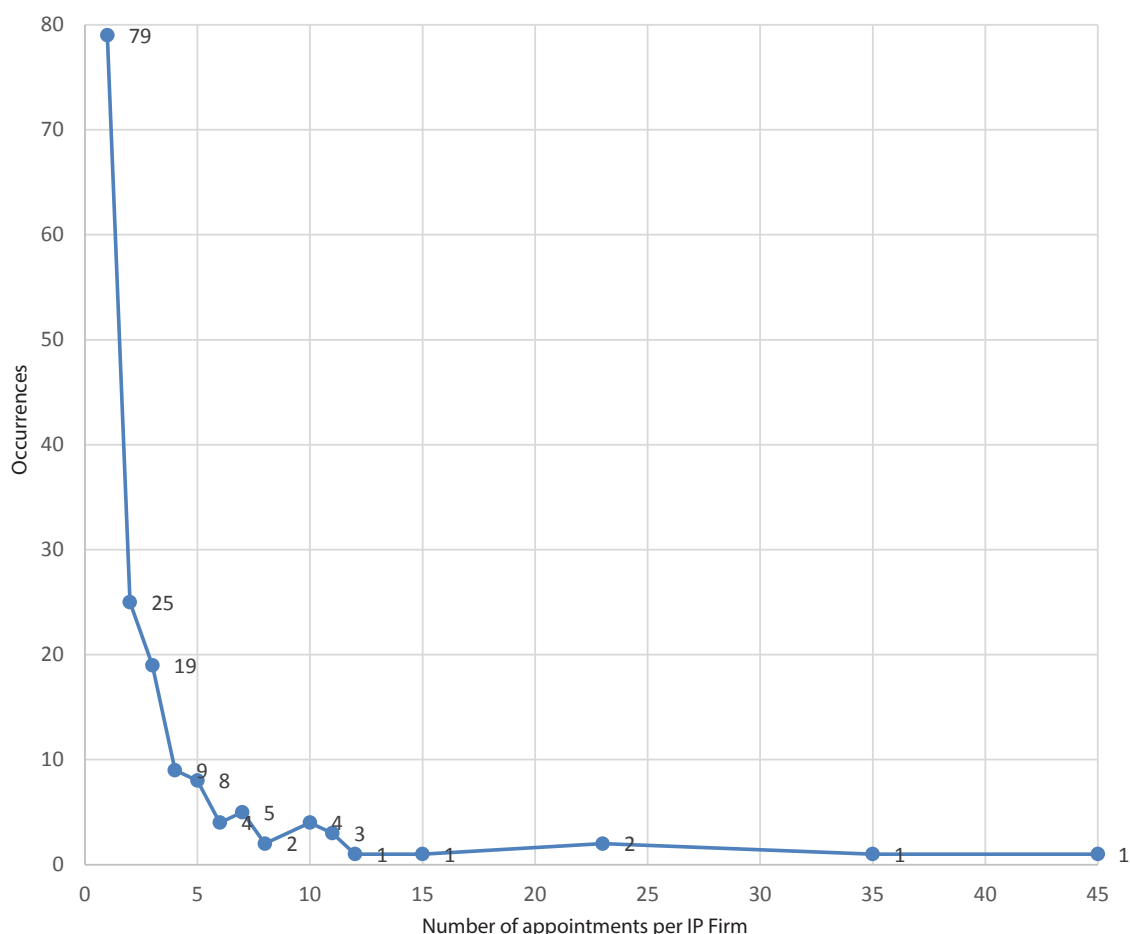


Chart 13: Frequency of CVA appointments by IP Firm

Only 4 firms took more than 20 appointments in all of the 552 cases reviewed, representing a mix of size of firms (and number of appointment takers). The outcomes of these CVAs are mixed, as can be seen in Chart 14. Three of the four firms experienced worse implementation rates than the general trend, and two noticeably higher termination rates. All four firms had a higher proportion of CVAs still ongoing than apparent from the overall data.

The findings in relation to IP Firms undertaking CVAs reveal some interesting points. It appears that there are a large number of firms doing a small number of CVAs each year. Very few IP Firms are involved with large numbers of CVAs, and some of those that are employ many IPs, in which case the work is potentially being spread widely.

There are distinctions between these IP Firms, from size and region to sectors of the market in which they frequently operate. Combined with the large number of variables at play in the CVAs reviewed, it is not possible to comment on the outcomes of cases generally. It is clear, however, that for large numbers of IP Firms, and IPs, there is a lack of continuous experience of advising on CVAs to approval and subsequent supervision. In light of the experience gap due to this infrequent exposure, it is arguable that some IPs are not exposed to current best practice. Perhaps the introduction of some form of best practice guidance would improve the likelihood of a positive outcome, making up for individual IPs' (and IP Firms') lack of frequent exposure to the CVA, and its evolution.

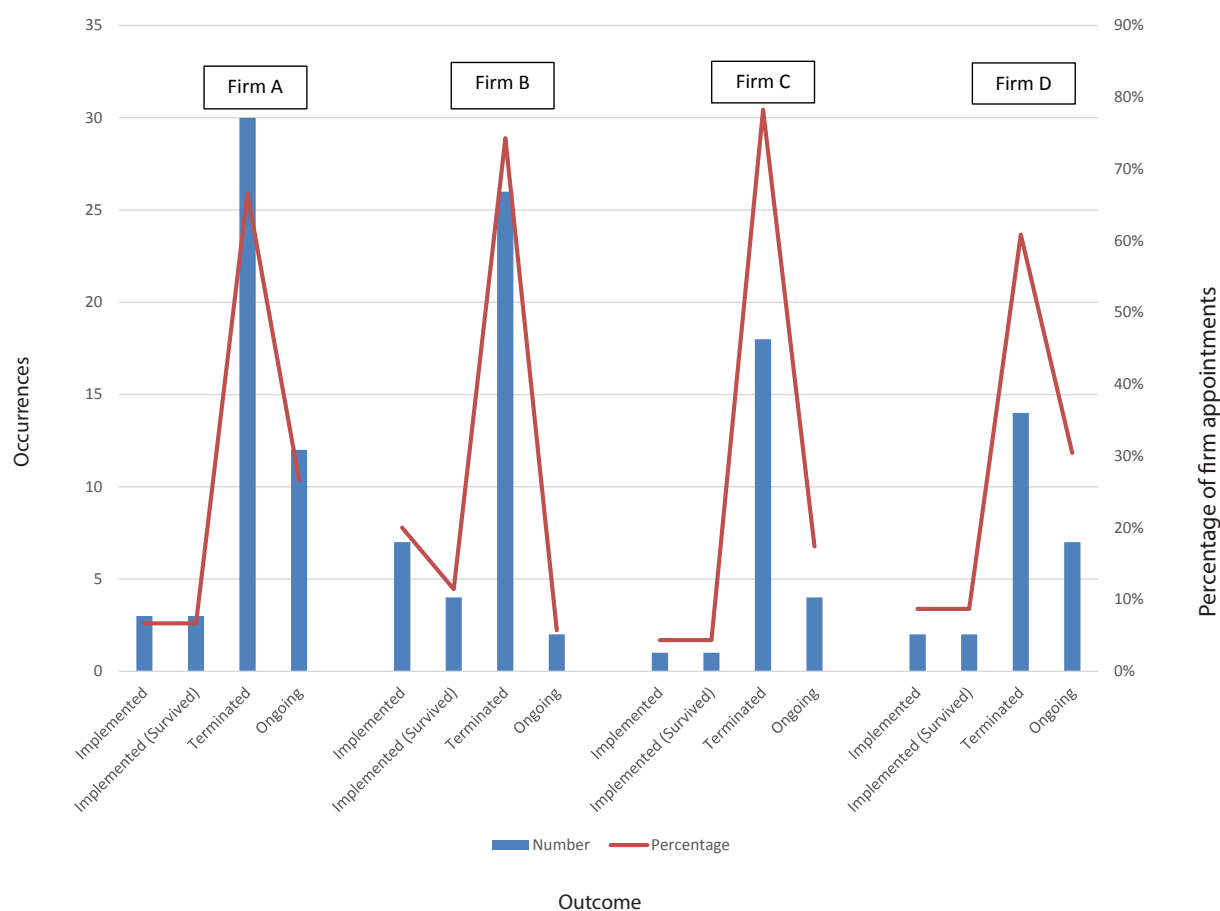


Chart 14: CVA Outcomes for the most active IP Firms

4.2 Phase Two Analysis

At face value, if a CVA has been terminated prematurely it will not have achieved its aims, and therefore will not have been successful.⁴¹ This is a rather arbitrary distinction that potentially overlooks positive outcomes in CVAs even though they are ultimately terminated. The data collected in Phase One revealed that CVAs commenced in 2013 were terminated from anything between one and eighteen quarters. There is considerable scope for what could have happened in this timeframe.

In order to assess whether a CVA might be deemed a success or a failure, further analysis of the data was carried out. It was observed as a common trait of trading-based CVAs, that supervisors are obliged to take steps to terminate the CVA in the event of default in contributions, often when three contributions are missed, unless the default is addressed by the company. On this basis, where a CVA has continued for a certain period, say one year, it would be reasonable to expect a level of contributions to have accrued that could lead to some form of distribution to unsecured creditors, given these funds are usually held on trust for CVA creditors.⁴² For example, if a CVA is terminated after 12 months, then even allowing for three months of defaulted contributions and time for the supervisor to take requisite action (such as petitioning for the company's winding up) before termination, one might expect six months of contributions to be made. Should this be the case, it would give rise to the possibility of an alternative perception for those CVAs being terminated, beyond simply being viewed as having failed. The closer to completion of the proposed CVA period, the more substantial those contributions could be expected to be.

41. This appears to be the approach adopted by the Insolvency Service in the May 2016 Consultation.

42. *Re NT Gallagher & Son Ltd* [2002] BCLC 133.

On this basis, secondary data collection was undertaken in respect of companies involved in terminated CVAs, to determine the outcomes of these CVAs in more detail. With 244 CVAs commencing in 2013 being terminated after more than four full quarters, this was intended to shed further light on degrees of success and failure in these terminated CVAs.

Based on filings made by supervisors to Companies House, the following data was collected in relation to a sample of the 360 CVAs commencing in 2013 which terminated on or before 5 November 2017:

1. Contributions to the CVA

- i) Proposed monthly contributions
- ii) Proposed length of CVA
- iii) Total value of contributions made
- iv) Value of lump sum payments made
- v) Actual number of contributions made

2. Creditors of the Company

- i) Amount owed to preferential creditors
- ii) Amount owed to unsecured creditors
- iii) Presence of and impact on secured creditor

3. Dividends in the CVA

- i) Preferential dividend paid (if any)
- ii) Preferential dividend rate
- iii) Proposed unsecured dividend
- iv) Unsecured dividend paid (if any)
- v) Unsecured dividend rate

4. Costs of the CVA

- i) Total costs of CVA
- ii) IP fees paid (including nominee and supervisor fees)

In some cases, some of the data points were not set out expressly in the filings. In such a case, an estimate based on other filed data was used. For example, if the filings did not record the number of contributions actually made, an estimate could be drawn from the expected monthly contributions and the total contributions. Similarly, if a total unsecured creditor figure was not set out in the filings, an estimate could be gauged from the unsecured dividend and reported unsecured dividend rate.

An initial sample collection was undertaken based on different lengths of CVA prior to termination. The terminated CVAs were categorised by length in quarters, with data collected for the lesser of either five companies or 50% of each group, selected at random. Based on the presumption that a CVA lasting up to four quarters would expect some level of contributions, and therefore some level of distribution, the initial sample looked at CVAs lasting 4, 6, 8, 10, 12, 14 and 16 quarters. The length of four quarters was selected as the starting point to enable CVAs lasting almost a full year to be captured, as well as to enable the threshold of a year to be challenged should evidence of dividends be found in this group.

The initial sample revealed no dividends being paid in those CVAs lasting four quarters and very few dividends paid in those CVAs lasting six quarters. This is unsurprising, given the priority given to the costs of the CVA. A more comprehensive sample was then collected for companies involved in terminated CVAs lasting between 6 and 18 quarters, again selected at random. Data was collected for:

- 25% of all companies per quarter, with a minimum of five companies per quarter; or
- 50% of companies if fewer than ten per quarter; or
- 100% of companies if fewer than five per quarter.

A higher proportion of companies from less populous quarters were sampled to ensure reasonable sample sizes.

This resulted in a sample of 64 companies involved in CVAs lasting from 6 to 18 quarters prior to termination.

Of the 64 CVAs for which data was collected, dividends were reported as being paid in 37 cases. In one further case a dividend was due to be paid, but the amount was not reported in any of the filed documentation. These dividends ranged from 0.0054p/£ to 79.81p/£, representing yields as against proposed dividends ranging from 0.01% to 79.81%.

Whilst the sample suggests that dividends, albeit of varying levels, were paid in over half of the cases, it must be noted that the sample is skewed by having a higher level of representation proportionately of the longer CVAs, due to the sampling method.

4.2.1 Dividend Payments

It might be expected that the rate of dividend occurrence, and the rate of dividend paid, would increase over time, as there will have been more opportunity for contributions to accumulate the longer that a CVA runs. Breaking the data down by length of CVA by quarters reveals that there is a trend to this effect, though it is not universally held.

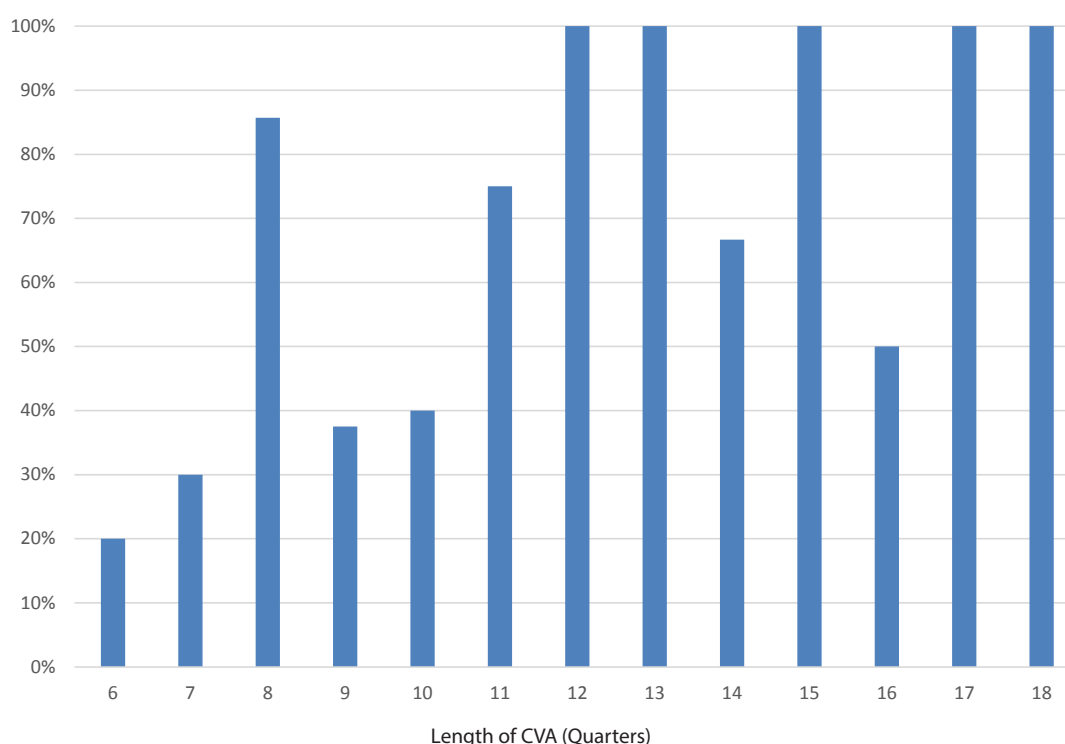


Chart 15: Length in Quarters vs Percentage of cases where dividend paid

Chart 15 shows a general trend towards dividends being paid in a higher proportion of CVAs the longer the process lasts. There is a spike in dividend payments in Quarter 8, and from Quarter 12 to Quarter 18 nearly all CVAs see some form of dividend save for dips at Quarters 14 and 16.

This data includes three CVAs which were asset-based, with expected lump sum contributions, rather than trading-based with regular monthly (or on occasion weekly) contributions. These three CVAs were all terminated with no dividend paid. There is also one case where a dividend was expected, but no data was available on the actual dividend paid. Based on the premise that we would expect an increased prospect of a dividend based on accumulations over time, if we exclude these four cases, a slightly different picture emerges (see Chart 16, below) which supports the expected trend, save for the anomalies at Quarters 8 and 16, which remain.

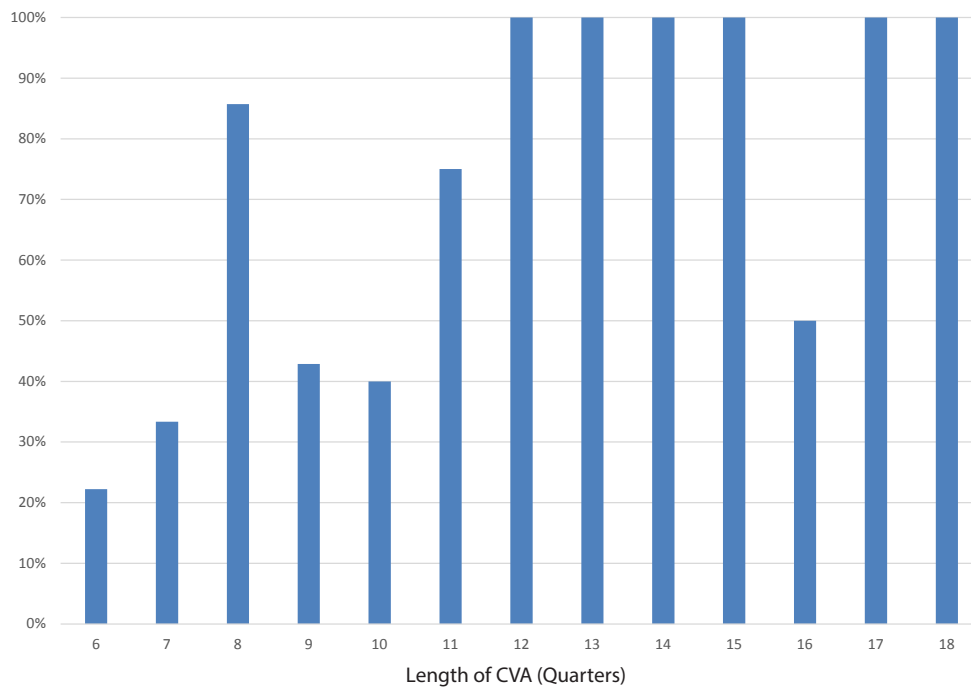


Chart 16: Percentage of CVAs where dividend paid by quarter (adjusted to exclude lump sum only CVAs and cases where dividend level not known)

The second expectation expressed above is that the level of dividend paid would increase in line with the length of the CVA. This would reflect the greater period of time for contributions to be collected, allowing a larger fund for distribution. This is not reflected in the data, however, with no clear pattern between level of dividend paid and length of CVA (see Chart 17). There is some evidence of higher dividends being paid in these longer CVAs, but also a large number of lower payments continue to be seen. Length of CVA in itself is not therefore determinative of level of dividend.

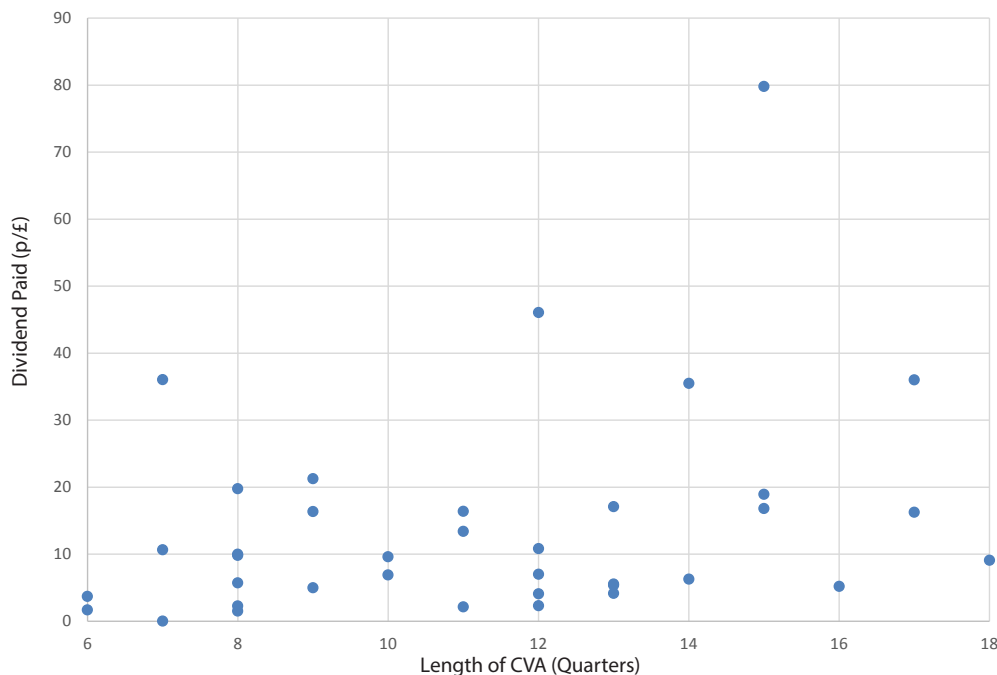


Chart 17: Distribution of dividend rates over time

Even if looked at from the perspective of average dividend payments per quarter, the expected trend is still not apparent, with movements up and down between quarters (Chart 18). If the cases where no dividend was paid are excluded and only those cases where a dividend was paid are considered (Chart 19), whilst the average dividend generally increases, there is still no discernible pattern.

