The Lawdragon, Covid-19 and Breathing New Life into Company Rescue

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I. THE PROBLEM

There are many and far reaching societal consequences of the Covid-19 crisis. Each academic discipline is capable of reacting individually to the challenges faced in its respective area. I am proud to be one in a long line of academics at the University of Wolverhampton with a reputation for high quality, impactful research in the area of insolvency law and practice.

In these desperate economic times many companies are struggling to see a way through the maze of local and national trading restrictions. Many fundamentally sound businesses have become distressed due to the stop/start nature of trading conditions. There are about 2 million SME companies in the UK. SMEs employ over half of the working population. Their problems are problems for the nation. In this article, I will explain how I have used the accumulated expertise in insolvency law and practice to help put in place a new corporate rescue innovation, based upon a tried and tested procedure, designed to help save companies (and jobs) which are struggling due to the pandemic.

II. A LAWDRAGON IN THE WORLD OF INSOLVENCY LAW

For the past decade, I have been privileged to have forged ever closer links with the UK insolvency profession and the UK Government. I have been trusted to conduct research on behalf of the UK insolvency profession, the UK Government and have also taken on very significant overseas and cross-border responsibilities.[1] During the summer of 2020 I received international recognition when I was named as a Lawdragon by inclusion in the *Lawdragon Global Restructuring Advisors & Consultants Guide*.[2]

For a number of years, I have been one of only two academics who sit on the two main UK insolvency technical committees: firstly, the General Technical Committee ("GTC") of the Association of Business Recovery Professionals ("R3") and second, the Technical Committee of the Insolvency Lawyers' Association. Both of these committees work *pro bono* to advise UK insolvency practitioners and lawyers on new legal and practice-based developments in the world of insolvency.

III. SO WHAT HAPPENED WHEN THE PANDEMIC BEGAN?

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[1] Amongst other matters, I have acted as a consultant to the Kenyan Government, acted as an expert witness in the Italian tax courts and taken on the Leadership of the prestigious INSOL International Global Insolvency Practice Course.

[2] https://www.lawdragon.com/2020/08/10/lawdragon-global-restructuring-advisors-consultants-guide/

The options for companies suffering financial distress during the pandemic are reasonably limited. If Government financial support cannot keep them going, they will need to consider taking insolvency advice. Insolvency procedures often fail to lead to an optimum outcome for the companies or their creditors – administration and liquidation see a great deal of a company's wealth being expended on costs and fees.

I used my position of relative influence to recommend that the UK insolvency community should react to the Covid-19 crisis by engaging in a significant *pro bono* activity by preparing a standard form company voluntary arrangement precedent to facilitate small and medium sized company rescue. My suggestion was not universally well-received by practitioners and in a world where lawyers are professionally risk adverse, the project required the support of a powerful ally. Stewart Perry, a restructuring and insolvency partner at European law firm, Fieldfisher, who chairs R3's GTC was that ally. Together with the support of R3, he and I co-led the project on behalf of R3 beginning in April 2020. It came to fruition in October 2020.

(a) The R3 Standard Form Company Voluntary Arrangement

A Company Voluntary Arrangement ("CVA") is a rescue process contained in the Insolvency Act 1986. The CVA is the only consensual restructuring process contained in the Insolvency Act. It is a debtor-in-possession procedure where the company's directors remain in control of the company and its business. It may be contrasted with administration (and liquidation) where the powers of management of a company's directors are usurped and replaced by the appointment of a professional administrator (or liquidator). A CVA enables a company to propose a way forward to its creditors. If at least 75% in value of a company's unsecured creditors agree to the CVA proposal it will bind 100% of the unsecured creditors. A CVA is not approved if more than half of the company's unconnected creditors vote against it. The terms of a CVA proposal cannot bind a secured creditor unless it agrees.

Usually the terms of a CVA allow the company to pay a percentage of debts owed, in full and final satisfaction of its debts (a composition of debts). A CVA will commonly delay payment of debts owed, whether or not it also includes a debt composition. Any disgruntled unsecured creditor can challenge the terms of a CVA on the basis that it is unfairly prejudicial or that there was a material procedural irregularity in its approval.

Although CVAs have been around for nearly 35 years, they remain relatively rare in practice.[3] There are many reasons for this. I had previously led a research project, which included my colleague, Dr Lezelle Jacobs, in 2018 which researched the reasons behind the relative lack of success of CVAs.[4] A number of our recommendations are currently being considered by the insolvency profession. One of our recommendations was for the introduction of a standard form of CVA for small or medium enterprise ("SME") companies. One characteristic of a CVA is that it is usually a bespoke document and can be prohibitively costly. In recent times, CVAs have come more into the public awareness due to their use by large (and well-known) retail companies such as Debenhams. Our pandemic project concentrated on creating fit-for-purpose CVA precedent documentation for use by companies nearer the other end of the economic scale – the SME market.

The Covid-19 pandemic has made the need for a standard form of CVA for SMEs urgent. The R3 Standard Form Covid-19 CVA Proposal ("Standard Form") and accompanying Covid-19 Standard Conditions for Company Voluntary Arrangements ("Standard Conditions") were the result of our work over the summer months of 2020 (together with the assistance and

[3] In 2019 there were 351 CVAs in England and Wales which accounts for only 2% of all corporate insolvencies (17,225).

[4] Professor Peter Walton, Chris Umfreville and Dr Lézelle Jacobs *Company Voluntary Arrangements: Evaluating Success and Failure* (2018) (a research report commissioned by R3 and sponsored by ICAEW).

constructive criticism of other R3 members). The resulting documents also benefitted from the outcomes of a succession of meetings with Government representatives from BEIS, the Insolvency Service and HMRC as well as representatives from the banking industry. Both Standard documents are a free resource. We hope they will be used by companies and their advisors. They have been adapted for use in Scotland and Northern Ireland.[5]

Where its use is appropriate, the Standard Form is intended to save time and costs, and therefore make CVAs more accessible to the SME market. It is intended to encourage a responsible approach to the payment of corporate debts.

(i) The Standard Form CVA

The Standard Form is an example of academia working closely with industry to bring about a positive result for the economic challenges of Covid-19.

The Standard Form is intended for use by SMEs with profitable businesses which are carrying extra debt due to the Covid-19 pandemic and which need time to pay all their debts in full. If during the CVA, full payment becomes unrealistic, the Standard Conditions allow for the creditors to agree to a variation of the CVA which may include a composition of debts.[6]