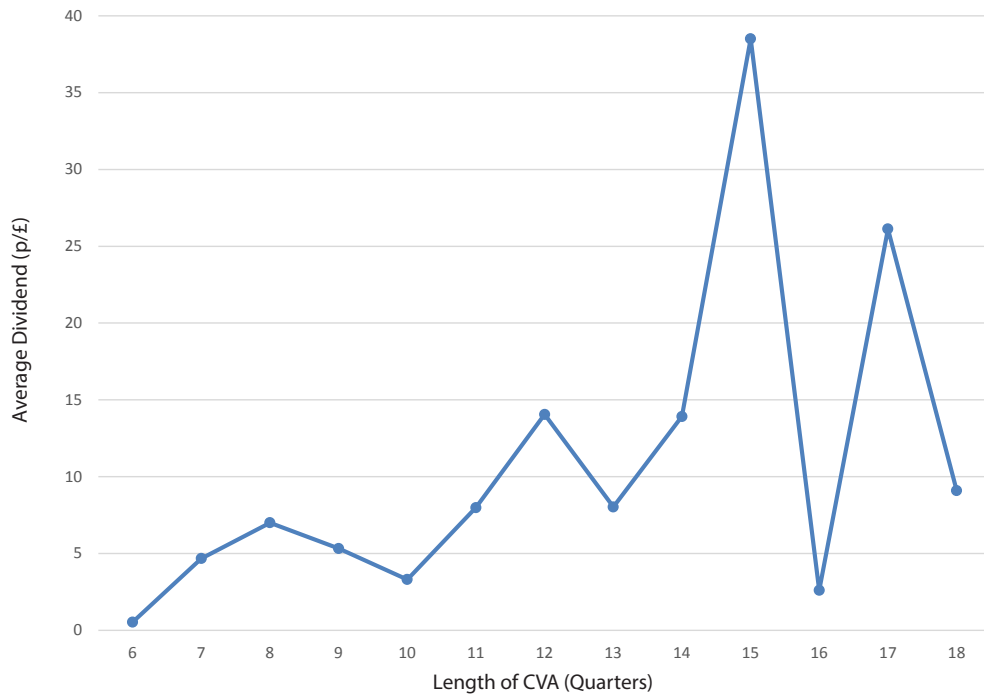


Chart 18: Average dividend paid per quarter (including cases where no dividend paid)

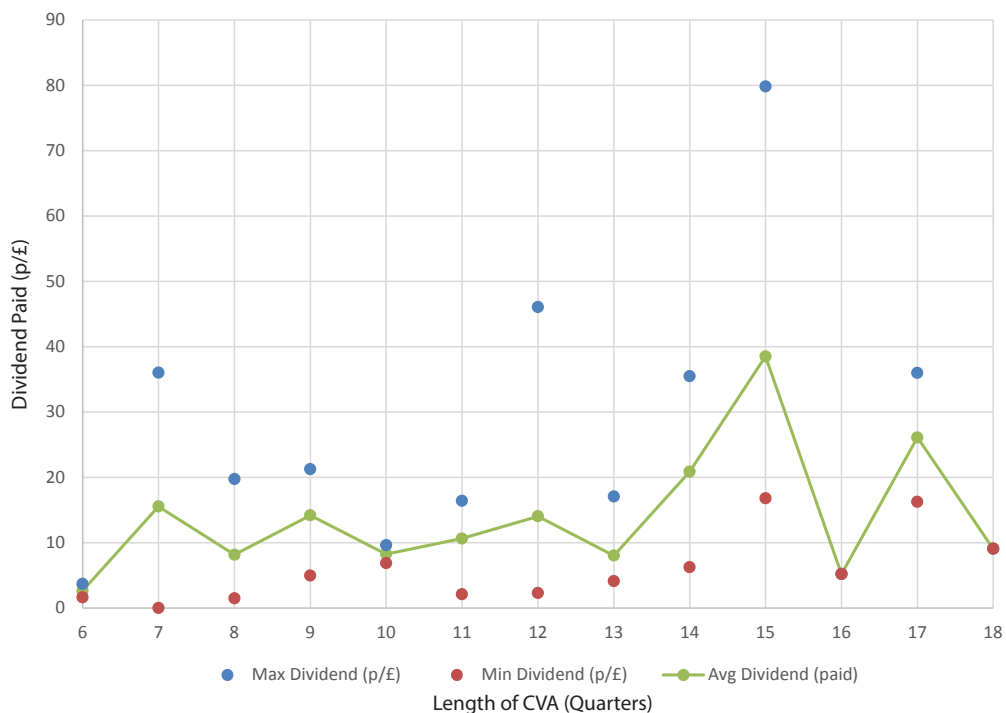


Chart 19: Average dividend paid per quarter (excluding cases where no dividend paid)

It therefore appears that, whilst dividend payments are generally more likely the longer that a CVA runs before being terminated, they are not certain to be achieved and there is no consistency in terms of the level of dividend being paid over time.

The expectations that, the longer the CVA, both the more likely a dividend is to be paid and the higher rate of that dividend, are not supported by the data collected. Whilst broadly speaking, the longer the CVA runs for prior to termination the greater apparent certainty of a dividend being paid, there are unexpected occurrences of no dividend being paid in CVAs lasting more than two and a half years. There also appears to be no consistent pattern as to the level of dividend payable. This raises the twin questions: why is no dividend being paid on some CVAs based on monthly contributions running for over two years; and where dividends are being paid, why are the levels often so low? Closer inspection of a number of factors which could affect these outcomes may provide some insight:

- To what extent are contributions being made throughout the CVA;
- Does the level of unsecured debt impact on dividend payment;
- How do the dividends paid relate to the proposed dividends agreed to by creditors; and
- What are contributions being used to pay besides dividends.

These issues will be considered in the following sections.

4.2.2 Contributions

The expectation of a dividend being paid out of a CVA which has run for in excess of a year prior to termination is based on the premise that regular contributions will have been made by the company during that period. As identified above, it was commonly observed that supervisors were required to bring CVAs to an end in the event of default, which often included repeated failure to make contributions. In some cases, companies were given opportunities to make up these contributions or seek variations to the CVA in light of changed circumstances. One such example involved a single director company where the director faced significant health issues which impacted on the company’s trading ability. It would be a surprise if such situations were allowed to have a significant detrimental impact on the original term of the CVA, however.

Whilst a number of CVAs ran for six or more quarters prior to termination, it was found that where no dividend was paid there were often a large number of missed contributions.⁴³ Of the 22 trading-based CVAs where no dividend was paid, only three were terminated after three or fewer missed contributions (all being terminated within six quarters of commencement). This small number is surprising, given the common requirement to bring a CVA to an end in such circumstances. As Chart 20 reveals, generally in cases where no dividend was paid, the longer a CVA ran for, the higher the number of missed contributions. This peaked with a CVA terminated after 16 quarters with 34 monthly contributions not made.

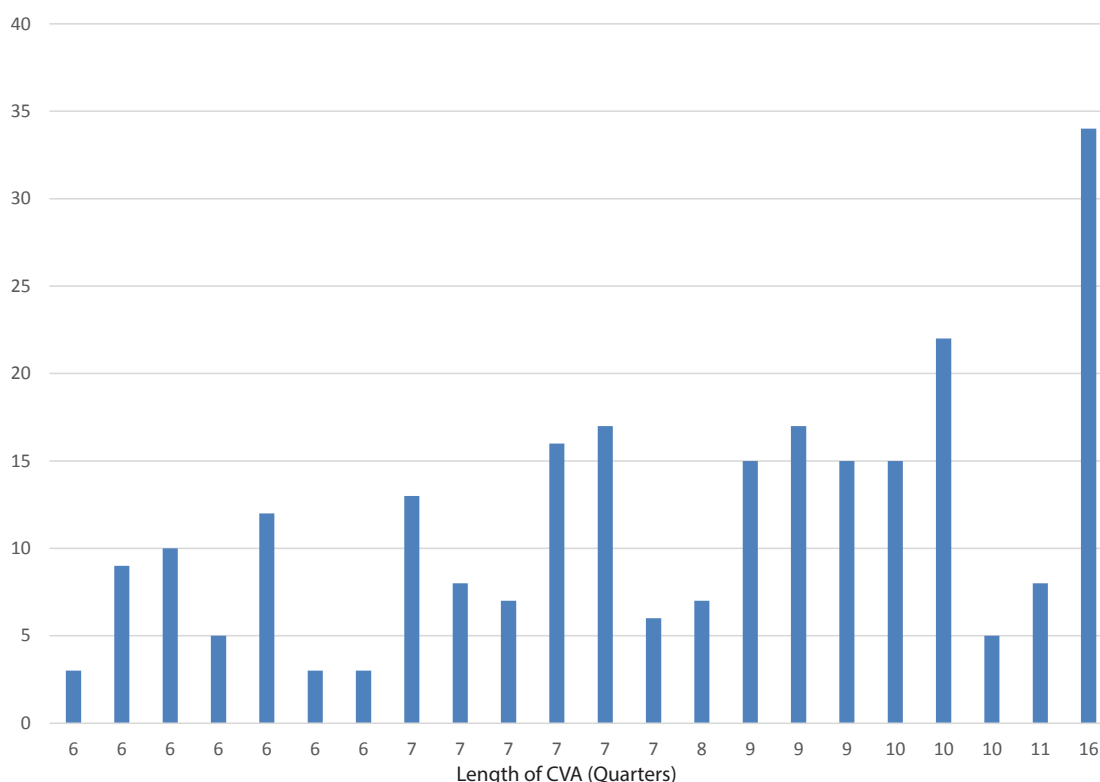


Chart 20: Missed contributions prior to termination where no dividend was paid (excludes lump sum only CVAs)

43. For example, if a CVA proposal made provision for monthly contributions, then over a 12 month period 12 contributions would be expected. In many cases, this was not the case, for example if only 8 contributions were made, then there would be 4 missed contributions in that 12 month period.

This suggests that the length of a CVA may in fact be misleading as a measure of relative success. The impact of these missed contributions is to reduce the effective length of the CVA, in some cases quite dramatically, as illustrated in Chart 21.

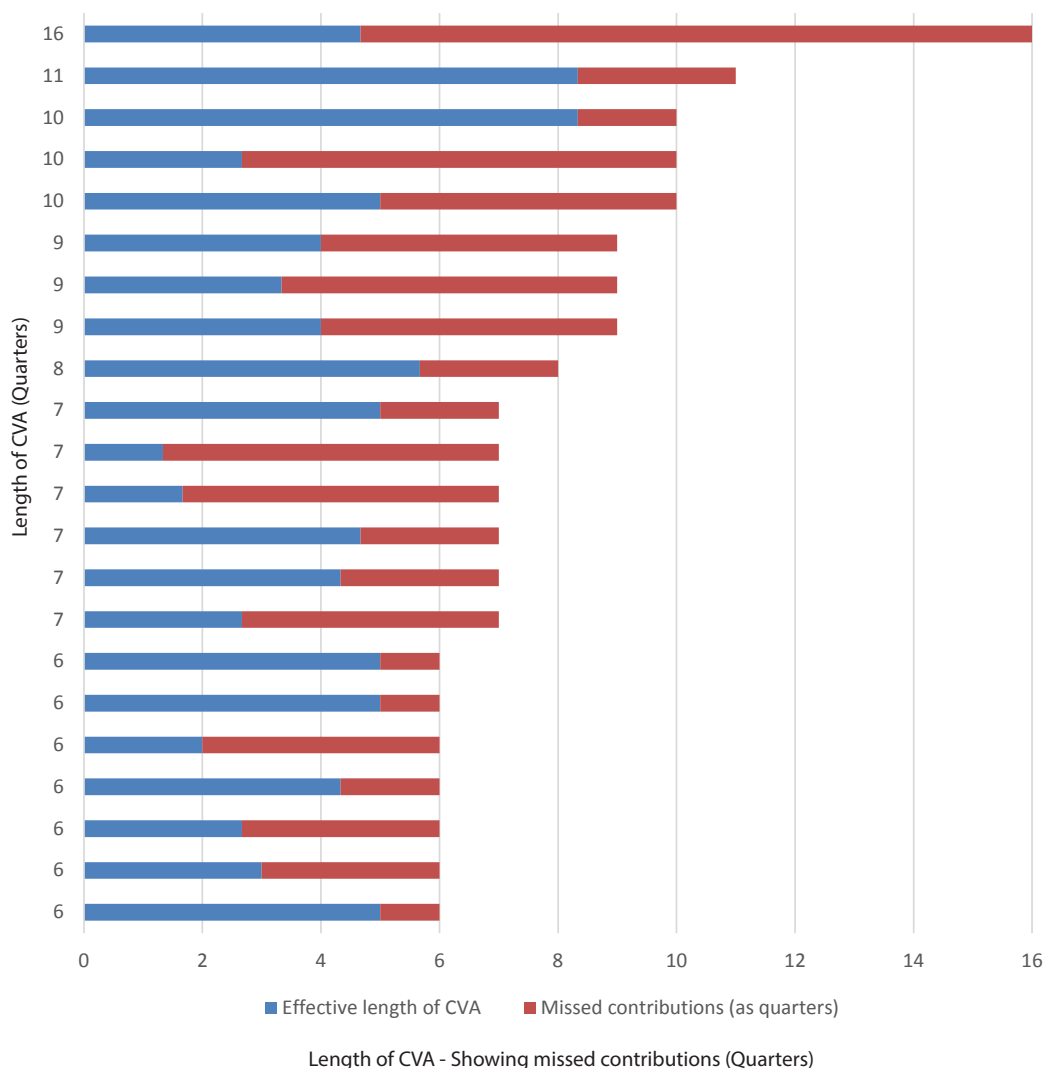


Chart 21: Effective length of CVAs when missed contributions taken into account

It can be seen that when the number of missed contributions is taken into account, 20 of the 22 CVAs where no dividend was paid have an effective length of less than six quarters. That is, less than six quarters’ worth of contributions were actually made during the CVA. Given the low incidence of dividend payments in CVAs terminated within six quarters of commencement (see Charts 15 and 16 above), it is not surprising that no dividend payments were made in these cases.

The remaining two cases had effective lengths of just over eight quarters. Whilst the incidence of dividend payments in this group was higher than for six or seven quarters, the general trend for CVAs running for less than ten quarters was for dividends to be paid in fewer than 50% of cases (see Charts 15 and 16). Closer inspection of these two cases does reveal some surprising differences. The CVA which ran for 10 quarters with 5 missed payments amassed contributions of £13,875, with expected monthly payments ranging from £541 to £758 per month over the course of the CVA. In contrast, the CVA which ran for 11 quarters with 8 missed payments amassed total contributions of £62,584, comprised of expected payments of £2,441 per month

together with a lump sum payment of £4,000. It is perhaps more surprising, therefore, that no dividend was paid in this case. This will be considered further in Part 4.2.5 below.

In 12 out of the 22 cases in this sample, the company failed to make 50% or more of the expected contributions due during the CVA prior to termination, as shown in Chart 22 below. Such a high proportion of missed contributions, especially in longer cases, is surprising given the common requirement that a CVA be brought to an end following a relatively small number of missed contributions. Given the CVA process is intended to collect funds to settle historic liabilities to unsecured creditors, high levels of missed contributions may be detrimental to those creditors’ interests, and earlier termination may have better served their interests.

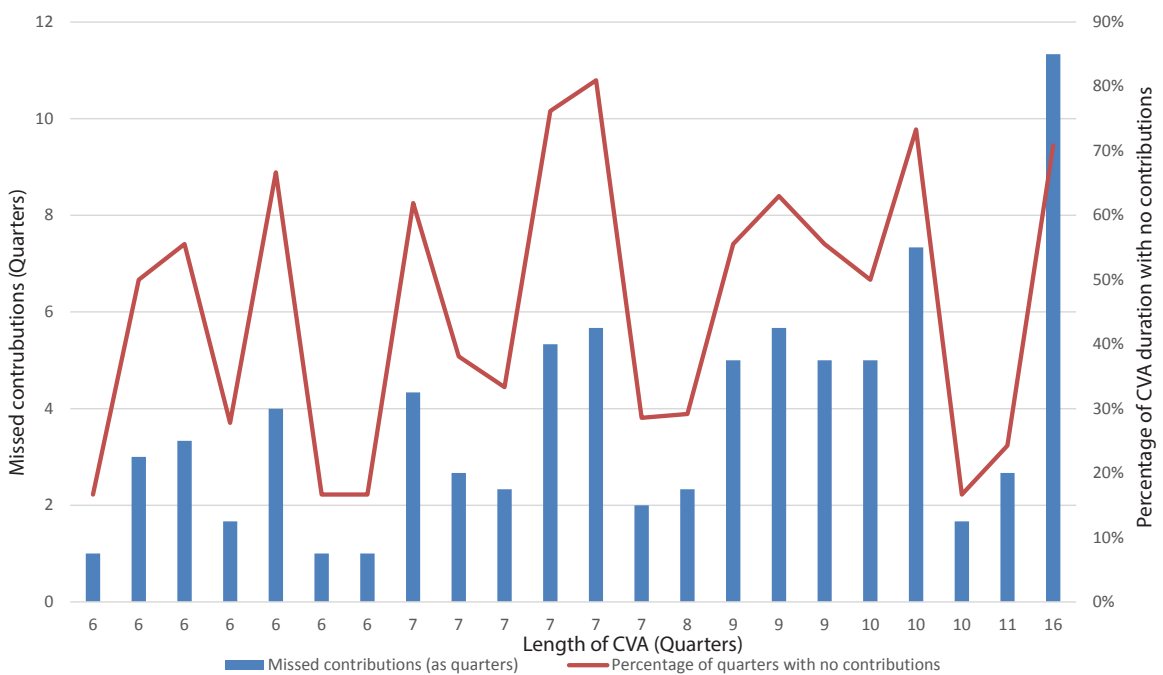


Chart 22: Missed contributions as a percentage of the length of the CVA.

The length of a CVA prior to termination does not appear, in itself, to be a reliable indicator of the likelihood of a dividend being paid, due to the possibility that significant missed contributions can distort the picture as to the true level of expected funds accrued.

4.2.3 Impact of unsecured debt on dividend payment

The level of a company’s unsecured debt would be expected to have some bearing on both the proposed and actual dividends in a CVA. For example, the higher the level of unsecured debt, the lower the likelihood there may be of a dividend being paid in a terminated CVA. Where a dividend is paid in such circumstances, it may be expected to be relatively modest given the extent of creditors claiming a share of the amassed contributions. On the flip side, perhaps a company with higher debt levels would have to propose higher monthly contributions in order to pay a dividend acceptable to its unsecured creditors. This could impact on a company’s cash flow, and affect its ability to sustain the required level of contributions, leading to early termination or perhaps missed contributions during the term of the CVA.

Chart 23 shows the level of proposed dividend (blue marker) and actual dividend paid (red marker) for each company in the sample by level of unsecured debt. This shows a general trend of lower dividends being proposed by those companies with higher levels of unsecured debt, though this is not a universal truth. It also reveals a wide array of dividend proposals by companies with lower unsecured debt profiles.

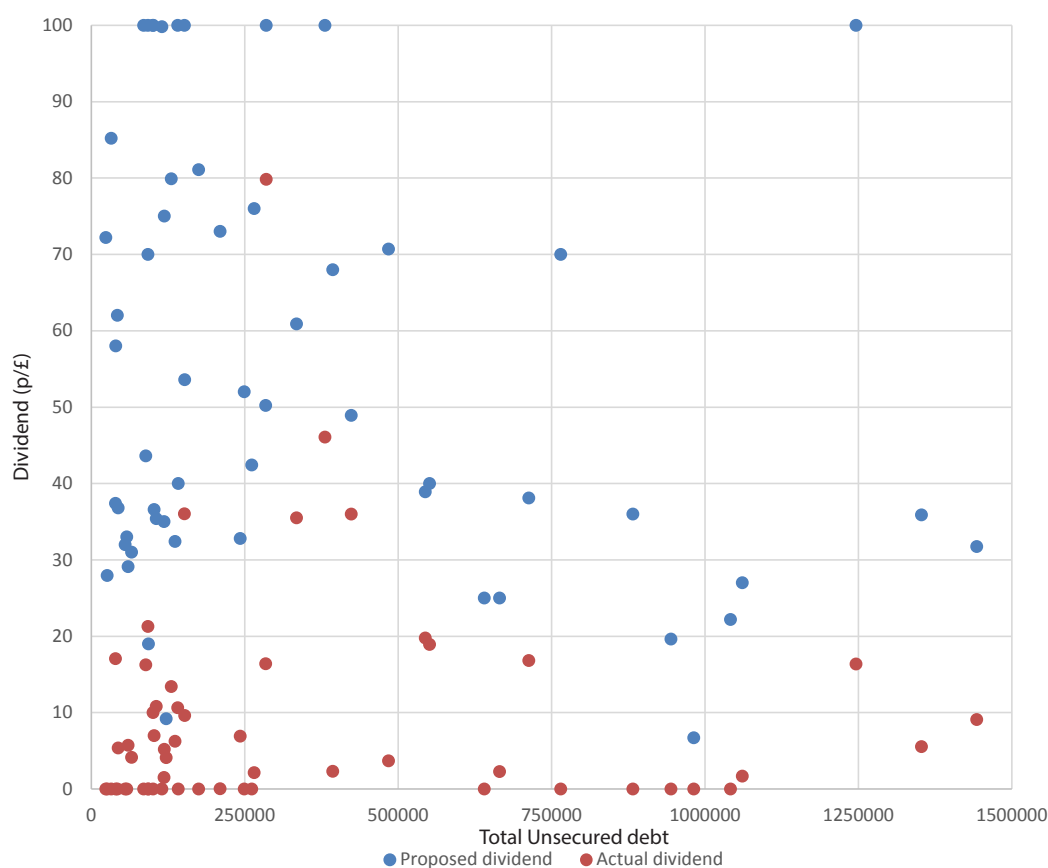


Chart 23: Actual and proposed dividends against level of unsecured debt

Whether or not a dividend is paid does not appear to be related to the level of unsecured debt, as further evidenced by Chart 24 (which lists levels of unsecured debt where no unsecured dividend was paid) or the proposed dividend (as can be seen from Chart 23 above). It can be seen that no dividend is paid for a wide range of levels of unsecured debt. Whilst the majority of incidences of no dividend relate to debt levels below £250,000 (see Chart 24). Chart 23 shows that a similar number of unsecured dividends are paid at this level, suggesting this is not a factor either.

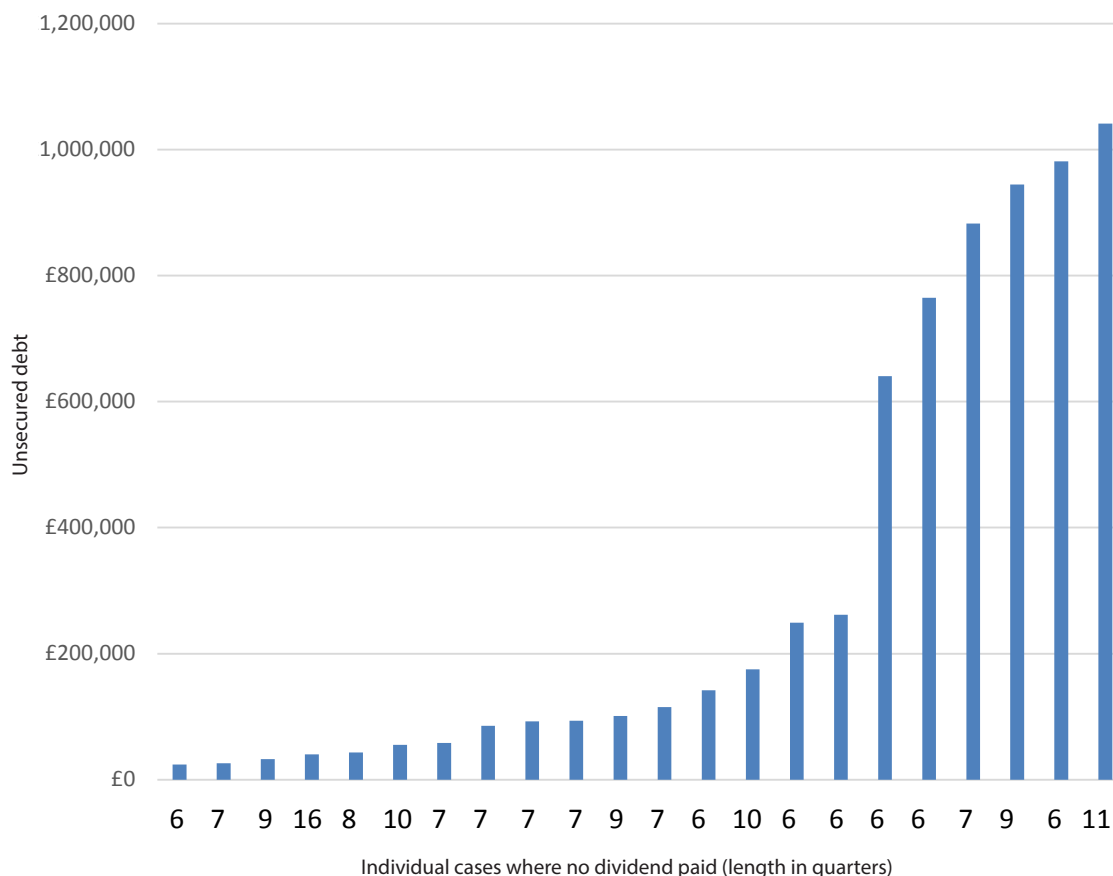


Chart 24: Level of unsecured debt where no dividend paid

There is also no clear pattern between the level of debt and the period that a CVA runs through until termination. Whilst the higher unsecured debts levels are dominated by CVAs terminated after 6 or 7 quarters, the company with the highest level of unsecured debt ran for 11 quarters prior to termination with no unsecured dividend paid.

From the data available, there does not appear to be any clear link between level of unsecured debt and some level of positive outcome from a terminated CVA, with a variety of outcomes evident across debt levels.

4.2.4 Level of unsecured dividend payments

The data reveals that dividends were paid in the majority of the terminated CVAs sampled, with distributions in 37 of the 64 cases, as well as a further case where a dividend was expected but no information as to the dividend paid was available. Whilst at first glance this appears to paint a positive picture, closer inspection reveals a wide array of dividend payments with payments ranging from 0.0054p/£ to 79.81p/£ (as discussed in Part 4.2.1 above). This range in itself does not tell the whole story, however, as it does not consider the level of dividend that creditors were expecting. For example, if a dividend of 10p/£ was expected, payment of 5p/£ would represent 50% of expected returns, which could be viewed as a positive outcome.

For the relative success of these CVAs to be considered, the actual dividends paid need to be compared to the proposed dividend, and considered in light of the length of the CVA. Information for proposed dividends was available for 35 of the 37 cases where a dividend was paid.

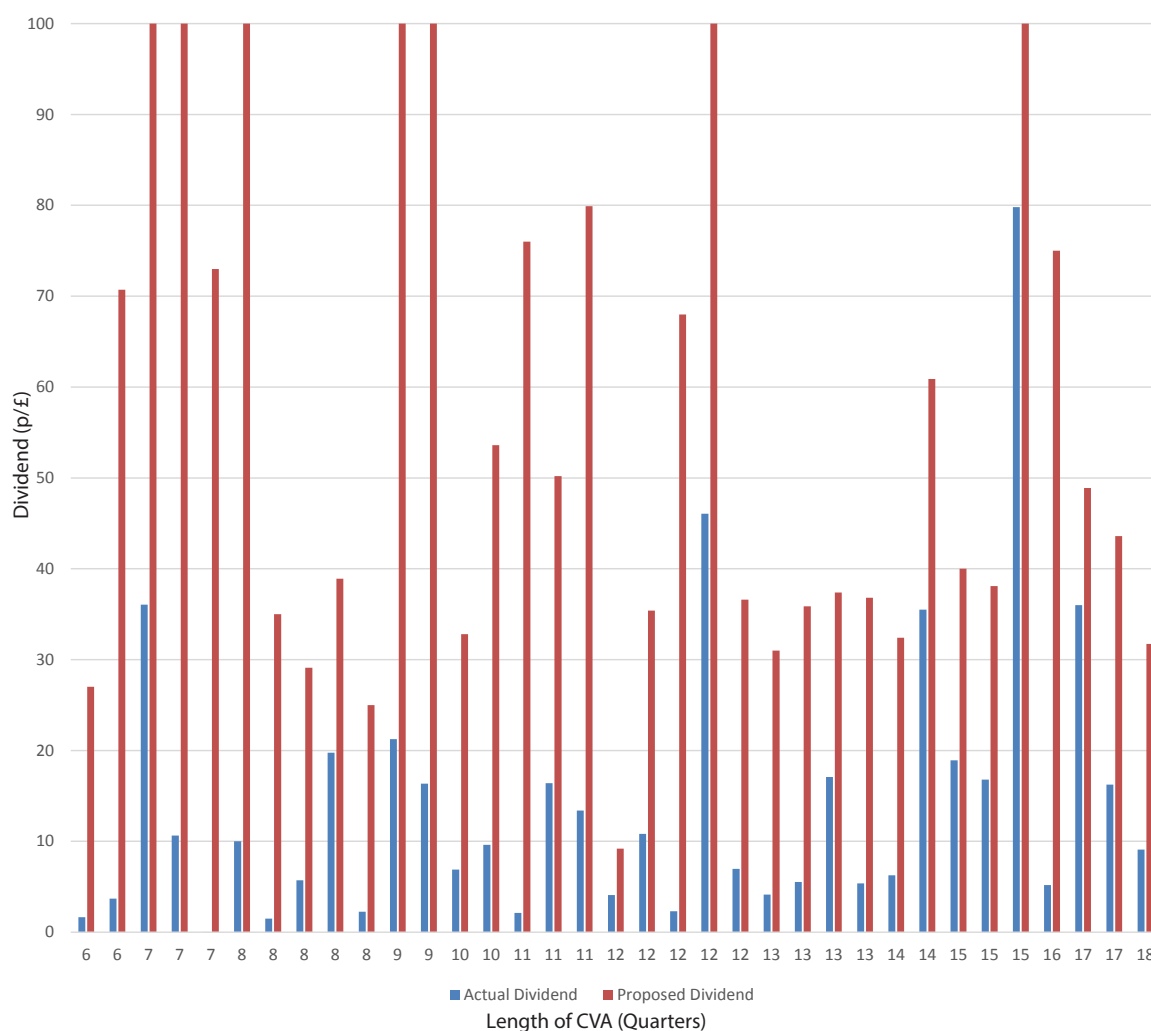


Chart 25: Actual unsecured dividend paid against proposed unsecured dividend

A wide range of proposed dividend levels were approved by creditors, from the lowest at 9.2p/£ to seven cases where full repayment was expected. In 16 of the cases, expected dividends were 50 pence in the pound or higher. It can be seen from Chart 25 that there is a wide disparity between these proposed dividends (red bar) and the level of dividend actually paid (blue bar), with no discernible pattern in the relationship between the two. This is more clearly evident when the dividend paid is expressed as a percentage of the proposed dividend, as shown in Chart 26 below.

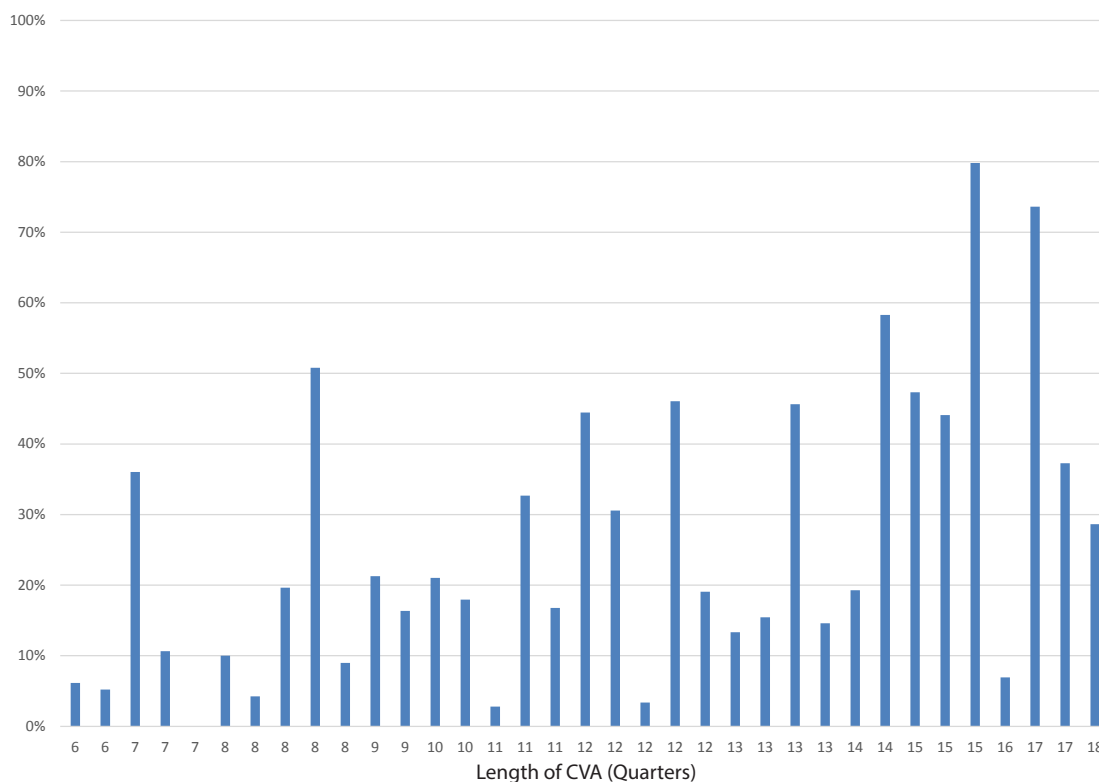


Chart 26: Dividends paid as a percentage of the proposed dividend

Generally speaking, the actual dividend payments were much lower than the proposed dividends, even in those CVAs which ran for longer periods and approached their total proposed length. On average unsecured creditors received 25.95% of the expected dividend, only receiving in excess of 50% of the expected dividend in four of the 35 CVAs reviewed. It would be a natural assumption that, the longer a CVA runs, the more contributions will be collected, and therefore the higher the dividend paid. In turn, the longer the CVA runs for, the closer the dividend paid would be to the expected dividend figure. Whilst this does occur in some cases, it is not common and there are a surprising number of low payments made in CVAs running for over three years.

The above discussion does not take into account how long each CVA ran for relative to the proposed length of the CVA. This could explain some of the spikes in the data, for example, the CVA terminated after seven quarters which paid out 36% of expected dividends or that terminated after 8 quarters which paid out over 50% of expected dividends, seen in Chart 26 above. Comparing the proportion of expected dividend paid to the relative length of the CVA prior to its termination might offer some clarity.

One would expect that the longer that a CVA runs for, the more closely aligned the percentage of expected dividend (i.e. the actual dividend paid as percentage of the proposed dividend) would be to the relative length of the CVA (i.e. the actual length of the CVA as a percentage of its expected length). It is important to acknowledge some important characteristics here that will impact on this general observation. This includes: that payments may increase over time; lump sum payments may be expected towards the end of the proposed term; and that IP Fees will usually take priority and account for the initial contributions.⁴⁴ As such, if a CVA runs for a relatively short period, it would not be surprising that little or no dividend would be payable out of the contributions collected. Considering these factors, we might expect this correlation to be more evident the closer the CVA gets to completion. This relationship is set out in Charts 27 and 28 below.

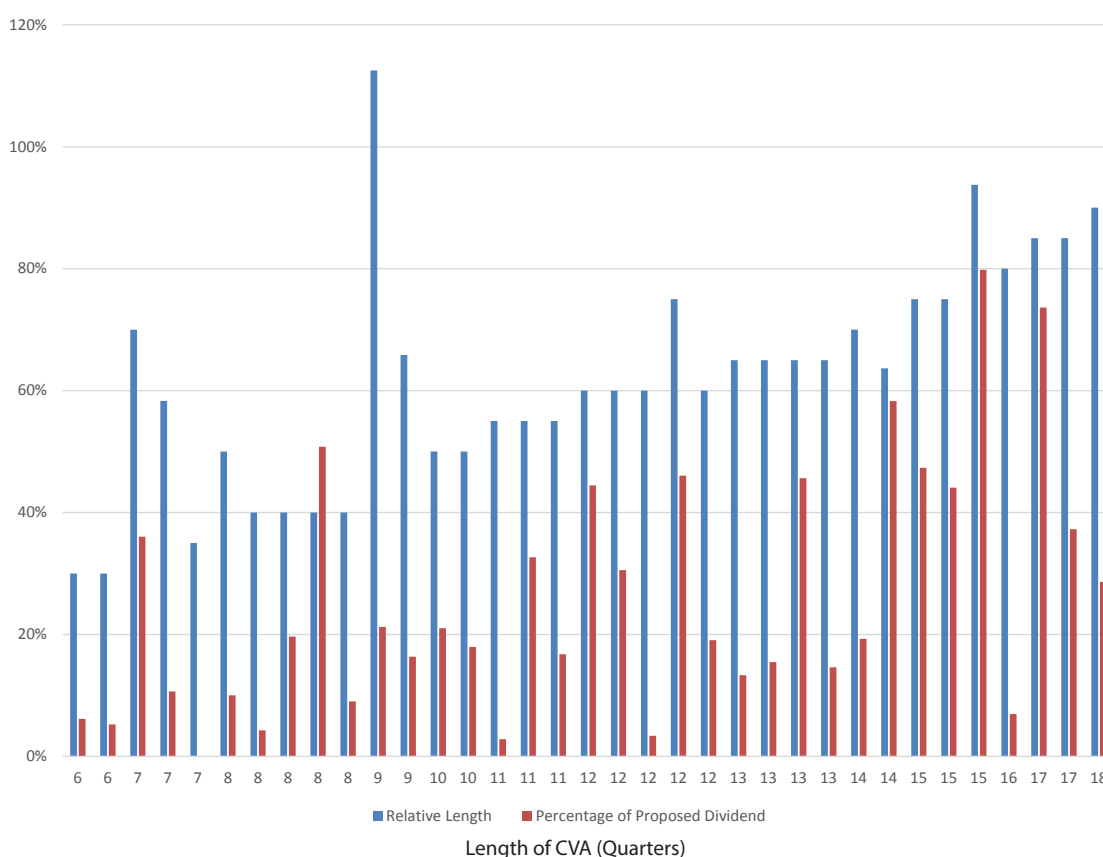


Chart 27: Dividends paid as a percentage of the proposed dividend compared to relative length of CVA at termination

44. Insolvency Rules 2016, rr.2.3 and 2.43.

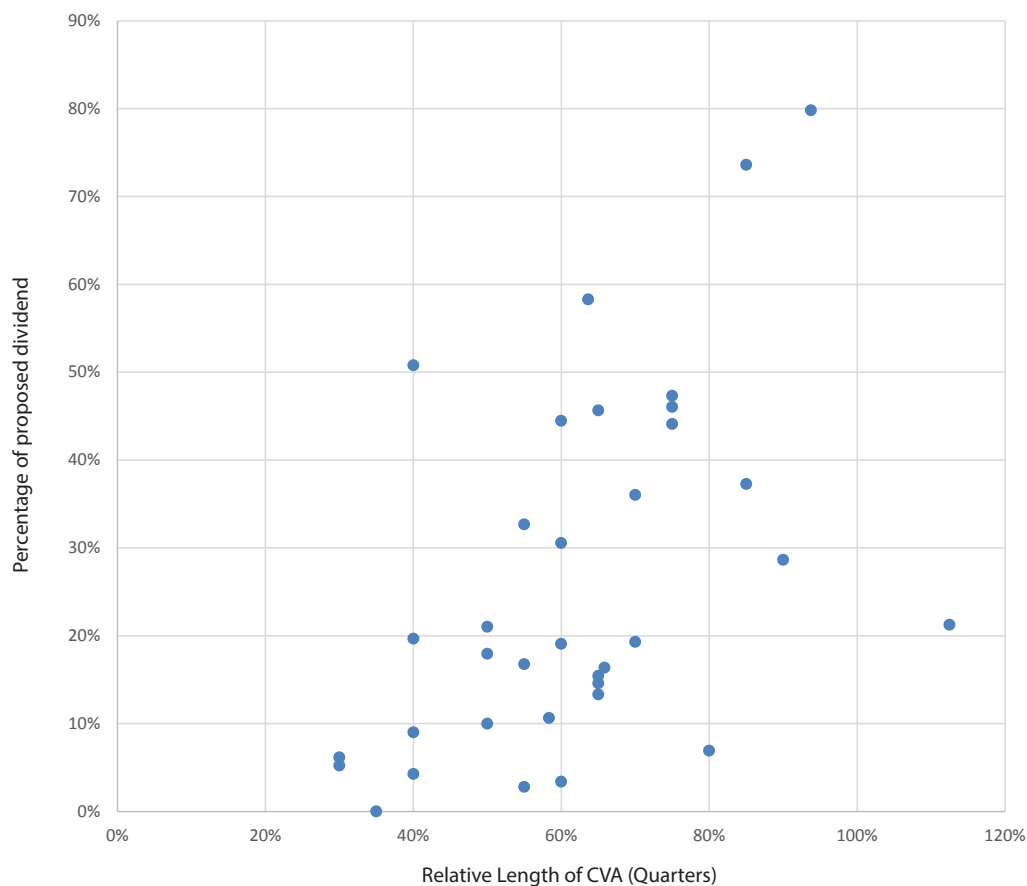


Chart 28: Percentage of proposed dividend paid against relative length of CVA at termination

There is some evidence here to suggest that the longer a CVA runs for relative to how long it was expected to run, the higher the rate of dividend as a proportion of the expected dividend. This is what we would expect to see. It is important to note, however, that whilst this trend is evident, the levels of dividend paid are relatively low given the length of the CVA. Creditors only received 50% or more of what they expected in four cases. Furthermore, of the six CVAs which ran for at least 80% of the period initially approved by creditors, four paid out less than 40% of the expected dividends, and in three cases less than 30% of the expected dividend. This casts some doubt over whether these companies would have been able to meet the requirements of the CVA proposal had they run for the full term. Indeed, one of the CVAs sampled was terminated beyond the end of its proposed term, paying out just 20% of what was proposed. This may still be considered a positive outcome for unsecured creditors, as is explored in more detail below.

In Part 4.2.2 above, we considered the impact of missed contributions on the effective length of a CVA where no dividend was paid. Even where a dividend was paid in a terminated CVA, there were frequently a number of missed payments prior to termination. It is important, therefore, to consider the impact of these missed contributions on the final dividend paid.

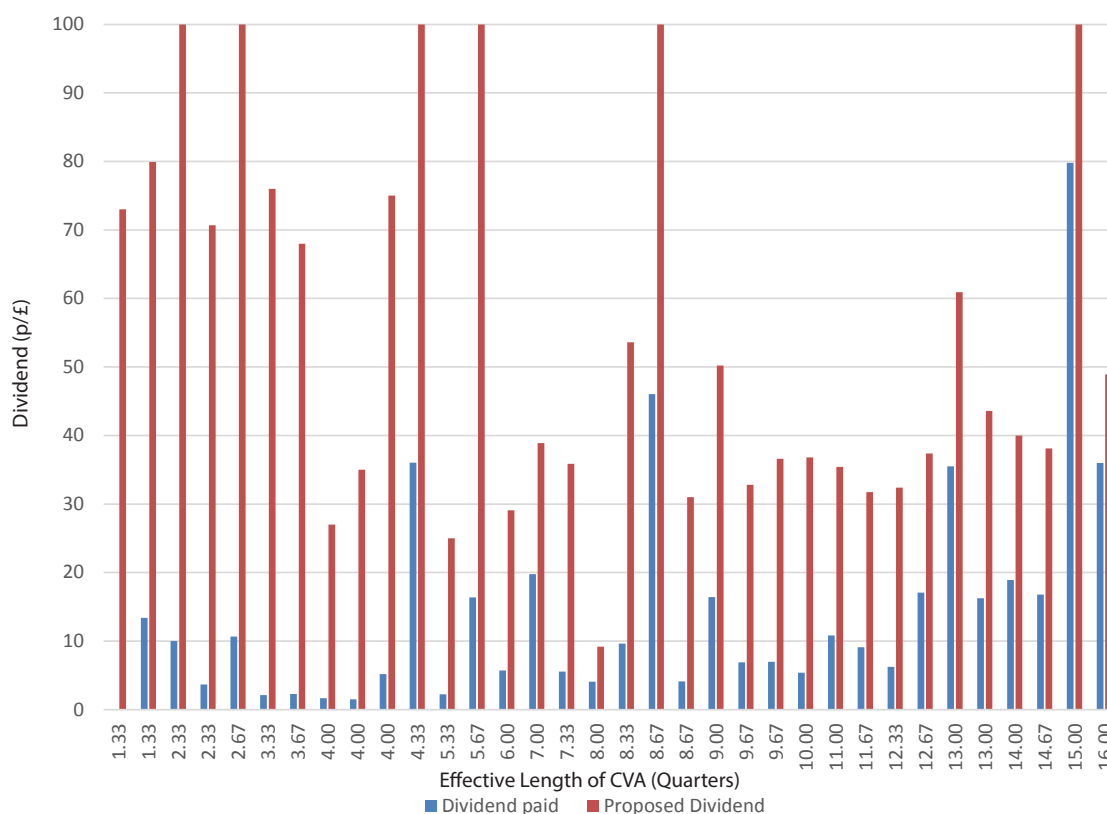


Chart 29: Actual unsecured dividend paid against proposed unsecured dividend by effective length of CVA

Chart 29 shows the effective length of these CVAs, when the length of the process prior to termination is discounted by the number of missed contributions. It can be seen that even where a dividend was paid, there were often a number of missed contributions, and often a significant number. There are a number of examples which appear to have had a significant impact on the level of dividend paid. In one case, 12 quarters of contributions were missed, reducing the effective CVA length to 4 quarters, and reducing a proposed dividend of 75p/£ to an actual dividend of 5.1976p/£. Similarly, a dividend of just 0.0054p/£ was paid in a CVA which saw the effective length reduced from 7 to 1.33 quarters. This impact is more clearly illustrated if we consider the dividends in relation to the number of missed payments, set out in Chart 30 below.

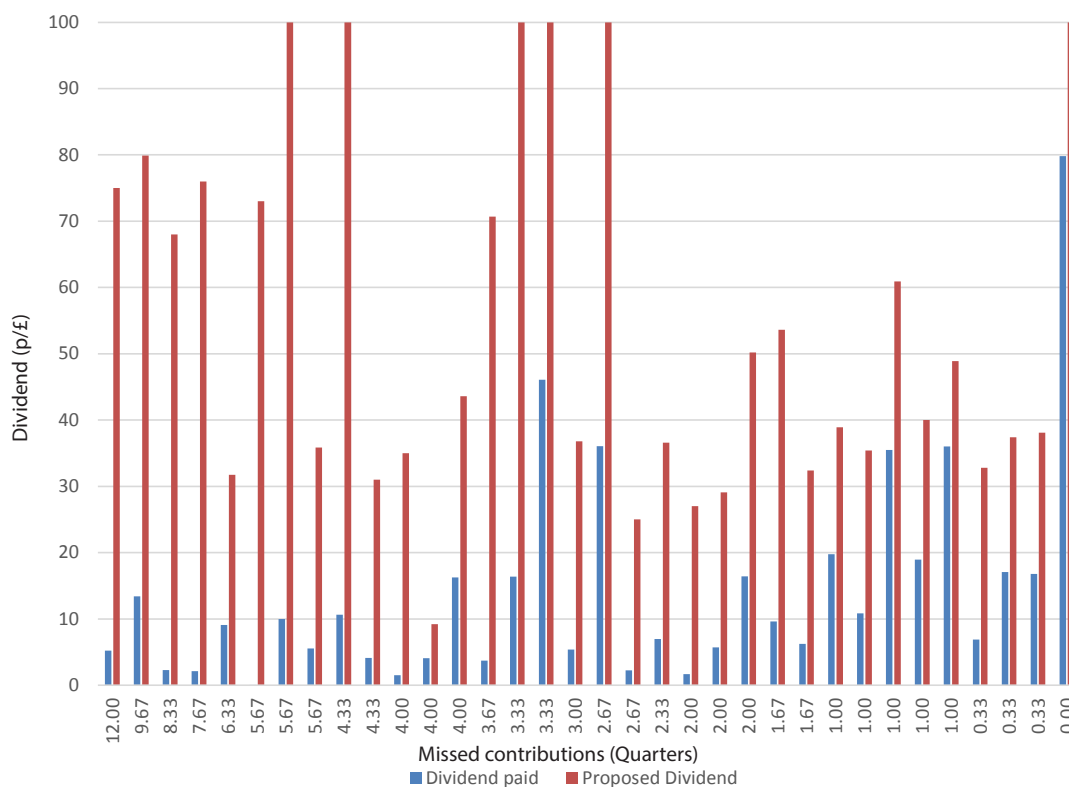


Chart 30: Actual unsecured dividend paid against proposed unsecured dividend by number of missed contributions

There is no clear pattern evident here. It does appear generally that the fewer missed contributions, the higher the actual dividend paid is in relation to the proposed dividend. This is perhaps not surprising, though there are some obvious exceptions to this.

More light is shed on this by highlighting two specific cases. These CVAs each had initial payments of £5,000 per month, ran for 12 quarters prior to termination, and had similar levels of unsecured debt (just under £400,000). The main differences were that the second was due to run for 48 months with a proposed dividend of 100p/£ (compared to 60 months and 68p/£) and its contributions were expected to increase over the term of the CVA to a final payment of £12,500 per month. The dividends ultimately paid in these CVAs were 2.3p/£ (rather than 68p/£) and 46.06p/£ (rather than 100p/£). Whilst there was a significant shortfall in each case, the latter offers a much better return for creditors. The main difference in the operation of these CVAs is the number of contributions received. The first case, which paid 2.3p/£, had 25 missed contributions during the term of the CVA. In comparison, there were just 9 missed payments in the second case, which paid out a significantly improved 46.06p/£. Whilst clearly not a factor which can determine relative success in its own right, it can be seen that high levels of missed contributions will have a negative impact on the level of dividend paid, as well as whether a dividend is paid (as seen in Part 4.2.2).

Whilst the level of dividend payments appear to be disappointing when compared to those proposed, perhaps it is worth considering this issue from a different angle: what might the outcome have been if an alternative insolvency process had been pursued by the company instead of entering into a CVA?

It is understood that creditors weighing up a CVA proposal would usually be provided with an estimate of the dividend they would receive in a winding up. Unfortunately there is no record of this figure filed at Companies House for any of the CVAs in the sample, so no direct comparison is possible. It can be seen, however, that in 17 of the CVAs dividends of 10p/£ or higher were paid. This would appear to be a favourable payment in comparison with unsecured dividends commonly paid in insolvent liquidation.

Another alternative to the CVA that the company could have considered is a pre-pack administration. Here returns to unsecured creditors are again often quite low, especially where the pre-pack involves a sale to a connected party.⁴⁵ Again, the dividend paid in these terminated CVAs appear favourable in comparison.

On this basis, the levels of returns in these terminated CVAs, whilst at first glance disappointing, may prove more beneficial to creditors than alternative processes that the companies could have pursued. This is especially so when other considerations are born in mind. These creditors enjoy the benefit of continued trade with the company during the CVA, together with the opportunity to make contingency plans during this period to position themselves should the CVA ultimately fail, potentially allowing such creditors to protect their future viability and avoid having to deal with the impact on their own business that the 'shock' that an administration or liquidation could cause.

4.2.5 Payments made during the CVA

We have seen that around a third of trading-based CVAs sampled continued for six quarters or more prior to termination with no dividend being paid. Whilst it was identified that there were significant levels of missed contributions across these CVAs which effectively reduced the length of all but two to less than six quarters (based on levels of contributions, see Part 4.2.2 above), in all of these cases some level of contributions were received. In some cases the level of contributions was quite substantial. This raises a question of what contributions are being used for when a CVA is terminated.

45. See for example C. Umfreville, P. Walton, and P. Wilson, *Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration* (2014) ("*Pre-Pack Empirical Research*") pp.31-33 found at: www.gov.uk/government/publications/graham-review-into-pre-pack-administration. In 60% of all pre-pack sales reviewed, no unsecured dividend was paid.

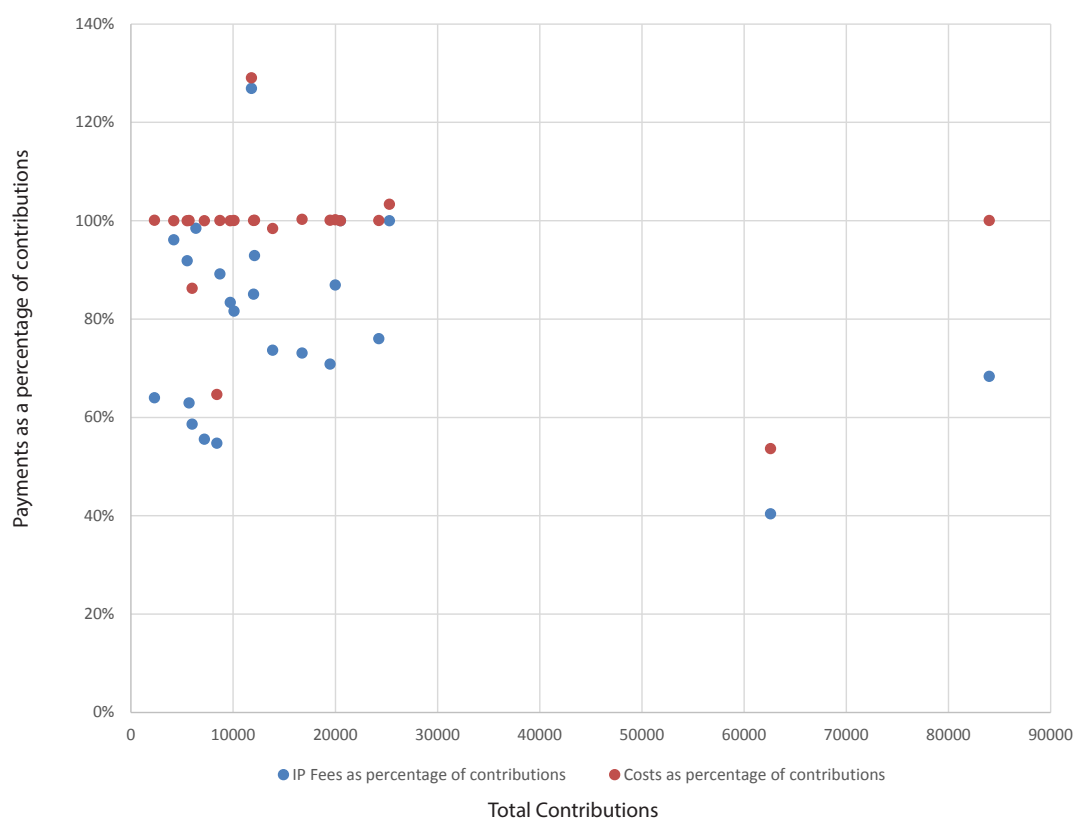


Chart 31: Payments made in CVAs where no unsecured dividend paid

It can be seen from Chart 31 that in all but four of the cases sampled, all of the contributions received were spent on the costs incurred during the CVA. These included the IPs' fees (both for acting as nominee and supervisor in many cases), legal fees, other accountancy fees and similar costs. In some cases these costs accounted for more than the total of the contributions; this included a CVA where there was a sum of cash at bank which was captured by the CVA. Of the four cases which did not account for all contributions in costs, the surplus was accounted for by irrecoverable VAT, making provision for winding up, and in the most extreme case, a preferential dividend payment of £26,303.70.

Of these costs, the fees drawn by the IPs were often the most substantial proportion. As can be seen from Chart 31, IP fees accounted for more than half of the contributions in all but one case and more than 80% of contributions in 12 cases. In the main, the level of contributions in these terminated CVAs was relatively modest, and so the level of fees drawn by the IP, whilst a large proportion of the total figure, was not necessarily a large figure, especially when considered in the context of the length of the CVAs in question. This is illustrated in Chart 32 below.

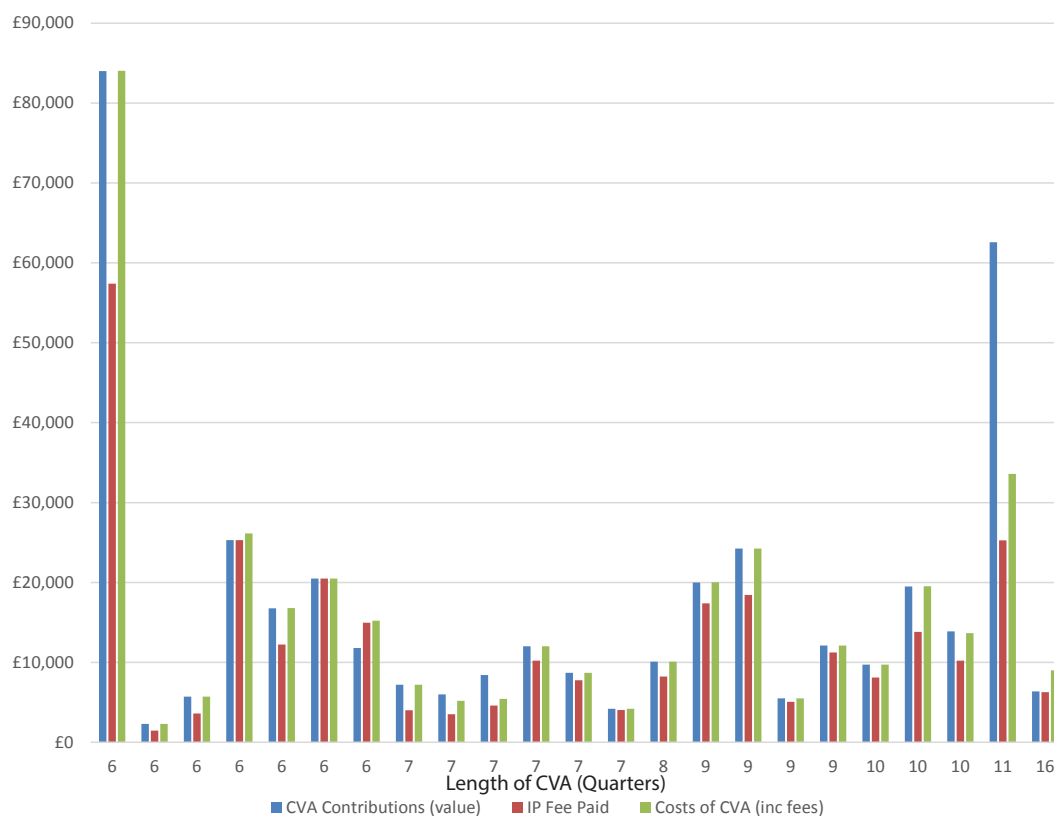


Chart 32: CVA contributions and payments by quarter (where no unsecured dividend)

There is one apparent exception here, with one CVA terminated after six months with contributions of £84,000, which were all absorbed by costs. Reports filed by the supervisor at Companies House show significant accountant, agent and legal fees paid during the course of the CVA.

It was noted that a number of supervisors reported incurring, and often drawing, higher fees than had been proposed at the outset of the CVA, both when a dividend was paid and when it was not. This escalation of IP fees and costs during the course of a CVA stands out. This is often attributed to the supervisor having to undertake more work than was initially envisaged, for example, in liaising with HMRC regarding post-CVA payments arrears, or having to be more involved with the company’s management to ensure compliance with the CVA terms, or dealing with issues arising from missed contributions. Whilst there is an obligation to report this to creditors, there is not necessarily any need to get creditor approval for any increase, unlike in administration or liquidation.⁴⁶ As a contractual arrangement between a company and its creditors, the CVA is not subject to the same requirements as to fees as administration or liquidation, rather provisions would have to be included in the proposal. It was noted that such provisions were included in some cases, often as a modification imposed by HMRC. If provisions requiring some degree of creditor approval for IPs to draw increased fees were adopted more widely, this would ensure greater transparency and could also increase creditor confidence in the CVA process. If IPs are having to undertake more work than envisaged, they should be reimbursed for this, but creditors may question whether there is any benefit to them in the CVA continuing if all contributions will go to fees and associated costs, rather than to the creditors themselves.

46. Insolvency Rules 2016 r.18.30.

4.2.6 Summary: Fifty Shades of Success

Early termination of a CVA is not necessarily indicative of the CVA having failed. Whilst the CVA may not have achieved the purpose set out in the proposal approved (and perhaps subsequently varied) by creditors, it can be seen that unsecured creditors regularly receive dividends from the CVA contributions, often in excess of what might commonly be expected in the likely alternative procedures of a pre-packaged administration or insolvent winding up.

There are, however, no clear patterns as to what factors lead to a terminated CVA being capable of being considered successful to some degree. One evidential issue is the lack of information found in Companies House records in respect of what may have happened without the CVA in the likely alternative liquidation. It is clear that many CVA proposals predict a nil return to unsecured creditors in an alternative liquidation so any dividend in the CVA would be a better result for unsecured creditors.

There are elements which appear to undermine the payment of unsecured dividends, though. Chief amongst these is the impact of missed contributions, which will undermine the accumulated funds available for unsecured creditors. High levels of missed contributions were evident in both cases where a dividend was paid, and where it was not. Another factor which depletes the funds available for unsecured creditors are the sums incurred and drawn in terms of IP fees and associated costs. No impropriety is suggested here, but questions may be asked whether it is in the creditors' interests that a CVA continues if contributions will be consumed by the costs of the process. IPs need to explain how the delay in terminating a CVA was expected to be in creditors interests.

Where dividends were paid, they were rarely close to the level that would be expected, even when looked at from a number of angles. Perhaps a more realistic approach as to the level of dividends and the proposed contributions set out in CVA proposals needs to be taken. Additionally, the management of the business during the CVA itself will be a crucial element in the ongoing trading success of the company. More perhaps needs to be done to ensure that the company's management team is best equipped to tackle this potentially difficult period, to facilitate contributions to be made in accordance with the CVA proposals.

It can be seen that a not insignificant number of CVAs terminate very early (within two quarters of commencement) whilst a further group terminates with a relatively short effective length when missed contributions are considered. When viewed alongside the shortfall in expected returns, even in those CVAs running for a considerable proportion of the projected period, there is some benefit in considering whether more rigorous interrogation of the CVA proposal would have been beneficial; either in determining that a CVA was not the appropriate vehicle for that company, or through the proposal of more moderate (and achievable) contributions and outcomes. Perhaps a short moratorium would have been a benefit here, to allow management to put together a more detailed proposal for consideration by the nominee, who would also have more time to raise questions, without the threat of immediate creditor action hanging over the company. Whilst the number of companies using any form of moratorium was too small to draw firm conclusions, there is a marked increase in implementations and decrease in terminations in these cases.

Ultimately, whether a CVA is a success in the eyes of stakeholders will depend on their position. For example, an employee, whilst no doubt keen to receive payment of any preferential claim to which they are entitled, would most likely prefer the company survives and their employment be preserved. Whilst there are undoubtedly various measures of success for different stakeholders, the only universal measure is that of dividend outcome. This goes to the heart of what a CVA is: an agreement between a debtor company and its unsecured creditors to address the company's historic debts. However, there is no arbitrary line of success or failure here.

In addition to the prospect of receiving a dividend from the terminated CVA, creditors also potentially benefit from the continued trading relationship with the company during the CVA. Although this will usually be lost if the CVA is followed by a terminal insolvency process, the extended trading period whilst 'on notice' of the company's financial difficulties allows the creditor to take steps to ensure that it is not overly exposed should it ultimately lose the CVA company's custom. Whilst this could lead to the creditor severing ties with the company in CVA, which would not be desirable for a positive outcome of a CVA, it also allows the creditor to widen its portfolio in anticipation. There is also evidence of some creditors changing credit terms during a CVA. This is to the detriment of the company in CVA and may contribute to the termination of the CVA, but it may also cushion the creditor from further losses in the event of the debtor's subsequent failure.

5. 2016 Pre-pack Administrations – Reasons for not Pursuing a CVA

Following the growth and evolution of the pre-packaged administration, it has become common for a business to be sold to a connected party. For example, 63.3% of pre-packs considered as part of the Graham Review were connected party sales.⁴⁷ Faced with the ability to leave unsecured debt in an oldco and start a business afresh in a newco, it is perhaps not surprising that directors frequently choose to participate in a pre-pack rather than attempt a CVA, especially considering the trading difficulties identified in Part 4 above and the impact of a CVA on cash flow considered in Parts 6 and 7.

During the period from November 2015 to December 2016 (the first ‘year’ of operation of the Pre-Pack Pool introduced as part of the Graham Review reforms) there were 371 pre-packs, of which 188 are recorded as being to a connected party.⁴⁸ This bears interesting comparison with the 338 CVAs which commenced in 2016.⁴⁹ A review of 100 of the pre-pack administrations commenced in 2016 reveals a number of reasons why insolvency practitioners deemed a CVA was not appropriate.

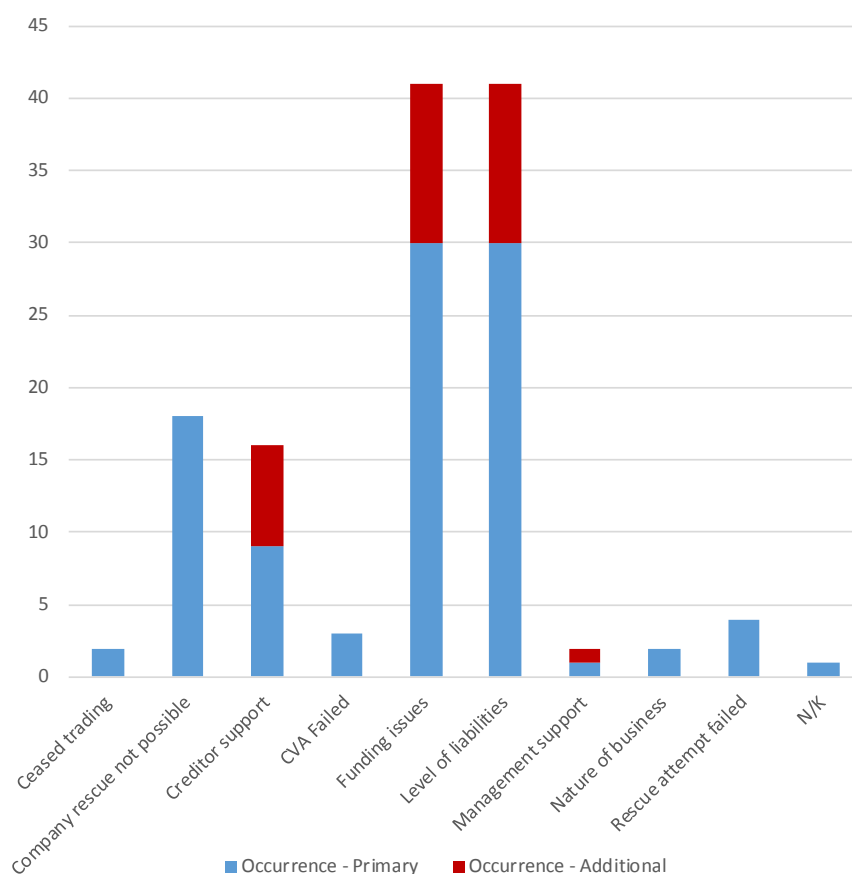


Chart 33: Reasons given by Administrators in pre-packs for not pursuing a CVA

47. See *Pre-Pack Empirical Research*

48. Pre-Pack Pool ‘Annual Review 2016’ found at: www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf

49. Insolvency Statistics – October to December 2016 (Q4 2016) found at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/586287/Q4_2016_statistics_release_-_commentary.pdf

It is interesting to note that the dominant reasons given for not attempting a CVA in these cases were funding issues and the level of existing liabilities. A lack of creditor support, which is likely to impact on funding during the CVA, is also commonly cited. In a third of pre-packs, the reasons for not using a CVA were not fully articulated, rather the benefits of a pre-pack relative to a CVA were extolled.

The role of HMRC in this decision making is of interest. In five of the 100 cases reviewed, HMRC was cited as a reason for choosing a pre-pack over a CVA. This included two instances where the administrator considered that HMRC would reject a CVA proposal given the company's prior compliance issues with Time To Pay arrangements and a further case where HMRC rejected a CVA as the major creditor. Whilst not prevalent, this does reflect some of the feedback received from the R3 Member Survey (see Part 6 below) and the Stakeholder Interviews (see Part 7 below) as to the role played by HMRC in determining whether CVAs can proceed.

This review of pre-packs undertaken in 2016 reveals a number of reasons for why the process may be favoured over a CVA. It does not provide conclusive evidence of the prevalence of pre-packs over CVAs. Indeed, the fact that there were almost twice as many CVAs as connected party pre-packs in 2016 shows that the CVA process continues to have an important role to play. Whilst a pre-pack allows the business to continue free of much of the existing debt and without some of the cash flow constraints apparent in a CVA, it does not offer the perfect panacea. For example, personal guarantees are more likely to be called upon in a pre-pack, especially if the purchase is being financed by a new lender, whilst there is also a risk of outside interest in the business resulting in management losing control of the business should it be sold as a going concern. The pre-pack administration may therefore account for some of the decline in CVA usage, but is unlikely to replace the CVA entirely. In fact, with the Graham Review reforms being evaluated by the Insolvency Service, and the possibility of a ban on connected party sales in administration, the CVA could take on renewed importance.⁵⁰

50. See Insolvency Service *Review of the pre-pack industry measures* found at: www.gov.uk/government/news/review-of-the-pre-pack-industry-measures. The provisions in Insolvency Act 1986, Sch.B1, para.60A, which will lapse if not exercised by 25 May 2020, allow for a ban or other restriction on connected party sales in administration (including pre-packs).

6. R3 Membership Survey

In the summer of 2017 an online survey of R3 members was carried out.⁵¹ The survey asked 28 substantive questions of practitioners. The survey questions have been reproduced in Annex A below. 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 three years. As the above analysis of CVAs entered in 2013 shows a total of 164 IP firms acting as supervisors of CVAs (with 79 taking only one appointment), the response rate to the survey is very encouraging. It suggests a large proportion of those involved in CVAs have answered the survey questions.

The responses show that although CVAs are often considered as an option, 45% of IP responses list as a major factor in the CVA not going forward, the realisation that on acquiring further information it became apparent that the company was not capable of being rescued. Over half of the IPs surveyed believe that a lack of support from HMRC is one of the main reasons which prevents a possible CVA being put to the creditors (this may be compared with a lesser figure of just over 30% identifying a lack of support from other unsecured creditors, or key suppliers and a figure of less than 20% for a lack of support from secured creditors). Just over 20% of IPs list an unwillingness of directors to make necessary changes as a major factor.

The responses were slightly different for cases where the CVA fails to proceed having been formally proposed, with nearly 60% of IPs identifying a lack of support from HMRC as a major factor, nearly 40% unsecured creditor support generally (excluding HMRC), a similar figure as before for lack of key supplier support (34%) and only a little over 10% listing lack of secured creditor support.

Interestingly, HMRC is considered to be the most engaged creditor in a CVA (listed by 55% of IP respondents), with trade creditors next most likely to be engaged (45%) followed by landlords (38%) with secured creditors (36%) and asset-based lenders (35%) being the others most commonly engaged. Although most engaged, HMRC is seen by 71% of IPs as the stakeholder most likely to oppose a CVA with landlords next most likely to oppose a CVA (35%) with secured creditors being seen as likely to oppose a CVA by 20% of respondents.

The two main reasons given by IPs for CVAs failing are the related factors of financial forecasts being overly optimistic and the company underestimating the working capital impact of the CVA (both listed by over half of respondents). The other main factors listed are that post-CVA creditors were not paid (29%), the directors did not implement changes required by the CVA (28%), the company's problems were not fully identified and tackled in the CVA proposal (24%) and customers withdrew their business (19%).

There was no real consensus from IPs as to how long a typical CVA runs for although a third listed 5 years with just over a third stating 3 years. CVAs are most likely to fail early on if they do fail, with 42% suggesting this most commonly occurs in the first year and 30% stating the second year with 13% suggesting there was no discernible pattern. The empirical findings explained above at 4.1.1 suggest a large proportion of CVAs are intended to run for 5 years. Of the 552 CVAs which commenced in 2013, 90 were still ongoing towards the end of 2017.

51. We 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.

There would appear to be certain business sectors where IPs believe CVAs are more likely than in others. IPs asked to identify the sectors where they had proposed the most CVAs, suggested that Wholesale and retail and Manufacturing (both scoring 33%) are the most likely sectors to consider a CVA. Construction scored 26% with Hotels and restaurants at 19% and Transport and haulage at 14%. This impression is broadly consistent with the 2013 CVA data considered above at 4.1.2.3 which suggests that businesses falling within the SIC codes for Construction, Repair of motor vehicles, Manufacturing, Administrative and Support Services and Accommodation and Food Services frequently enter CVA.

Over 60% of IP respondents consider CVAs to be either a very effective or fairly effective rescue tool. But less than 40% believe they often or very often achieve their objective. Nearly 70% of respondents believe that with some changes, CVAs have the potential to be used more than they are now.

Nearly 60% of respondents think that more support from HMRC would increase the potential of CVAs as a rescue tool. A revised moratorium process was the most popular suggested change to the CVA process itself with nearly 40% of IPs agreeing with the idea. Nearly the same number (37%) identify the need for a more realistic approach by directors. About a quarter of IPs list more support from suppliers being needed along with a better understanding of the CVA process.

7. Stakeholder Views

In addition to looking at a large number of CVAs (and pre-packs) 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.⁵² A number of semi-structured interviews were conducted in late 2017 and early 2018 with insolvency practitioners, insolvency lawyers, secured creditors, landlords and unsecured creditors.⁵³

The main topics covered in the interviews included a number of suggestions made by the Government in its May 2016 consultation.⁵⁴ The main points discussed were:

- the reasons for early termination of CVAs;
- the possible need for a pre-insolvency moratorium;⁵⁵
- the introduction of a provision preventing executory contracts being terminated by a company entering a CVA (such a provision would be wider than the current provisions dealing with essential suppliers⁵⁶ so that suppliers identified as essential would be required to continue to supply goods or services during any moratorium);⁵⁷
- the possibility of a standard form of CVA terms and conditions;
- the possibility of legislating for the priority of new rescue funding;⁵⁸
- the duration of CVAs.

As will be seen below, a number of other issues were raised by interviewees. Some of these issues were of general significance to CVAs whilst others were specific concerns of particular types of stakeholder. Some stakeholders had robust views on the approach to CVAs of other types of stakeholders.

52. In addition to interviewing individuals, we were also fortunate to have the benefit of views expressed at a roundtable event held at Chartered Accountants' Hall on 14th March 2018 where the main findings of our research were presented and discussed. We are very grateful to the observations made by attendees which were made under Chatham House rules.

53. HMRC were invited to take part in the interviewing process but were 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.

We have not been able to consider every type of business which may enter a CVA nor every type of creditor which may be a stakeholder. We have not, for example, looked at the position of the Pension Protection Fund. We have not considered CVAs in the context of sport such as football clubs where the rules of governing bodies may encourage or require an insolvent club to use a CVA to deal with its financial distress with a guarantee of payment, usually by the purchaser outside the terms of the CVA, of football related creditors (for an analysis of which see e.g. G. McCormack "Football creditors – a game of two halves?" [2011] *Insolvency Intelligence* 105.

Although some CVA supervisors have experienced difficulty in dealing with local authorities, for example, where a local authority refuses to permit a company in CVA to bid for local authority work, we have not interviewed representatives of the Local Government Association as the Association does not have any central policy advising its members how to react to CVAs. Decisions made by local authorities are made at a local level.

54. The Consultation.

55. See Part 7 of the Consultation.

56. For which see Insolvency Act 1986, ss.233 and 233A.

57. See Part 8 of the Consultation.

58. See Part 10 of the consultation.

7.1 Insolvency practitioners and insolvency lawyers

It was stated by several interviewees that the beauty of CVAs is their flexibility. It was generally thought that although CVAs have a mixed reputation in practice, the alternative option, usually a winding up, is probably worse from the point of view of creditors. If the circumstances are right, and the CVA is executed properly, it can provide a good outcome.

CVAs are often useful if a one-off event has caused the financial distress rather than just the “grind of operating in a competitive market.” Creditors are often sceptical of CVAs as their view is that a poorly run business which runs into financial difficulties may remain a poorly run business in CVA. It was felt that in order for a CVA to be approved and implemented it was important, unless the problem was a one-off, to emphasise the changes which management intends to make to the business. Creditors need to be told about cutting loss making parts of a business, new money being invested and positive changes in the management team. Otherwise the creditors may interpret the CVA as nothing more than a breathing space which on its own is unlikely to work the “magic” necessary to turn the company around. Practitioners and directors need to look at why creditors are not supporting CVAs. They need to reverse that trend by creating more creditor confidence in CVAs that are proposed.⁵⁹

One interviewee made the point that if changes are made to the business, once the CVA is approved, creditors may be in a better position than before as the company may in fact be better run and a more reliable trading partner than new customers who may be completely unknown quantities. Rather than being a negative, if done properly with appropriate advice, a company in CVA should be a better creditor than many others.

There are some practical downsides to CVAs, for example, they have a negative impact on a company’s credit rating with the consequence that credit insurance cover will be lost.⁶⁰ Companies often fail to forecast the impact on working capital of the withdrawal of credit insurance which leads to pro forma invoicing which impacts on cash flow. Cash flow forecasts will often therefore assume pro forma invoicing. It was suggested that at the lower end of the market directors underestimate the cost of a CVA. They do not always carry out a cost benefit analysis. It is necessary to factor in the costs and fees of the CVA.⁶¹ There is a general burden of doing business whilst in CVA and dealing with the administrative side of the CVA. In larger CVAs, a team of people are employed to deal specifically with the implementation of the CVA. Most interviewees with experience of companies in CVA trying to bid for local authority business felt that local authorities usually have a ban on companies in CVA being able to bid for such contracts. In such circumstances, a connected party pre-pack may be preferable.

Not all CVAs are intended to rescue the company. CVAs are often used successfully as a tool for an orderly winding down of the business where contracts can be completed without an immediate formal winding up and its restrictions. The reason for this use of a CVA is that the organised wind down leads to a better return to stakeholders than an immediate liquidation. One example provided by an interviewee involved a company which had lost licences necessary to produce its goods. As it owned a good deal of real property, it was suggested to creditors that an orderly realisation of its assets would lead to all creditors being paid in full and an eventual dividend to shareholders. Unfortunately, the bank, who was a secured creditor, forced the company into liquidation where, due to high liquidator fees, there was a shortfall to creditors and nothing for

59. For an example of how successful a CVA can be where there is early engagement with an insolvency practitioner and creditors, and where previously liquidation had been considered, see the ICAEW produced film: “Business recovery and insolvency – the client’s dilemma” available at: <https://www.youtube.com/watch?v=gGBCdFzMIzo&feature=youtu.be>.

60. The withdrawal of credit insurance cover has an impact on large and small businesses: see e.g. “House of Fraser faces cash squeeze” Sunday Times, 4th February 2018, Business and Money, p.1.

61. One interviewee observed that there was often little consideration or understanding of the use of accumulated tax losses which would usually be lost if there is no CVA.

shareholders. It was suggested that the proposed CVA would have provided a better result overall.⁶²

CVAs are sometimes perceived as a “free roll of the dice” where the management keeps doing what it was doing before. It was the view of one practitioner that creditors should be seen as more important than those who have managed the company into a state of financial distress and whose interests were more important than saving the jobs of the company’s workers. Some CVAs, it was suggested, are not necessarily in the best interests of the creditors but rather in the best interests of the company’s managers who wish to retain control of their companies.

It was suggested that in some cases, especially where the company is a small undertaking, the scrutiny by the nominee of the CVA proposal may be limited. Although the proposal may pass the fairness test,⁶³ the assessment of the viability of the business may be limited, possibly due to a lack of time or the nominee being provided only with limited information by the management team. The point was also made that although it was the duty of the nominee to provide an opinion on the likely successful implementation of the CVA,⁶⁴ it was the creditors who had previously traded with the company who were best placed to make that judgement themselves. Some practitioners felt that nominees may have a self-interest in recommending a CVA. Some other form of independent assessment of the CVA proposal may be useful but it was emphasised that such independent scrutiny should not be needed as the role of the nominee is to provide that independent assessment. The problem identified was that stakeholders do not always have full confidence in the recommendations of the nominee. One possible solution put forward might be to provide further and more detailed guidance to nominees in carrying out this function.

There was a clear view from interviewees that the customary 5 year duration of CVAs was too long. It was often a product of having to promise too much to creditors in compromising their debt where a shorter period would lead to a much reduced dividend. Often such companies may have been ultimately better off in administration or liquidation. There was a general view that 2 or 3 years should be the norm. This was felt a reasonable period of time which allowed the management team to remain focused and motivated with a relatively early exit in view which itself could lead to earlier opportunities to re-finance or to sell the business on.

The wide use of the 5 year duration may have been adopted from the commonly encountered duration of individual voluntary arrangements (“IVAs”). It was observed that some smaller CVAs were “glorified” IVAs as often the company would be a corporate form of sole trader. The view was expressed that a 5 year duration for a CVA seems penal rather than helpful. Individuals are trying to avoid the very personal consequence of bankruptcy. The incentive for a company to sign up for a 5 year CVA is less enticing as the consequences of administration or liquidation are not as personal as a bankruptcy. It was suggested that the limit in bankruptcy of 3 years for an income payments order⁶⁵ would be a better model to follow for CVAs. The suggestion was made, that if the CVA is to run for more than 3 years, the proposal should explain why a longer period was necessary.

62. See para 9.21 of the Consultation where the suggestion is made that such a secured creditor’s rejection of a CVA could be overruled by the court which could declare the CVA universally binding if it considered that the plan was fair and equitable.

63. See the leading case of *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] BPIR 839.

64. Insolvency Rules 2016, r.2.9(2).

65. Insolvency Act 1986, s.310.

Most practitioners identified cash flow problems as a significant cause of CVA termination. New lending would often ease this problem but there was no real support for the idea of providing security to new lenders over company property already subject to fixed charges.⁶⁶ Perhaps surprisingly, there was some support for such new funding to have a priority over the supervisor's fees. It was pointed out that asset-based lenders would often be willing to assist cash flow in CVAs but such assistance usually came at a high cost in terms of termination fees if the CVA failed. The use of such lenders would negate the need for the question of priority rescue funding.

The suggestion of a moratorium to assist with the planning for a CVA, a pre-insolvency moratorium, received a lukewarm welcome. Some practitioners felt that for any CVA to be successful it was fundamental that the company had stakeholder support anyway. It would be rare that a stay on actions would be needed. Concerns were expressed that any such moratorium would potentially be abused. There was general support for a short moratorium of no more than 21 days as long as some protections were built in to prevent abuse. It was suggested that the recent practice, of filing at court a notice of intention to appoint an administrator which provided a short stay on creditor actions,⁶⁷ even where there may be no firm intention to appoint an administrator, was a useful tool which may no longer be available.⁶⁸ A similarly straightforward procedure to acquire a short term moratorium may therefore be a welcome addition. It was the experience of some practitioners that certain creditors, when they hear of a potential CVA, immediately serve a statutory demand which they use as leverage to get paid in full prior to the CVA being put to a creditors' vote. One solution suggested was that, as soon as a CVA is filed at court, a short term moratorium could be automatically applied pending the creditors' vote on the CVA proposal. It was felt that any long term moratorium would see the supply of trade credit dry up and would often see good businesses taken down by bad businesses in moratorium.

One interviewee expressed a view that once a CVA is approved, the skill set of the supervisor may not always be to take an interest in what is happening to the business subsequently. Insolvency practitioners are not always skilled turnaround professionals.⁶⁹ It was suggested that not all supervisors stay fully engaged with the business so as to be able to challenge the directors on their business strategy if it is not working. The issue identified here is around what are properly the supervisor's role and duties beyond making statutory returns and acting as a conduit for money and to chase if money is not paid on time.

7.2 Landlords

Landlords expressed concerns around the reasons for CVAs terminating prematurely similar to those mentioned above by practitioners. There was a suggestion that some CVAs involved the same management team with no real salary cut, perhaps some redundancies but with the same business being conducted as before. The CVA is often seen as an attempt to reduce rent going forward.

The British Property Federation ("BPF") pointed out that the biggest issue in dealing with CVAs and insolvency practitioners is transparency. Where there was an open and honest dialogue the results were usually positive. The BPF often acts on behalf of its members in large CVAs where there are multiple units held under leases. The BPF provides a level of independent scrutiny of draft CVAs and is able to identify provisions which are likely to be difficult for its members. The BPF has been working to produce a document which explains what best practice might be in such cases. Landlords often see CVAs which are overly optimistic about the trading

66. One interviewee expressed the view that any super priority of new funding would not be workable in the UK. The interviewee's view was that if banks see a future for the company they will put more money in. If they do not wish to support the company and a new funder had priority over the bank this would "blow a hole in the bank's security and future lending policies".

67. Insolvency Act 1986, Sch B1, para 44.

68. *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* [2018] 1 WLR 24 suggests that it may be an abuse to obtain such an interim moratorium where there is no firm intention to appoint an administrator.

69. See e.g. the explanation of the differing skills required in restructuring as contrasted with turnaround in: M. Tait and M. Hill "When is turnaround a good fit?" Winter 2017 *Recovery* 21.

future of the company. There is therefore perceived to be a need for the independent scrutiny provided by the BPF where landlords are exposed.

As with other types of creditors, landlords want fair treatment. They generally accept that different leases will be treated differently in a CVA as some are more profitable to the company than others, with some unprofitable. It is therefore common, at least in large retail CVAs, to have perhaps 3 (or more) categories of lease identified. 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.

Landlords are generally open to such proposals but are more easily convinced of the need for rent reductions if the CVA is supported by reliable accounts for each unit. It is not always easy for landlords to see why they must compromise future rent if unsecured creditors are promised payment of 100% of their respective outstanding debts under the CVA.

It is apparent that over the years a number of practices which were not positively received by landlords have been largely resolved. The practice of valuing future rent at £1 for voting purposes appears to have been replaced with chairs of creditors' decision procedures making a genuine attempt to decide upon a reasonable value for voting purposes. The practice of guarantee stripping⁷⁰ appears no longer to occur.

Landlords do still see practices which they see as potentially unfair. One example provided by one interviewee was a CVA where landlords were expected to take a compromise on future rent as they were not deemed to be suppliers who were critical to the success of the CVA. The same CVA suggested that the company's fleet of directors' cars was a critical supply. Any extension of the statutory essential suppliers' regime would need to include landlords. Another example given was a CVA where landlords accepted a compromise on future rent only for the company to take on new leases of properties from other landlords within a month of the CVA being approved.

Landlords recognise that CVAs often cause them some short term pain but they are often a necessity. Landlords would rather have a solvent tenant paying some rent, if that tenant returns to full payment in time, than an insolvent tenant and a void property.⁷¹ According to some interviewees, some recent high profile CVAs have led to a level of distrust from some landlords of some large tenants and some insolvency practitioners. Landlords will usually support CVAs (or at least be accepting of them) but some interviewees believe that not all CVAs are well thought through. Some CVAs fail due to, what some see as, the CVAs being too timid and not making enough overall cost savings.

70. For an example of an attempt to draft a guarantee-stripping CVA which was overturned by the court as being unfairly prejudicial to the creditor with the benefit of a guarantee see *Mourant v Sixty UK Ltd* [2010] BCC 882.

71. See e.g. the discussion in the Times, 6th January 2018 at page 51, article entitled "House of Fraser pleads for rent cuts". Not all landlords are so accepting of CVAs – see the Sunday Times, 4th March 2018 at page 1 of the Business and Money section, article entitled "Play by rules, landlords tell retailers on the brink" where Lord Oakeshott, chairman of property manager Olim is quoted as saying: "CVAs completely undermine the rules for trading with other retailers who play it straight and pay their rents."

Some of the specific problems identified by landlord interviewees are the following:

1. If a large retailer goes into CVA with a large majority of its leases being categorised as requiring a compromise of future rent but with a break clause allowing the landlord to take back the property and re-let, the CVA is intrinsically weakened and subject to failure if all or a large proportion of the compromised landlords take back the properties in question leaving only a small number of units remaining in the company.
2. When calculating the voting power of landlords when considering a CVA proposal, there are not usually significant arrears to consider. However, there exists a potential lack of clarity as to how votes in relation to future rent are calculated. Some interviewees favoured a standard mechanism for valuing future rent in all cases so as to avoid unnecessary costs and confusion.⁷² Any discount or compromise of future rent should not apply to arrears (as it sometimes does). As mentioned above, the CVA may compromise only one group of landlords whilst promising full payment to others but those being paid in full may still get the same voting rights as the compromised landlords. There is no suggestion of sharp practice by nominees who are usually very open about their calculations. It is a need for clarity and consistency which has been identified.
3. Where there are rights to take back the property, some landlords have experienced difficulties with the company acting contrary to the spirit of the CVA by putting up legal barriers to early possession. Some consistency of approach to the drafting of such clauses and how the company satisfies their terms may be useful.
4. Some clauses appear potentially unfair to landlords. For example, clauses compromising rent may also include terms compromising all other claims under the lease including dilapidations with the consequence that tenants can do what they like to the property with impunity under the terms of the CVA.
5. It is usual for there to be an express term which states that if the CVA terminates, the CVA ceases to have effect and the creditors return to their pre-CVA position. Sometimes the CVA excepts from this the rent reduction clause, so the landlord is not returned to the pre-CVA position which is arguably unfairly prejudicial to the landlord.
6. In order to give a CVA the best chance of success, it must provide the company with some flexibility. Where a break clause permits a compromised landlord to take back possession, there is a suggestion that the CVA ought to contain an option for the company to go back to paying 100% of the rent and retain the property. This would enable the company to retain the lease if it has become profitable during the CVA.

Landlords recognise that a CVA can be used as an effective winding down mechanism. This may suit a landlord who can continue to receive rent for 6 or 12 months and in the meantime find a new tenant. CVAs can be used effectively to cram down the landlord by a 75% majority vote of the other unsecured creditors.⁷³ Landlords are generally happy to have a CVA approved, even if they vote against it, as it is usually better than not having something in place. They may even vote for it where they are not entirely happy with its terms. In such cases they may decide strategically to receive some compromise payments of rent then take the property back in 3 or 4 months to re-let to a new tenant. The CVA in such cases provides a 'softer landing' for the landlord and is a better option than having a void property.

The suggestion for a pre-insolvency moratorium was not welcomed wholeheartedly by those landlords who were interviewed due to concerns that it would be open to abuse. Suggestions were made that such a stay on actions should only be possible if ordered by the court and only on condition that all liabilities incurred during

72. One interviewee suggested that a standard formula was in existence based upon the calculation first used in the JJB CVA with a 75% discount applied to future rent once the potential void period and period of rent compromise were taken into account.

73. Landlords are not secured creditors (*Razzaq v Pala* [1998] BCC 66 and *Re Lomax Leisure Ltd* [1999] 2 BCLC 126) and so can be bound by the terms of a CVA if approved by a 75% majority vote of unsecured creditors.

it were given priority, perhaps over the supervisor's fees. A concern was suggested that such a moratorium may lead to unintended consequences, for example, where a bank might lose its priority (wholly or partly) it may not be so ready to lend again. A majority of landlord interviewees felt that there was no need for a moratorium in larger cases.

There was a general view among the landlord interviewees that the length of a CVA should be no more than 3 years without good reason: the shorter the duration, generally the better from a landlord's perspective. From a landlord's point of view if the CVA is to run for 5 years with a significant compromise on the future rent, the landlord would probably be better off with another tenant. If a CVA is too long it tends to be "a slow death by a thousand cuts" for the company.

7.3 Secured creditors

Fully secured creditors are not bound by a CVA unless they agree to be.⁷⁴ Despite their strong position, secured creditors are still often engaged in the CVA process. As with other creditor groups, they look to protect their position and the secured creditors who were interviewed had clear views on how CVAs operate.⁷⁵ In common with other creditor groups, the interviewees were of the view that CVAs are not usually the product of a single problem which needs fixing. If there is only a single issue, a fix is usually feasible. The secured creditors interviewed were concerned that directors proposing a CVA may not always have a "handle on the problem" and lack the expertise to make the changes necessary to remedy the company's problems. If the directors cannot or will not make fundamental changes to the business model the CVA will not normally work.

Secured creditors viewed the main weakness of many CVAs as being the "innate optimism of small shopkeeper mentality". There is a view that at the lower end of the market, where total debts owed are less than £100,000, a CVA is often a wish by directors to avoid liability under personal guarantees. Individual desperation may lead to a CVA. Banks do not usually have the resource to look at such small cases. Therefore at the bottom end of the market, secured creditors will usually rely upon their security. However, they do not actively trip up the CVA but instead go along with it as long as CVA operates successfully.

In larger cases, and certainly where debts owed are in excess of £500,000, banks will usually scrutinise draft CVAs. The view of secured creditors is that the larger the case the more reliable the information from the company tends to be. In assessing a CVA, secured creditors will look at the company's trading history. If turnover is going down with lower profit margins, the CVA is not likely to help the company unless significant changes are made to its business model. It was commented that if a business is losing money rapidly, the value of the debt ledger and stock in trade will also be going down along with a consequent diminution of the value of the bank's security (for example, under a floating charge). In such cases, a bank will be less happy to support a CVA but will still usually engage individually with the debtor's case and with the insolvency practitioner acting as nominee.

It was the view of the secured creditors interviewed that it would be rare for a secured creditor to prevent a CVA going ahead by taking action to enforce its security. It may do so if its customer has been unreliable in the past or the bank has no confidence in the insolvency practitioner firm. Secured creditors, consistently with other creditor groups, believe that directors need to take advice early. There is seen to be a concomitant need to promote and enforce directors' duties more efficiently. Sometimes a bank views the cash flow or collectibles' predictions within a draft CVA as "fantasy" in which case the bank will not support the CVA. In such cases, it may not rely on its security but instead enforce the directors' personal guarantees.

74. Insolvency Act 1986, s.4(3) states that a CVA cannot affect the rights of a secured creditor to enforce its security except with the concurrence of the creditor concerned.

75. The research project did not attempt to consider the wider question of how some banks have treated their small business customers. The Treasury Select Committee is currently looking at lessons to be learnt from, for example, the conduct of the Royal Bank of Scotland's Global Restructuring Group.

The view of the secured creditors interviewed is that insolvency practitioners could do more. They need to believe the CVA is going to work, do better due diligence and keep a better eye on the CVA as it progresses. The supervisory provisions of the small companies' moratorium in Schedule A1 of the Insolvency Act 1986 should not be a concern to practitioners. The duties laid out in that Schedule are the duties the supervisors should be carrying out anyway. Again, this observation points to a need to identify more clearly the role and duties of a supervisor.

The proposed pre-insolvency moratorium would probably create a problem for banks. The effect of a 90-day stay on actions would likely lead to the value of the banks' security disappearing during that time.⁷⁶ A bank, in such circumstances, unless included within the definition of an essential supplier, who must continue to supply banking services, might be forced to freeze bank accounts despite the moratorium, which would at a stroke prevent any attempt at rescue.

7.4 Unsecured creditors

Unsecured creditors and representatives from creditor organisations were generally in favour of CVAs as a process which engages creditors. It was perceived as a positive characteristic of CVAs that creditors get to vote on a CVA. This compares favourably with the general lack of creditors' input into a pre-pack. One interviewee was of the view that there is often more thought behind a CVA than a pre-pack.

Consistently with the views of other creditor groups, unsecured creditors identified the main problem with CVAs as being a failure by directors to make convincing changes to the business plan. It was felt that a CVA often involved the same directors on the same salaries carrying on the same business with no independent assessment of the viability of the company beyond the views of the nominee. One interviewee described CVAs as often "just a ruse for directors to remain in place and milk more money" from the company. Often directors are ignorant as to their own responsibilities and potential liabilities and have poor financial information available which does not assist in planning a CVA. The view was expressed by one interviewee that CVAs were often used to cram down landlords to force through a rent reduction.

Unsecured creditors felt that CVAs tend to fail if their intended duration is for 3 years or more. The shorter the intended duration of a CVA, the more likely it is to complete successfully. The perceived problem with many CVAs is that the promised dividend over a period of 2 or 3 years may be too small to encourage creditors to vote in favour of it. The demand from creditors for a more significant dividend often leads to an increased duration being required of up to and beyond 5 years as more monthly instalments are needed to ensure a bigger theoretical final pay out.

One problem identified by several unsecured creditors was that a CVA often creates cash flow problems as suppliers will usually require payment for their supplies up front (pro forma invoicing). A number of examples of this practice were mentioned both in terms of large and small companies. CVAs have a negative impact on the availability and cost of credit insurance even if the supplier has the benefit of a retention of title clause. It was commented that a company in CVA can often survive on a cash purchase basis for 2 years or so, but will struggle to survive for a longer period. There was some support for the idea of a form of rescue funding which eases these cash flow problems and grants some priority to the finance provider. It was commented that such funding would need to be ring fenced to support future trading. There was no consensus as to the level of priority such funding should enjoy.

In addition to the CVA creating cash flow problems, it seems a number of suppliers or contractors refuse to do business with a company in CVA. Although there is no central guidance provided to local authorities from the Local Government Association when considering CVAs, a number of insolvency practitioners reported that

76. For more detailed concerns about the proposed moratorium see the British Bankers' Association's response to the Government's 2016 Consultation at pages 71 et seq found at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/578524/Summary_of_responses_26-10-16_Redacted.pdf.

companies were no longer able to bid for local authority work once the company entered a CVA. Similarly, some large suppliers refused to continue to supply goods to companies in CVA.

Unsecured creditors were often critical of the way HMRC engages with CVAs. It was commented that HMRC often does not take part in early negotiations as to what terms the proposal should take but instead comes in at the last moment with significant amendments. If those amendments are not agreed, HMRC will vote against the proposal. Other comments were made that HMRC was lax at policing its own debt. It was suggested that HMRC does not always enforce breaches of its own Time To Pay scheme. It was also commented that HMRC frequently insists upon a duration of 5 years which often creates a slow lingering death for the company.

There was a general feeling that not all creditors are treated equally in a CVA. Secured creditors and HMRC were seen to be very powerful in negotiating amendments to CVA proposals. One interviewee identified a lack of engagement with trade creditors in the planning stage of a CVA.

A variety of opinions critical of insolvency practitioners were expressed. It was commented that insolvency practitioner fees are often seen as high. In addition, such fees are usually fully payable before any dividends to unsecured creditors. The effect of this is that creditors often see no dividend or a much reduced dividend even where the insolvency practitioner may receive full payment or close to it. The commonly encountered 5 year duration for CVAs was interpreted by one interviewee as the supervisor being paid a fee for several years with little benefit of that extended fee being experienced by the unsecured creditors. A shorter duration might lead to a smaller practitioner fee and more money for creditors. The imposition of a set scale of insolvency practitioner fees was favoured by one interviewee.

Some unsecured creditors felt that not all nominees were sufficiently rigorous in assessing the rights of some (often connected) creditors to vote on CVA proposals with the result that potentially fictitious debts were allowed. The change made by the Insolvency Rules 2016 which makes physical creditors' meetings a rarity was seen by some as detrimental to creditor engagement.⁷⁷ As creditors often have a deeper knowledge of the past conduct of the company's directors, the absence of a meeting made uncovering such knowledge less likely. There was a general lack of confidence in some insolvency practitioners carrying out their roles as nominee, convener of creditor decision procedures and supervisor. One interviewee felt that the court should appoint conveners of creditor decision procedures and supervisors. There was often a lack of confidence in the judgement of the insolvency practitioner when providing an opinion on the viability of the company in CVA. The need for an independent assessment of the CVA proposal was identified by a number of interviewees. Linked to that, there was some support for the introduction of the use of the existing Pre-Pack Pool to assess the viability of CVA proposals to inform creditors' decisions when voting on such proposals.

There was little support from unsecured creditors for a pre-insolvency moratorium. There was a feeling that a moratorium granted by the court on the application of directors was not needed and would be ripe for abuse by directors. If one were to be available there would be a need for safeguards and its duration should be no longer than 21 days. The view was expressed that there would need to be a guarantee for payment of any essential supplies during the moratorium in cash or in advance and that any unpaid debts incurred during the moratorium should be paid ahead of the supervisor's costs.

77. It should be noted that one insolvency practitioner believed that the new system of creditor decision making had actually led to more creditor engagement.

7.5 HMRC

As HMRC felt unable to take part in the interview process, the following assessment of how it deals with CVAs is based upon the comments of other stakeholders. Although the views of insolvency practitioners were not entirely consistent, a large majority reported that it is often difficult to get a timely response from HMRC when a CVA is being negotiated. Some interviewees reported enjoying good relations with HMRC whilst a majority felt that they did not. Some IPs felt that there was a need to be entirely transparent with HMRC and pointed out that HMRC was an involuntary creditor. It was observed by one stakeholder that HMRC had a statutory duty to protect taxpayers, not to make commercial decisions. A view was expressed that HMRC lets its debt build up and is slow to act. One interviewee suggested that HMRC might be encouraged to institute an internal procedure whereby it responded within 2 weeks of each request. As HMRC is often a major creditor, practitioners recognised the importance of early engagement in ensuring a workable CVA proposal. Some practitioners explained that their experience was that when they do receive a response from HMRC it is often just a formulaic template with standard amendments of the proposal which is often not that helpful especially where the CVA is complex. Some of these standard amendments are examples of best practice, for example, a requirement for the supervisor to retain funds during the CVA sufficient to pay the fees for a compulsory winding up petition in the event that the CVA terminates. Others are often protective of HMRC's interests, for example, a provision that there is to be no time limit for HMRC to lodge claims under the CVA, and that no variation of the CVA may be proposed following approval of a CVA, which seeks to vary modifications imposed by HMRC.

A number of practitioners observed that if the company had previously a poor history of compliance with HMRC, HMRC would vote against a CVA seemingly as a matter of policy. One example provided was of a proposal where there had been early engagement by the company and nominee with the creditors including HMRC. There was a strong business plan and the CVA proposal promised unsecured creditors a 100% dividend. On the date that the CVA proposal report was filed at court by the nominee, HMRC petitioned for and was subsequently granted a winding up order. The nominee's view was that HMRC had refused to support the proposal due to previous poor compliance by the company even though the company had offered to move to making monthly VAT returns with extra monitoring in place. There is a general belief that HMRC votes based upon policy grounds rather than purely commercial grounds. One stakeholder observed that consideration should be given in proposals as to what a CVA outcome would be in the event of the CVA terminating prematurely. If such termination would make the situation worse for HMRC, than if the CVA had not happened, HMRC would clearly be reluctant to support it. If the result of a terminated CVA would not make HMRC's position worse, it would be more likely to see it positively.

A number of interviewees were of the view that the way HMRC regarded CVAs was inconsistent. Sometimes HMRC was passive, sometimes it was active. Even where HMRC supported the approval of a CVA its support was still needed to assist in its successful implementation. A number of nominees felt that when there is early engagement with creditors this needs to be met with HMRC raising issues early. One IP's experience of dealing with HMRC was that there was a pattern to how it behaved. If the proposal promised anything less than a 100% dividend, HMRC would vote against the CVA. If a 100% dividend was promised, HMRC would usually abstain and not vote. If there were historic compliance issues or if HMRC suspected an element of fraud, HMRC would vote against the proposal. That practitioner's experience was that HMRC never actively votes in favour of a CVA.

8 National and International Reform Proposals

8.1 Introduction

The World Bank's annual Doing Business Report⁷⁸ plays an important role in law reform as is evidenced by the reference to it in the 2015 Conservative Party election manifesto.⁷⁹ The Conservative Party (now 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 has consulted on possible improvements to the existing corporate insolvency regime. The UK holds an overall ranking of 7th in the 2018 Doing Business rankings.

It is, however, important to note that although this is not an undesirable ranking the UK has slipped somewhat in its distance to the frontier points from 82.34 in 2017 to 82.22 in 2018.⁸⁰ 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 1.80 percentage points from 82.04 in 2017 to 80.24 in 2018.

This position can be contrasted with that of the Netherlands. The Netherlands currently ranks 32nd overall with an improvement of 0.51 percentage points from 75.52 in 2017 to 76.03 in 2018. One obvious indicator for their overall improvement is the Resolving Insolvency indicator where the Netherlands is ranked 8th with an increase of 0.22 percentage points from 84 in 2017 to 84.22 in 2018. The Netherlands also outranks the UK on the Strength of Insolvency framework index where the UK holds an 11 against the Netherlands' 11.5. The Netherlands is currently in the process of corporate law reform, including the likely introduction of a new Scheme of Arrangement which seeks to amend the Dutch Bankruptcy Act.⁸¹

With national and international law reform initiatives in mind, this Part of the report will reflect on the World Bank principles for effective insolvency and creditor/debtor regimes as a starting point. It will then consider: recent developments in the United Kingdom; the Draft Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures;⁸² recent insolvency law reform initiatives in the Netherlands; and Chapter 6 of the Companies Act in the Republic of South Africa where a strikingly different type of reform has been introduced.⁸³

The focus of the comparative aspects will be on provisions aimed at encouraging and facilitating effective corporate rescue in the aforementioned jurisdictions and so may prove valuable comparators to the UK CVA regime.

78. The full 2018 report can be accessed here: <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB2018-Full-Report.pdf> (Hereafter referred to as "World Bank Doing Business Report")

79. The Consultation at page 6.

80. World Bank Doing Business Report. The frontier represents the best performance observed on each of the indicators across all economies. For a detailed explanation of the World Bank Doing Business report methodology please see Part 8.2 below.

81. Bill - Wet homologatie onderhands akkoord ter voorkoming van faillissement (Hereafter referred to as WHOA).

82. Draft Directive.

83. Companies Act 71 of 2008.

8.2 World Bank Ease of Doing Business Report 2018 and World Bank principles for effective insolvency and creditor/debtor regimes

The objectives of the World Bank's annual ease of Doing Business report are, according to the foreword, "as clear as they are ambitious: to inform the design of reforms and motivate these reforms through country benchmarking."⁸⁴ 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. The most important indicator for purposes of this report is the one on Resolving Insolvency.

"The Doing Business indicators on resolving insolvency provide evidence of a strong relationship between regulatory quality and efficient outcomes. The indicator set measures the quality of regulation as the recovery rate for secured creditors and the extent to which domestic law has incorporated certain internationally-accepted principles on liquidation and reorganization proceedings. Efficient outcomes occur when viable businesses are given a chance to survive, while loss-prone, inefficient firms exit the market, putting resources to better use elsewhere in the economy. In the absence of strong legal bankruptcy legislation, however, the balance between firm survival and efficient exit is distorted."⁸⁵

From the discussion above it is clear that the UK is slipping behind in the Resolving Insolvency ranking and that this possibly has an influence on the economy's overall Doing Business ranking. It could, therefore, be understood that the UK is not currently evolving to adopt modern practices that accommodate and encourage international business and investment as well as others. The Doing Business report offers policymakers a benchmarking tool useful in stimulating policy debate, both by exposing potential challenges and by identifying good practices and lessons learned.⁸⁶ This will also become evident from the discussion on the proposals put forward for consultation by the UK Government. The belief is, however, held by some that not all the tools in the Consultation (discussed below) based on these principles would lead to a significant positive improvement to the corporate rescue landscape in the UK, regardless of their impact on the UK's World Bank ranking.⁸⁷

The World Bank principles most relevant to this discussion are:⁸⁸

Principle B2 and B2.3 – The laws governing directors' obligations in the period approaching insolvency should promote responsible corporate behaviour while fostering reasonable risk taking and encouraging business reorganisation. Where creditors suffer loss or damage due to a director's breach of obligations, the law should impose liability, subject to defences (including the taking of reasonable steps to avoid or minimise the extent of insolvency). The principle further recommends that appropriate remedies for a breach of directors' duties, after insolvency proceedings have commenced, be provided. The remedies might include payment in full to the insolvency estate of any damages assessed by the court.

Principle C2.2 – The law should require a debtor to disclose relevant information pertaining to its business and financial affairs in detail sufficient to enable the court, creditors and affected parties to evaluate reasonably the prospects for reorganisation.

84. World Bank Doing Business Report foreword page iv.

85. World Bank Doing Business Report page 3.

86. World Bank Doing Business Report page 18.

87. A Review of the Corporate Insolvency Framework (July 2016) R3 Response p1.

88. World Bank principles for effective insolvency and creditor/debtor regimes 2016 (revised 2015).

Principle C5.2 – The commencement of insolvency proceedings should prohibit the unauthorised disposition of the debtor’s assets and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor’s assets. This “stay” should be as wide and all-encompassing as possible, extending to an interest in assets used, occupied, or in the possession of the debtor.

Principle C9.2 Subject to appropriate safeguards, the business should have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to enable the debtor to meet its ongoing business needs.

Principle C10.2 – To gain the benefit of contracts that have value, the insolvency representative should have the option of performing and assuming obligations under those contracts. Contract provisions that provide for termination of a contract upon either an application for commencement or the commencement of insolvency proceedings should be unenforceable subject to special exceptions.

Principle C14.3 and C14.5 – For voting purposes, classes of creditors may be provided with voting rights weighted according to the amount of a creditor’s claim. Claims and voting rights of insiders should be subject to special scrutiny and treated in a manner that will ensure fairness. Plan approval should be based on clear criteria aimed at achieving fairness among similar creditors, recognition of relative priorities, and majority acceptance, while offering opposing creditors or classes a dividend equal to or greater than they would likely receive in a liquidation proceeding. Where court confirmation is required, the court should normally defer to the decision of the creditors based on a majority vote. The system should provide for plan effects to be binding with respect to forgiveness and to cancellation or alteration of debts. The effect of approval of the plan by a majority vote should bind all creditors, including dissenting minorities.

It is worth keeping these principles in mind when considering proposals for reform and it is clear from the discussions that follow that the principles are to a great extent being followed in reform proposals.

8.3 United Kingdom

In May 2016 the UK Government launched *A Review of the Corporate Insolvency Framework: A consultation on options for reform*.⁸⁹ The Consultation 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;
- Measures to encourage ‘rescue finance’ (money lent to a company in an insolvency procedure to assist in its survival).

8.3.1 New moratorium⁹⁰

The proposed moratorium would last for three months, with the possibility of an extension if needed. During the moratorium creditors would have a general ‘right’ to request information from the insolvency practitioner.

Two thirds of the respondents who commented on the proposal agreed in principle that the introduction of a pre-insolvency temporary moratorium would facilitate business rescue.⁹¹ Respondents favoured a shorter length moratorium with a length of 21 days being the most common recommendation by respondents. Respondents also recommended that the duration be extendable. R3 suggested a moratorium 21 days in length, extendable to 42.⁹²

Respondents felt that insolvency practitioner supervision would constitute an important safeguard against abuse and also suggested that it would be crucial for obtaining and maintaining creditor confidence in the moratorium.

Interestingly, the UK scored 0/1 in the Doing Business report for the question “Does the insolvency framework provide that a creditor has the right to request information from the insolvency representative?” Allowing creditors to request information was favoured by respondents, although a large number of respondents stated that information should be provided on a regular basis, rather than creditors having a freestanding ability to request information. R3 was in agreement with this indicating that it would be much better for the provision of information to be initiated by the company itself in conjunction with the supervisor. It is unclear whether the provision of information would suffice in order for the UK to score 1/1 on that question in the Doing Business report.

8.3.2 Essential supplies⁹³

The proposal sought views on the possibility of extending the definition or concept of essential supplies by granting debtors the ability to designate certain supplies as essential. The rationale put forward was to help businesses to continue trading through the restructuring process including making it easier for companies to maintain contracts that are essential for the continuation of business. This should also make it less likely for companies, micro, small and medium enterprises in particular, to be held ‘hostage’ by key suppliers seeking to profit from a company’s distress and thereby harming the prospects of a successful rescue to benefit all creditors.

The proposed provisions would acknowledge that there are supplies of goods and services outside the provision of gas, water, electricity and IT that can also be essential to the survival of a business.⁹⁴ The responses to this proposal were quite varied. Some respondents (47%) agreed with the proposal whilst 41% of respondents disagreed with some commenting that the criteria were too debtor-friendly. This is, of course, due to the possible adverse outcome the proposal could have on the suppliers that are nominated as ‘essential.’

90. See C. Umfreville “Mora’ the same: reflecting on the latest attempts to salvage company rescue” (2017) 28 *International Company and Commercial Law Review* 385 and “A review of the corporate insolvency framework: a new moratorium to help business rescue?” (2016) 385 *Company Law Newsletter* 1-4 for an in-depth analysis of moratoria and the moratorium proposals contained in the Consultation document.

91. Summary of Responses: A Review of the Corporate Insolvency Framework. September 2016 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/578524/Summary_of_responses_26-10-16_Redacted.pdf.

92. R3, *A moratorium for Businesses: Improving Business & Job Rescue in the UK, April 2016* p2. Found at: <https://www.r3.org.uk/index.cfm?page=1114&element=27200>

93. See P. Bailey “Insolvency Service consultation on corporate insolvency framework: the remainder” (2016) 386 *Company Law Newsletter* 1-4 for an analysis of the proposals concerning essential supplies, the new rescue plan and rescue finance.

94. The Consultation p 19. See also s.233 of the Insolvency Act 1986.

Safeguards such as the court's involvement and a supplier's ability to challenge their designation as 'essential' were proposed but a majority of respondents did not agree that the proposals as drafted offered sufficient protection for suppliers. R3 indicated that it had considerable concerns with this proposal and with how the proposal could be applied in practice stating that they believe that there are relatively few situations where the proposal could assist business rescue.

The UK scored a 0/1 in the Doing Business report for the question "Does the insolvency framework allow the continuation of contracts supplying essential goods and services to the debtor?" This proposal therefore appears to have the World Bank rankings in mind. The extent to which the definition of essential supplies would need to be extended in order to be sufficient for the UK to score 1/1 on that question in the Doing Business report is unclear. On 1 October 2015, the Insolvency Act 1986 was amended to ensure continuity of supply of utilities and IT goods or services to insolvent businesses.⁹⁵ Evidently this did not change the UK's score on the abovementioned question.

8.3.3 New restructuring plan

The development of a new and flexible restructuring plan which would enable a rescue plan to bind secured creditors and introduce a 'cram down' mechanism was proposed. The ability of dissenting creditors to block a restructuring proposal (depending on the procedure) may hinder successful rescue attempts. The Consultation specifically refers to a scenario under a CVA where a secured creditor can voluntarily join in a restructuring plan, but that this seldom happens in practice. The company would then have to negotiate separate deals with secured creditors and this may undermine the achievement of an optimal rescue solution and delay the process.⁹⁶

A majority of the respondents (61%) agreed with the principle that a court-approved 'cram down' should be possible in certain circumstances. Many respondents agreed with the suggestion that creditors should be grouped in court-approved classes. The notion of dividing creditors into classes is another question in the World Bank Doing Business report for which the UK scored a 0/1. The question asks: "Are the creditors divided into classes for the purposes of voting on the reorganisation plan, does each class vote separately and are creditors in the same class treated equally?" It has been argued that the introduction of class voting would make the voting process fairer and less at risk of challenge.

The proposed voting requirements are that a plan needs a majority in number representing 75% in value of the creditors or class of creditors to vote in favour in order for the court to sanction the plan. This enables the objections of a minority of creditors to be overruled, and for a proposal to proceed in those circumstances. In considering the nominee's application, the court would apply two tests, to determine whether a class can be crammed down: that at least 75% (measured by value of gross debt) and more than 50% in number of each remaining class of creditors have agreed to the terms of the restructuring plan; that the plan is in the best interests of the creditors as a whole, in that it recognises the economic rights of 'in the money' creditors and all other creditors are no worse off than they would be following liquidation. These proposed voting requirements were generally accepted as suitable by the respondents.

The role of the court in the proposed cram down mechanism will make sure that the rights of creditors are fairly considered and that cram down only takes place when it is fair and equitable and leaves impaired creditors no worse off than would be the case in liquidation. The power to reject a plan if it is not fair and equitable is a key protection to counterbalance the new class structure and cram down option. Creditors or shareholders who disagree with the court's decision to declare a procedure binding will also have a right to appeal. These safeguards were generally accepted as adequate by respondents.

95. See Insolvency Act 1986, ss.233-233A.

96. The Consultation p 7.

8.3.4 Rescue finance

The existing framework does permit rescue finance. The Consultation sought views on whether the law pertaining to this should be reformed or developed to aid rescue. The responses to this proposal indicated that a lack of finance rarely prevents the rescue of viable businesses.⁹⁷ A majority of respondents indicated that there is currently a market for rescue finance and that the *status quo* should continue.⁹⁸ It is stated that any changes that are made to the ‘order of priority’ will have an impact on the UK’s lending environment.

8.4 European Union

In 2016 the European Commission published a proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures.⁹⁹ The explanatory memorandum to the proposal highlights the importance of efficient rescue and restructuring mechanisms to increase investment and job opportunities. The focus of the Draft Directive is on harmonising the principles of restructuring proceedings and second chance frameworks in the Member States.¹⁰⁰ Above all, however, the proposed Directive aims to enhance the rescue culture in the European Union. The relevance of the Draft Directive for the UK in the wake of BREXIT might be disputed but the international best practice guidelines provided in the Draft Directive may be of importance to the UK in the reaching of any trade deal with the European Union. It is also noteworthy that whilst the UK need not implement any resulting formal Directive as applicable law, it does not want to fall behind in developing its corporate insolvency regime in accordance with these best practice guidelines. The Draft Directive covers a number of points, some of which are discussed below.

8.4.1 Rules on company managers’ duty of care in the zone of insolvency

The Draft Directive 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.¹⁰¹ The importance of early intervention is emphasised throughout the proposal 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.¹⁰² Furthermore, a restructuring framework should be available to enable debtors to address their financial difficulties as soon as they become aware of it. The restructuring framework should be available before the debtor becomes insolvent according to the national law of the jurisdiction. It is clearly the intention of the Draft Directive to link inaction by the management of the company when experiencing financial difficulties to negligent conduct and a breach in their duty of care. Where the company is in financial difficulties, steps should be taken by the management such as seeking professional advice on restructuring and insolvency; protecting the company’s assets in order to maximise value; considering the business’s structure and function to determine viability and reduce expenditure; holding negotiations with creditors and entering preventive restructuring procedures.

97. Summary of Responses: A Review of the Corporate Insolvency Framework. September 2016 p 4. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/578524/Summary_of_responses_26-10-16_Redacted.pdf

98. R3 also indicated that it does not believe reforms to rescue finance are needed in the light of current economic and political uncertainty. Secured creditors already make funding available for viable businesses, relying on their existing security and administrators already have the ability to borrow on a ‘super priority’ basis.

99. Draft Directive. It should be noted that the Committee on Legal Affairs published a draft report on amendments to the Proposal on 16 November 2017. The draft report can be accessed here: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bCOMPARL%2bPE-613.399%2b02%2bDOC%2bPDF%2bv0%2f%2fEN>

100. “The elements of preventive restructuring procedures affecting their effectiveness and consequently the number of businesses rescued and their long-term viability diverge significantly between Member States.” Draft Directive p 3 of the Explanatory Memorandum.

101. Draft Directive art 18.

102. Draft Directive art 3.

8.4.2 Rules on reducing the length of the insolvency procedure

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.¹⁰³ Various provisions aimed at reducing the length of restructuring procedures, most notably the limits placed on the length of the stay, are proposed. Other recommendations to reduce lengthy procedures include specialised judges with the ability to take quick decisions, professionalism of practitioners in the field of restructuring and the take-up of digital communication means in insolvency proceedings. In order to create legal certainty it is necessary to maintain and enhance the transparency and predictability of procedures. Addressing the irregularity pertaining to the length of insolvency proceedings will contribute to this aim.

8.4.3 Rules on Moratoria, executory contracts and essential supplier contracts

Articles 6 and 7 of the Draft Directive provide for the rules pertaining to the stay of individual enforcement actions.¹⁰⁴ The proposal affords a debtor with the opportunity to request a judicial or administrative authority for a time-limited stay from enforcement actions to aid in achieving successful negotiations on a restructuring plan. 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.¹⁰⁵ It may be general covering all creditors, or limited, covering one or more individual creditors.¹⁰⁶ In a nutshell it proposes that a stay can initially be no longer than four months,¹⁰⁷ but that it can be extended under certain conditions if there is sufficient progress in the negotiations on a restructuring plan and the creditors are not unfairly prejudiced. In the interest of legal certainty the maximum total duration of the stay cannot, however, exceed a period of 12 months.¹⁰⁸ Creditors to which the stay applies should not be allowed to withhold performance, terminate, accelerate or in any other way modify executory contracts during the stay period, provided that the debtor continues to comply with its obligations under the contract. Member States may limit the application of this provision to essential contracts which are necessary for the continuation of the day-to-day operation of the business.¹⁰⁹ Some contracts to which the debtor is a party are for essential supplies such as gas, electricity, water, telecoms and card payment services and early termination of these contracts would endanger the ability of the business to continue during the restructuring negotiations. When a debtor enters an insolvency procedure, some suppliers may have rights entitling them to terminate the supply contract solely on account of the insolvency (*ipso facto* clauses). When the stay is granted, it is necessary that creditors to which it applies are not allowed to invoke *ipso facto* clauses which make reference to negotiations on a restructuring plan.¹¹⁰ Creditors should, however, have the right to challenge the stay once it has been granted.

8.4.4 Voting on restructuring plans and the binding of dissenting creditors obstructing the adoption of restructuring plans for viable businesses ('hold-outs' and 'cram downs')

Any creditors that are affected by the proposed plan for restructuring and equity-holders should have a right to vote on the approval and adoption of the plan. The Draft Directive proposes that parties who are unaffected by the restructuring plan should have no voting rights in relation to the plan, nor should their support be

103. Draft Directive p 5 of the Explanatory Memorandum. "In half of the Member States insolvency is resolved in 2 to 4 years."

104. Draft Directive art 6, 7.

105. Draft Directive: art 6(2).

106. Draft Directive art 6(2).

107. Draft Directive: art 6(4).

108. Draft Directive: art 6(7).

109. Draft Directive art 7(4).

110. Draft Directive: art 6(5).

required for the approval of any plan. The Draft Directive also has proposals on preventing creditors in blocking the restructuring procedure. It states that dissenting minority creditors and shareholders should not be allowed to obstruct the adoption of restructuring plans of a viable business (“hold-out”), provided that their legitimate interests are protected. To this end, the Draft Directive proposes that requisite majorities (not higher than 75%) be established by the national law of Member States.¹¹¹ Without a majority rule binding dissenting secured creditors, early restructuring would in many cases not be possible. The required majority should be based on the amount of the creditor’s claim or equity holders’ interests in any given class. The Draft Directive further states that where a plan is not supported by the requisite majority in each affected class, it may still be confirmed by a judicial or administrative authority provided that it is supported by at least one affected class of creditors and that dissenting creditors are not unfairly prejudiced under the proposal (“cross-class cram down”).¹¹² In this instance the plan should abide by the absolute priority rule which ensures that a dissenting class of creditors is paid in full before a more junior class can receive any distribution under the restructuring plan.¹¹³ The confirmation of the plan by the authority is necessary to ensure that the reduction in rights of creditors or interests of equity holders is proportionate to the benefits of the restructuring and that they have access to effective remedies. The judicial or administrative authority should therefore reject a plan that reduces the rights of dissenting creditors or equity holders below what they could reasonably expect under a liquidation distribution.

8.4.5 New financing and the protection of new lenders under the insolvency procedure

The success of a restructuring plan may often depend on whether there are financial resources in place to support first the operation of the business during restructuring negotiations and second the implementation of the restructuring plan after its confirmation. The Draft Directive, therefore, proposes protection, under specific circumstances, to new¹¹⁴ and interim financing¹¹⁵ in order to support the restructuring process. The protection of the lenders is to provide an incentive to support financially the debtor during the process. New financing ought to be exempt from avoidance actions which seek to declare it void, voidable or unenforceable as an act detrimental to the general body of creditors in the context of insolvency proceedings to follow.¹¹⁶ Provisions that stipulate that lenders may incur civil, administrative or criminal sanctions for extending credit to a debtor in financial difficulty, should liquidation proceedings follow, are jeopardising the availability of the necessary financing to aid successful restructuring.¹¹⁷ The Draft Directive foresees possible abuses and in order to avoid this, proposes that only financing that is reasonably and immediately necessary for the continued operation or survival of the debtor’s business or the preservation or enhancement of the value of the business, be protected. Protecting new lenders from avoidance actions and possible personal liability are the minimum guarantees, to further encourage lenders to take the enhanced risk of providing financing in these circumstances may require further incentives such as giving such financing priority at least over unsecured claims in subsequent insolvency proceedings.¹¹⁸

111. Draft Directive: art 9(4). “Member States shall lay down the required majorities for the adoption of a restructuring plan, which shall be in any case not higher than 75% in the amount of claims or interests in each class.”

112. Draft Directive: art 9(6), 11.

113. The absolute priority rule makes it possible to determine, when compared to the capital structure of the enterprise under restructuring, the value allocation that parties are to receive under the restructuring plan on the basis of the value of the enterprise as a going concern.

114. Financing which is necessary to implement a restructuring plan.

115. Financing allowing the business to continue to operate during the negotiation of the restructuring plan.

116. Draft Directive: art 16(1).

117. Draft Directive: art 16(3).

118. Draft Directive: art 16(2).

8.5 The Netherlands¹¹⁹

Although the Netherlands only has an overall ranking of 32nd in the World Bank Doing Business report it does have a favourable ranking of 8th in the Resolving Insolvency indicator.¹²⁰ According to the report this should be indicative of a sound approach to resolving insolvency based on accepted best practice principles. When one considers their current Bill on the confirmation of a private restructuring plan in order to prevent bankruptcy it is clear that most of the World Bank principles as well as the proposals put forward in the Draft Directive were closely followed and incorporated. The Bill is also known as WHOA (Wet homologatie onderhands akkoord ter voorkoming van faillissement).¹²¹

WHOA was inspired by the English Scheme of Arrangement as well as Chapter 11 of the United States of America's Bankruptcy Code and includes elements of both.¹²² 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.¹²³

WHOA provides for an out of court composition with creditors by way of a restructuring plan that may be initiated by either the debtor¹²⁴ or a creditor¹²⁵ 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.

8.5.1 Stay of enforcement

The stay on enforcement actions in WHOA does not happen automatically but has to be requested from the court.¹²⁶ During this period, the duration of which may not exceed two 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 two months. This means the total duration of the stay may not exceed four months. The granting of the stay may also be challenged by a creditor or third party.¹²⁷ The stay may also be general in nature or targeted to specific claims and creditors.

119. We would like to thank Professor Michael Veder (Radboud University, Nijmegen) for his kind assistance and valuable input in this part of the report.

120. World Bank Doing Business Report.

121. For an unofficial translation of the Bill visit <http://www.resor.nl/>.

122. Clifford Chance "Revised Draft 'Dutch Scheme (WCO II)'" available online at: https://www.cliffordchance.com/briefings/2017/09/revised_draft_dutchschemewcoii.html.

123. Clifford Chance "Revised Draft 'Dutch Scheme (WCO II)'".

124. WHOA: art 370.

125. WHOA: art 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 one 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.

126. WHOA: art 375.

127. WHOA: art 377.

8.5.2 Essential supplies and executory contracts

Although WHOA does not provide for the retention of essential supplies contracts specifically, it does offer some flexibility to amend contracts or to reject contracts that are too onerous for the debtor.¹²⁸ 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.¹²⁹ 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.¹³⁰

The proposal of a restructuring plan does not constitute a ground for modification of obligations or duties of, or towards, the debtor for the suspension of the performance of an obligation towards the debtor and for the rescission of a contract concluded with the debtor.¹³¹

8.5.3 Class formation; voting on the plan; confirmation and cross-class cram downs

Where a restructuring plan concerns creditors or shareholders who have interests or rights or who would receive rights under the restructuring plan that are so different that they cannot be said to be in a comparable position, those creditors and shareholders must be placed into different classes.¹³² These enfranchised creditors and shareholders will then vote on the plan in their respective classes.¹³³ A class of creditors will have approved the plan if at least two thirds of the total amount of claims belonging to the creditors in that class voted for the plan.¹³⁴ A class of shareholders will have approved the plan if at least two thirds of the number of votes cast by that class voted for the plan.¹³⁵

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 will become binding on all enfranchised creditors and shareholders.¹³⁶ This will bring about a cross-class cram down although the absolute priority rule will still apply.¹³⁷

128. WHOA: art 372.

129. WHOA: art 372(1).

130. WHOA: art 372(2).

131. WHOA: art 372(3).

132. WHOA: art 373.

133. WHOA: art 378.

134. WHOA: art 378(4).

135. WHOA: art 378(5).

136. WHOA: art 382(1).

137. Clifford Chance "Revised Draft 'Dutch Scheme (WCO II)'".

8.6 Republic of South Africa

South Africa's Companies Act 71 of 2008 heralded a new era of corporate rescue for financially distressed corporations by replacing the largely unsuccessful Judicial Management Procedure of its predecessor.¹³⁸ Chapter 6 of the South African Companies Act provides for business rescue proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for: the temporary supervision of the company, and of the management of its affairs, business and property; a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and the development and implementation, if approved, of a plan to rescue the company.¹³⁹

The South African Business Rescue regime places an emphasis on early intervention and as such has given the term "financial distress" a very wide definition by introducing a six month time period. Section 128(1)(f) of the Act 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 six months,¹⁴⁰ or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.¹⁴¹ The adding of the six 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.¹⁴²

If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution to initiate Business Rescue proceedings, the board must deliver a written notice to each affected person (creditors, shareholders, employees and trade unions), setting out the criteria referred to in the definition of "financially distressed" in section 128(1)(f) that are applicable to the company, and its reasons for not adopting a resolution to initiate Business Rescue proceedings.¹⁴³ Directors' duties have therefore been broadened by the inclusion of this provision either to take action or explain why they have not.

The drafting, acceptance and implementation of a Business Rescue plan are among the most important aspects of a modern rescue model.¹⁴⁴ The Business Rescue practitioner devises the plan in consultation with all the relevant stakeholders of the company. When a vote is called, the proposed Business Rescue plan will be approved if it receives support from the holders of more than 75% of the creditors' voting interests that were voted,¹⁴⁵ and if the votes in support of the proposed plan included at least 50% of the independent

138. E. Snyman-van Deventer and L. Jacobs, "Corporate Rescue: The South African Business Rescue Plan Examined" (2014) NIBLeJ 103-115, p 103.

139. Companies Act 71/2008:sec 128(1)(b)(i)-(iii).

140. Companies Act 71/2008:sec 128(1)(f)(i). Referring to the so called cash flow test for insolvency.

141. Companies Act 71/2008 :sec 128(1)(f)(ii). Referring to the so called balance sheet test for insolvency.

142. *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."

143. Companies Act 71/2008:sec 129(7).

144. P. Kloppers, "Judicial Management - A Corporate Rescue Mechanism in Need of Reform?" (1999) 10 Stell LR 417 - 435, at 427. See also E. Snyman-van Deventer and L. Jacobs, "Corporate Rescue: The South African Business Rescue Plan Examined" (2014) NIBLeJ 103-115, p 103.

145. Companies Act 71/2008 sec 152(2)(a).

creditors' voting interests, if any, that were voted.¹⁴⁶ A Business Rescue plan approved in the abovementioned way is binding on the company, each of the creditors of the company, and each holder of company securities, whether or not that person was present at the meeting or voted in favour of the plan.¹⁴⁷ This ensures that creditors cannot hold out on acceptance of the plan in the hope that they will be able to negotiate a better return on their claims, or refuse to participate in the Business Rescue procedure in the hope that they can enforce their claims elsewhere. Once the plan has been accepted by the requisite majority, all affected persons are bound by its provisions and cannot thereafter enforce any shortfall on their claims outside the Business Rescue procedure.

Chapter 6 makes provision for a general moratorium once the Business Rescue procedure has commenced (automatically), preventing creditors and other interested parties from taking any legal or enforcement action, including liquidation proceedings,¹⁴⁸ which could prevent the possible rescue of the company. Although no definition of the terms 'legal proceeding' or 'enforcement action' are provided in Chapter 6, the intention of the provision is to cast the net as wide as possible in order to include any conceivable type of action against the company. For the duration of the Business Rescue proceedings, no legal proceeding against the company, or in relation to any of the company property, may be commenced or proceeded with in any forum, except with the written consent of the practitioner or with leave of the court and in accordance with any terms the court deems suitable.¹⁴⁹

Although the purpose of Business Rescue proceedings is stated as being "proceedings to facilitate the rehabilitation of a company", the term "rehabilitation" is not defined in the Act. The term would appear to intimate the restoration of the company to solvency,¹⁵⁰ but provision is also made for a situation where the ultimate rescue of the company is not possible, that another outcome ensuring a higher return for creditors than they would have received under liquidation is also acceptable. An application for Business Rescue may be aimed at either of the two goals set out in section 128(1)(b), namely, (a) the primary aim of rescuing the company; or (b) the secondary aim of securing a better return for the creditors than the immediate winding-up of the company.¹⁵¹ A corporate rescue mechanism that only regards the preservation of the company as a success is a short-sighted one, especially if most of the negative socio-economic consequences of liquidation have been thwarted despite the demise of the company.¹⁵²

146. Companies Act 71/2008 sec 152(2)(b).

147. Companies Act 71/2008 sec 152(4).

148. Liquidation proceedings can be superseded by a compulsory business rescue application under the provisions of s 131(7). In addition, a company cannot pass a resolution to wind-up the company voluntarily once a resolution to place the company under supervision has been adopted in terms of s 129(1) (s 129(6)), or where an application to Court to place the company under supervision has been made in terms of s 131(1) (s 131(8)(a)).

149. Companies Act 71/2008 section 133(1)(a)-(b).

150. This is reinforced by the words "continuing in existence on a solvent basis" in Companies Act 2008, sec 128(1)(b)(iii).

151. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* [2013] 3 All SA 303 (SCA) at paras 22–28.

152. L. Jacobs. P 11 of Unpublished LLD thesis (University of the Free State, South Africa) entitled: "Die vertrouensverpligtinge van ondernemingsreëlingspraktisyns: 'n Regsvergelykende studie." Translated title: The fiduciary duties of Business Rescue Practitioners: A Comparative study (available at: <http://scholar.ufs.ac.za:8080/xmlui/bitstream/handle/11660/2344/JacobsLM.pdf?sequence=1&isAllowed=y>). See also H. Rajak and J. Henning, "Business rescue for South Africa." (1999) SALJ 116(2): 277. "The term 'rescue' obviously includes cases where the debtor's recovery is complete, that is to say where the debtor emerges from the protective period solvent, with business intact and capable of being continued successfully from the point where the protection began. All creditors will have been or will be paid in full. 'Rescue' must, however, also be understood to encompass cases where the debtor's recovery is partial but where the overall result is one of greater benefit to the various interests concerned (including the public interest) than would have arisen on liquidation."

8.7 Concluding remarks

Although international best practice principles, as contained in the World Bank principles as well as the Draft Directive proposal, are diverse, it is clear that there is a general drive towards uniformity and harmonisation in approach to corporate reorganisation legislation. The UK's drive towards incorporating these developments is a sure way to minimise the risk of getting left behind.

The expansion of directors' duties in the zone of Insolvency is one development that necessitates further discussion as this was not an issue raised by the Consultation. The efficient rescue of viable companies is more probable if the debtor takes action at an early stage, while there is still something to be done. The law should therefore place a responsibility or duty on the directors of a struggling company to act as swiftly as possible in addressing the difficulties. Possible early warning mechanisms could include accounting and monitoring duties for the debtor or the debtor's management as well as reporting duties under loan agreements. Liability and remedial provisions should address inaction or delayed action by directors and incentivise early intervention.

9. Summary of Findings

9.1 Introduction

It is clear from speaking to different stakeholders and considering the empirical data, that one of the strengths of a CVA is its flexibility.¹⁵³ It may take many forms and have varying aims. Due to its many different shades, it has not been straightforward to quantify which CVAs may be viewed as a success and which a failure. It is clear that many CVAs which have terminated prior to their intended end date, may reasonably still be viewed as more of a success than a failure. Although it has not always been possible to categorise each CVA as a success or a failure, the project has shown up a number of important factors which are frequently already in place, or might be introduced, which would improve the overall success of CVAs. It is clear that although different stakeholders view the success or failure of a CVA from their own viewpoints, there are still a number of general observations which may be made which may assist in improving CVAs and provide for more stakeholder confidence in CVAs.

Principles and provisions such as those advocated by the World Bank and included by the EU in the Draft Directive should help countries in their efforts to evaluate and improve their commercial law systems (including insolvency law) in promoting a sound investment climate and economic growth. The principles are designed to be flexible and need to be adapted to a country's realities with an understanding of the market environment in which it has to operate. This means that a one size fits all approach is not called for but rather that countries should be cognisant of these best practice principles and guidelines in developing their laws based on national needs and problems.

9.2 Success or Failure? What the data suggests

A headline figure of 65.2% of the CVAs commencing in 2013 terminating without fulfilling their stated purpose could be seen as indicative of CVAs not providing successful outcomes. When looked at from the other end, however, 34.8% of those CVAs were either implemented in accordance with their terms or have continued to operate for periods approaching five years. In turn, many of those terminated CVAs led to returns to unsecured creditors comparable with, or even better than, that which could reasonably be expected in the alternative processes of liquidation or pre-pack administration. Identifying the success or failure of a CVA is not, therefore, an arbitrary task, but often depends on a number of variables.

During the data collection it was noted that the information available from Companies House regarding the CVAs reviewed was not always consistent. For example, some final statements on termination included clear information about the level of dividend paid, the proposed dividend, the number of contributions and a clear narrative as to the causes of early termination, whilst others comprised some or none of this information. There was even one instance where the final statement set out that a dividend would be paid once all creditor claims were received, but no subsequent information was filed, resulting in there being no record of the dividend actually paid. In some cases, there was no final statement filed. Some of the key information could be gleaned from other filings, such as interim reports, but this was not always the case. There is clear scope for the quality of filing, and in turn transparency of the CVA outcomes, to be improved. For example, supervisors could be encouraged (through the relevant SIP) to include with the final statement a summary of what was proposed compared to what has happened, including detail of the estimated winding up dividend set out during the CVA proposals. This would allow creditors (and other interested parties) to evaluate the outcome of the CVA, and determine the relative success of terminated CVAs. This could help improve creditor confidence in the CVA process, and perhaps in turn improve engagement in future CVAs.

¹⁵³. This echoes the intention of the Cork Committee who emphasised the flexibility of their proposal for the introduction of voluntary arrangements in the following terms at para. 364(2): "a basis of distribution other than *pari passu* may be adopted. Unless such flexibility exists, the advantages accruing to the creditors from the provisions of third party moneys or from any after-acquired property of the debtor will be lost." Some stakeholders expressed the view that part of the flexibility found with CVAs was due to the absence of the requirement under Companies Act schemes of arrangement to categorise creditors into several classes (beyond recognising creditors as secured, preferential or unsecured).

The available evidence does suggest characteristics which would appear to undermine the prospect of a CVA achieving a positive outcome. The CVA can be seen to be an effective tool in many situations, but it goes without saying that it is not the answer for every company. With a large number of CVAs terminating very early, it is clear that some companies are entering into a CVA when other options should be explored instead. Furthermore, there were a number of cases where very low returns were distributed despite the CVA having run for an extended period. This brings into question the viability of the terms of the CVA agreed at its outset (or subsequently varied). There needs to be both more consideration given, and the space for that consideration, to the ability of the company and its management to achieve the CVA proposals, including the level of contributions and their duration.

Distributions to unsecured creditors can be negatively affected by the failure of companies to make regular contributions and those contributions that are made simply covering the costs of the CVA process. More control and appropriate oversight of the CVA process would be beneficial to ensure both that CVAs do not drag on without the pool of contributions growing, and that the supervisors' fees and expenses do not increase disproportionately to the funds available for their discharge. The greater the number of missed contributions, the worse the impact would seem to be for the unsecured dividend. The CVA must be paid for, but it should not be allowed to continue if the chances of a positive outcome for the unsecured creditors are in doubt. The introduction of measures similar to the fees estimate regime applicable in administration and liquidation may go some way to ensure these checks are in place, and in turn improve confidence in the process.¹⁵⁴

There are also benefits of CVAs for unsecured creditors beyond simply the dividend paid in respect of the historic debt. These are many and complex, depending on both individual stakeholders and stakeholder groups, and cannot be quantified, certainly not on the data available from this study.

9.3 Duration

An intended CVA duration of 5 years is commonly encountered. There is widespread concern that such a period is generally too long. The Cork Committee, when it recommended the introduction of voluntary arrangements, stated: "the duration of a voluntary arrangement will normally be for a maximum period of three years, but there will be power to extend the period in special circumstances."¹⁵⁵ The data considered in Part 4 above shows that 90 CVAs which commenced in 2013 were still ongoing towards the end of 2017, but that many which were expected to run for up to 5 years were terminated early. Additionally, there were examples of CVAs being brought to an early conclusion by agreed variation involving a lump sum payment. This permitted a dividend to be paid to unsecured creditors and for the company to continue to trade free of the CVA. In such cases it would seem that the directors acted to bring the CVA to a conclusion before the originally agreed duration had elapsed.

Most stakeholders, who expressed a view on duration, felt that 3 years was a more reasonable default duration which should only be extended if exceptional reason could be put forward to require a longer period. If companies are unable to project an acceptable dividend to creditors over a 3 year period, perhaps a CVA is not the most appropriate choice for such companies. Half of start-up companies across Europe do not survive 5 years and so it seems incongruous to expect a distressed company to trade on in CVA for 5 years. Such an extended duration appears to be detrimental to the successful turnaround of companies with directors often struggling to remain fully engaged in the process. The consequence of a shorter CVA may be that there is a lower dividend paid to creditors but it may lead to higher percentage of business rescue.

Rules on reducing the length of insolvency procedures enjoy a lot of attention in the Draft Directive and a move towards shortening the period of time that a company is undergoing a CVA would seem to be in accordance with what is regarded as best practice internationally. In the EU there is clear evidence that

154. It should be noted that there are already a number of rights which creditors have vis-à-vis the nominee and supervisor. Creditors may apply to the court under Insolvency Act 1986, s.6 if they are dissatisfied by any act, omission or decision of the supervisor. Under Insolvency Rules 2016, r.2.45, creditors are entitled to request information in relation to the remuneration of a nominee or supervisor where that remuneration is based upon time spent.

155. Cork Committee at para. 387.

the low recovery rates in many Member States can be attributed to proceedings taking too long. Where stakeholders can rely on a certain degree of predictability (even regarding duration of proceedings) it could aid in the engendering of confidence and certainty in the process.

9.4 Approval and Supervision of the CVA

Unfortunately, there appears to be a general concern held by many types of stakeholder that the CVA process is not always beneficial to them, or at least, that it might be more beneficial to them. Some creditors feel that other creditors get a better deal than them. Some creditors feel that nominees are not always as independent as they ought to be in the planning stages of a CVA. Some creditors observe that nominees may be struggling, in the limited timeframe available, effectively to assist with the drafting and execution of a workable CVA.¹⁵⁶ It is interesting to note that the Cork Committee emphasised a number of “matters of paramount importance” in relation to its recommendations for the introduction of voluntary arrangements. One of these was that if the insolvency practitioner’s “professional competence, independence and integrity give rise to doubts, confidence in the new system will quickly evaporate.”¹⁵⁷

The role of nominees, when involved in the drafting of a CVA, is to maintain an independent stance, to act in good faith,¹⁵⁸ and only to propose a CVA if they consider it has a reasonable prospect of being approved and implemented.¹⁵⁹ The nominee must be of the view that a CVA is appropriate in the circumstances. Negotiating as a go-between with the company and creditors is a core element as to what the nominee must do. This may be particularly challenging in some cases where HMRC is a major creditor and the company has a poor compliance record. A supervisor’s role is to agree creditors’ claims and pay creditors according to the terms of the CVA. There may be a need to advise the company as to the likely consequences of failing to make payments under the CVA. There may be a need to negotiate variations to the CVA. A number of statutory processes and returns must be made.¹⁶⁰

It would appear that some CVAs suffer from a number of weaknesses. It is often the case that the plan put together for or by the directors is not sufficiently robust to turn around the company. Many types of creditor will closely scrutinise a CVA to assess how it affects their interests. Banks will frequently do so if the debt involved is significant. The BPF will often provide independent scrutiny of a draft CVA on behalf of its landlord members. HMRC would appear to scrutinise some CVAs closely and may demand certain amendments in order to protect its own interests. There is often a sense that the scrutiny provided by the nominee, who will usually have been involved in the drafting and negotiation of the CVA, may not always be adequate.

Statement of Insolvency Practice (“SIP”) 3.2 on CVAs states: “The company’s directors, shareholders and creditors should be confident that an insolvency practitioner will act professionally and with objectivity in each role associated with the arrangement. Failure to do so may prejudice the interests of both the company and creditors, and is likely to bring the practitioner and the profession into disrepute.” It may be helpful if further guidance could be issued to IPs, in an updated SIP, so that the duties involved in their successive roles as adviser and nominee are emphasised. The independence of the nominee’s report on a proposal needs to be clearly and convincingly articulated to creditors. It might be that any enhanced guidance to IPs might include a simple checklist which highlights, for example, the introduction of any new money, any prospective changes in management and any specific intended cost savings. It might also suggest that IPs explain the company’s HMRC compliance record and, where there have been compliance problems, how those problems will be addressed by the CVA. Such provisions might encourage more stakeholder confidence in the process.

156. Blackburne J said in *Welsby v Brelec Installation Ltd* [2000] 2 BCLC 576 at 586: “An arrangement is usually put together in some haste. Modifications to it are frequently made at the statutory meeting of creditors with little time to reflect on how they relate to the other terms of the debtor’s proposal. Quite often, as this case demonstrates, the resulting terms are clumsily worded.”

157. Cork Committee at para.364.

158. See e.g. *Mourant v Sixty UK Ltd* [2010] BCC 882.

159. Insolvency Rules 2016, r.2.9.

160. See the explanation of the role of an insolvency practitioner in the context of a voluntary arrangement in *Paymex Ltd v HMRC* [2012] BPIR 178.

If the independent assessment by the nominee of a draft CVA is positive, it might be made incumbent on public sector creditors such as HMRC to vote down a CVA only if they fully explain their reasons for so doing. This may go some way to address the general concern that HMRC is often the most engaged creditor in the CVA process but also the most likely to vote against a CVA, possibly due to policy rather than commercial concerns.

Once a CVA is operational, there appears not to be any specific requirement for the supervisor actively to supervise the execution of the proposed business plan. Some supervisors do take an active interest in how the company in CVA is progressing and keep a helpful eye on the business and any changes being made. This level of oversight is not universal and is not seen by many supervisors as their role. Again, it may be useful for specific guidance to be provided to supervisors, in an updated SIP, so that they are clear on the parameters of their role. This may also assist directors and creditors in planning for and assessing a proposal. If the directors need additional help during the implementation of the CVA, perhaps from a turnaround professional,¹⁶¹ it would be useful to identify this need early and not rely on an uncertain or incorrect understanding that the supervisor will provide that assistance. This would help address the issue frequently observed in the data collection, survey and interviews, that the biggest problem is often that the directors do not change their ways. A clear understanding of what a supervisor will and will not do may lead to more CVAs staying on track. The introduction of a register of turnaround professionals might assist in finding suitable assistance for directors.

As part of the supervisor's role, it may encourage further confidence in the process if a supervisor has the power to report "unfit" conduct by the directors of the company to the Secretary of State for the purposes of possible disqualification action being taken under the Company Directors Disqualification Act 1986. There would be no duty on the supervisor to investigate any allegations but if he or she became aware of culpable behaviour, a power to report the directors in question may instil further stakeholder confidence in the CVA process.

A lack of trust in directors' abilities sometimes stems from the perception that they allowed the affairs of the company to deteriorate to an extent that is fatal to the interests of the company's stakeholders. The World Bank best practice principles suggest that a provision to promote responsible corporate behaviour whilst leaving room for reasonable risk taking and encouraging management to act when financial distress is imminent is of great import. The international drive is towards early intervention. The sooner a debtor takes action to address the financial difficulties the greater the chance of a successful resolution thereof. This may be achieved by broadening or at least clarifying the scope of the directors' duties in the zone of insolvency. Directors should be expected to take reasonable steps to avoid insolvency and failure to do so timeously should be regarded as negligent conduct according to the Draft Directive. The South African Business Rescue regime tried to incorporate this principle by broadening the directors' duty of care to initiate rescue where distress is foreseen. Failure to act sufficiently early would therefore lead to a breach of duty.

9.5 Pre-insolvency Moratorium

It is reasonably clear that a number of CVAs struggle due to the terms of the CVA failing to address the historic problems of the distressed company. This weakness might be remedied if the chances to plan for, and execute, a coherent turnaround were increased. Although not always needed,¹⁶² it seems that an easily accessible, short term moratorium might permit the directors more time to plan an effective business rescue which is viable. If a short term pre-insolvency moratorium (of perhaps 21 days) were available to the company, the stay on creditor actions should provide time for a CVA proposal to be drafted, be the subject of the nominee's independent assessment, and still have time to be amended, if needed, prior to being put to a creditors' vote.

161. It may be, as one interviewee suggested, that the skillset of an insolvency practitioner is not what is required at this point. It may be that a turnaround professional (who of course may also be an insolvency practitioner) is needed to be involved during the implementation of the CVA.

162. The reasonably common practice, at least prior to the decision in *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* [2018] 1 WLR 24, of filing a notice of intention to appoint an administrator in order to secure a 10 day moratorium would suggest there is a need for such a moratorium.

Although the Cork Committee¹⁶³ recognised that a company could benefit from the moratorium provided by an administration to plan for a rescue,¹⁶⁴ it saw that a simple CVA would “prove of value to small companies urgently seeking a straightforward composition or moratorium.”¹⁶⁵ This view appears to remain valid today.

Most interviewees were concerned by possible abuse of such a moratorium. Most of those concerned felt that such abuse could be minimised if the moratorium were for a short period of time only. Although there was no general consensus, it was generally felt that the moratorium should only be possible if ordered by the court and only on condition that all liabilities incurred during it were given priority, perhaps over the supervisor’s fees.

International best practice principles advocate the importance of a short or time-limited stay that is as wide and all-encompassing as possible. A moratorium need not, according to these principles and guidelines, be automatic and including the court or other administrative authority in the granting of a stay would still be regarded as a sound practice.¹⁶⁶ The duration of the moratorium should not be for too long and as such the Draft Directive proposes a moratorium of no longer than four months and the proposed Dutch WHOA allows only for a duration of two months.¹⁶⁷ Having a time-limited general or targeted moratorium that has to be requested from the court would be regarded as in line with international best practice principles.

9.6 Rescue Funding

It was noticeable that the reason why so many CVAs struggled to succeed was a reported pressure on cash flow. Some interviewees saw debt factoring (where available) as one solution to the problem. There was little appetite for the introduction of a form of “debtor in possession” funding which took priority over other creditors due to the uncertainty of possible unintended consequences. The common 5 year duration of CVAs was also recognised as imposing a long term pressure on cash flow which might be alleviated if CVAs were for only 2 or 3 years. It seems there is likely to be a place for some form of rescue funding in the right case. It may be that the inherent flexibility of the CVA permits such funding to be secured according to the individual facts of a particular case. The terms upon which such funding have been agreed could be negotiated with major creditors and written into the CVA. Access to commercially sound forms of funding in rescue (including priority repayment thereof) is in accordance with international best practice.

9.7 Essential Suppliers

Again, there was little support amongst those interviewed for an expansion of the current essential supplier regime. As many interviewees explained, early engagement with creditors was important for a successful CVA. A company would usually need to keep its suppliers informed of its plans and so it would be unusual for a company to have the need to apply to court for an order requiring continued supplies from someone it had identified as an essential supplier. It would be unrealistic that such a forced supply could extend to the full duration of a CVA. If limited to what may be only a short term moratorium, it would be unusual for such a power to be used.

Although the best practice principles contained in the Draft Directive recognise the need that suppliers should not be allowed to withhold performance especially where the performance of these suppliers is necessary for the continuation of the day-to-day operation of the business, it does not extend the definition of essential supplies any further than utilities, telecoms and card payment services. Limiting the essential supplier

163. Such a short term moratorium was suggested by the Cork Committee in the context of IVAs (which recommendation became the interim order under Insolvency Act 1986, s.252) and the recommendation for CVAs included the incorporation of the IVA provisions “*mutatis mutandis*” (Cork Committee at para. 377 and 429).

164. In the context of discussing Companies Act schemes of arrangement, the Cork Committee commented at para. 408 that an “insolvent company’s inability – particularly if it is a trading company – to hold the position (that is to prevent winding up or the random seizure of assets by individual creditors) during the period necessary for the devising and processing of a scheme, makes it extremely difficult for even the most uncomplicated scheme of arrangement to be launched. A straightforward moratorium ... for a limited period ... may be the plainest good sense for all concerned.”

165. Cork Committee at para. 430.

166. The Dutch WHOA moratorium is not automatic and needs to be requested from the court.

167. This moratorium is extendable, but only for a maximum period of two months subject to conditions.

definition to what is currently the position would therefore still be regarded as in accordance with international best practice principles.

9.8 Standard Terms and Conditions for CVAs?

Although there was little support for a standard form CVA, it is clear that many important issues addressed by CVAs are subject to reasonably standard provisions. As many CVAs relate to SMEs¹⁶⁸ which are often seen as a “glorified” form of IVA, it seems peculiar that a standard form, at least for SMEs, cannot be created. This would cut the costs of many CVAs and lead to more confidence in them, as stakeholders would become more aware of their terms. It is clear that a great many IP firms only act in one CVA per year, so a standard form of basic SME CVA, updated periodically, might benefit those practitioners and bring some uniformity to practice without impacting on the CVA’s inherent ability to be flexible to the individual circumstances. If a complete standard form CVA is not feasible it would appear possible to draft certain commonly encountered clauses for incorporation into CVAs generally. Some of HMRC standard amendments might benefit from a wider dissemination as might a standardised version of certain landlord specific clauses. If standard terms for a CVA could be agreed by the various stakeholders, it might be that those stakeholders only vote against a CVA based upon those standard terms if they fully explain their reasons.¹⁶⁹

168. It was the view of many stakeholders that where a CVA involved larger companies, there was usually no need for a formal moratorium. In such cases, HMRC was not usually a major creditor but landlords frequently were.

169. This process might operate in a way similar to the IVA Consumer Protocol for details of which see: <https://www.gov.uk/government/publications/individual-voluntary-arrangement-iva-protocol>.

10. Conclusion

“In my view, business rescue proceedings are neither for terminally-ill nor for chronically ill close corporations. They are for ailing corporations, which, given time, will be rescued and become solvent.”¹⁷⁰

The Cork Committee is often credited with introducing the concept of corporate rescue to the UK in the early 1980s. The basic principle of a compromise being agreed by creditors with or without the company taking advantage of a moratorium has stood the test of time. The CVA is a flexible and effective mechanism. However, as was commented by several of our interviewees, rescue is about people not just processes. The people involved when a company experiences financial distress include the many and varied classes of creditor, the directors and the insolvency practitioners. Each must play his or her part for a CVA to work. Early engagement by directors and nominees displaying judgement, trustworthiness and transparency coupled with a willingness on the part of creditors to be reasonable and flexible does lead to businesses being saved and creditors getting paid.

The current system works reasonably well but could work better. It could instil more confidence in its stakeholders. A stronger emphasis needs to be given to the use of a CVA only in situations where it is clearly feasible. A realistic default limit on the duration of CVAs may be helpful. Directors need to understand better their duties to creditors once a company enters a distressed state. Early engagement with creditors, careful planning and effective supervision of the plan are shown to be the hallmarks of good CVAs and need to be encouraged. If confidence in the system needs to be bolstered then an emphasis on the objective assessment of CVA proposals may help. As so many companies are small or medium sized, the costs of preparing CVA proposals may be made more reasonable with the introduction of some form of standard terms for CVAs. A short term pre-insolvency moratorium may assist with the careful planning of a CVA and help to ensure that only companies who will benefit from a CVA put forward proposals.

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.

170. *Wellman v Marcelle Props* 193 2012 JDR 0408 GSI: 12 per Tsoka J (South Africa).

Annex A

R3 Member Survey Questions

Q1. Are you a licensed insolvency appointment taker?

Answer Choices

Yes

No

Q2. Have you assisted directors to propose a CVA, proposed a CVA as an office holder, or acted as a CVA nominee in the last 12 months?

Answer Choices

Yes

No

Don't know

Q3. You said you had not assisted directors to propose a CVA or had not proposed a CVA as an office holder in the last 12 months. Is this because? (Please tick all that apply)

Answer Choices

There was no case suitable for a CVA

In my experience, CVAs never achieve their objectives

Pre-pack administration is a more effective tool

I don't like using CVAs

Don't know

Other (please specify)

Q4. Have you assisted directors to propose a CVA, proposed a CVA as an office holder, or acted as a CVA nominee or supervisor, or assisted a supervisor in the last three years?

Answer Choices

Yes

No

Don't know

Q5. In how many cases did you assist directors to propose a CVA, propose a CVA as an office holder, or act as a CVA nominee?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q6. And in how many of these cases were the CVA proposals approved by creditors?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q7. And in how many cases did you act as the CVA supervisor or as part of the supervisor's team (including legal team)?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q8. Were varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q9. Are still in progress - and have been varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q10. Are still in progress - and have not been varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q11. Ran for their full term, were completed successfully, and were varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q12. Ran for their full term, were completed successfully, and were not varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q13. Ended before their scheduled completion date, were varied, but were successfully completed?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q14. Ended before their scheduled completion date, were not varied, but were successfully completed?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q15. Were terminated without successful completion and were varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q16. Were terminated without successful completion and had not been varied?

Answer Choices

0

Don't know

More than 0 - Please enter a figure

Q17. Based upon your own experience with CVAs, which of the following are the main reasons why CVAs do not proceed before being put to creditors for approval? Please select up to three options.

Answer Choices

Further information suggests the company is not capable of being rescued

The directors are unwilling to make the necessary changes

Market changes make the CVA unviable

A lack of secured creditor support

Key suppliers have threatened to withdraw supplies

A lack of unsecured creditor support (excluding HMRC)

A lack of support from HMRC

Sector regulator/trade body rules inhibit CVAs

Don't know/no experience with CVAs

Other (please specify)

Q18. And, based upon your own experience with CVAs, which of the following are the main reasons why CVAs do not proceed after they have been formally proposed? Please select up to three options.

Answer Choices

A lack of secured creditor support

A lack of unsecured creditor support (excluding HMRC)

A lack of support from HMRC

Key suppliers have threatened to withdraw supplies

Don't know/no experience with CVAs

Other (please specify)

Q19. Based upon your own experience with CVAs, which of the following are the main reasons why CVAs are terminated? Please select up to three options.

Answer Choices

The directors do not implement the changes required by the CVA

Financial forecasts prove overly optimistic, which inhibits company rescue

The company's problems were not fully identified and tackled in the CVA proposal

Market changes subsequent to approval make the CVA unviable

Secured creditors enforce their security

Post-CVA creditors are unpaid

Sector regulator/trade body rules hinder CVA

Customers withdrew business

Key suppliers have withdrawn supplies

Withdrawal of trade credit

The company underestimated the working capital impact of the CVA - before and after approval

Don't know/no experience with CVAs

Other (please specify)

Q20. Based on your own experience, what period would you say the typical CVA is proposed to run for?

Answer Choices

- One year
- Two years
- Three years
- Four years
- Five years
- Over five years
- Don't know/no experience with CVAs

Q21. And, based on your own experience, when would you say an approved CVA is most likely to come to a premature end?

Answer Choices

- In the first year
- In the second year
- In the third year
- In the fourth year or later
- No discernible pattern
- Don't know/no experience with CVAs

Q22. And, based on your own experience, in which of the following sectors would you say you have proposed the most CVAs? Please select up to three answers.

Answer Choices

- Agriculture, hunting, forestry or fishing
- Mining and quarrying
- Manufacturing
- Electricity, gas, water utilities companies
- Construction
- Wholesale and retail
- Hotels and restaurants
- Transport and haulage
- IT companies
- Banks
- Real estate and property
- Government and the public sector
- Don't know
- Other (please specify)

Q23. Based upon your own experience, which of the following types of stakeholder would you say is typically most engaged in the CVA process? Please select up to three.

Answer Choices

- HMRC
- Secured creditors (excluding asset-based lenders)
- Landlords
- Pension funds
- Trade creditors
- Customers
- Employees
- Asset-based lenders
- Don't know/no experience with CVAs
- Other (please specify)

Q24. And, based upon your own experience, which of the following types of stakeholder would you say is typically most likely to oppose or be less receptive to a CVA? Please select up to three.

Answer Choices

- HMRC
- Secured creditors (excluding asset-based lenders)
- Landlords
- Pension funds
- Trade creditors
- Customers
- Employees
- Asset-based lenders
- Don't know/no experience with CVAs
- Other (please specify)

Q25. With which of the following statements do you most agree?

Answer Choices

- CVAs are a very effective business rescue tool
- CVAs are a fairly effective business rescue tool
- CVAs are neither an effective nor a poor business rescue tool
- CVAs are a fairly poor business rescue tool
- CVAs are a very poor business rescue tool
- Don't know/no experience with CVAs

Q26. With which of the following statements do you most agree?

Answer Choices

- CVAs very often achieve their objectives
- CVAs often achieve their objectives
- CVAs often do not achieve their objectives
- CVAs very often do not achieve their objectives
- Don't know/no experience with CVAs

Q27. And with which of the following statements do you most agree?

Answer Choices

With some changes, CVAs have the potential to be used as a rescue tool much more than they are now

With some changes, CVAs have the potential to be used as a rescue tool somewhat more than they are now
Even with some changes, CVAs do not have much more potential to be used as a rescue tool more than they are now

Even with some changes, CVAs have no potential to be used as a rescue tool more than they are now

Don't know/no experience with CVAs

Q28. And finally, which of the following changes, if any, do you think would increase the potential of CVAs as a business rescue tool? Please pick up to three.

Answer Choices

A revised moratorium process

A better understanding of the CVA process

More support for CVAs from HMRC

More support for CVAs from banks

More support for CVAs from landlords

More support for CVAs from suppliers

More support for CVAs from regulators or sector trade bodies

A more realistic approach to CVAs by directors

Don't know/no experience with CVAs

Other (please specify)

Company Voluntary Arrangements: Evaluating Success and Failure



Company Voluntary Arrangements: Evaluating Success and Failure

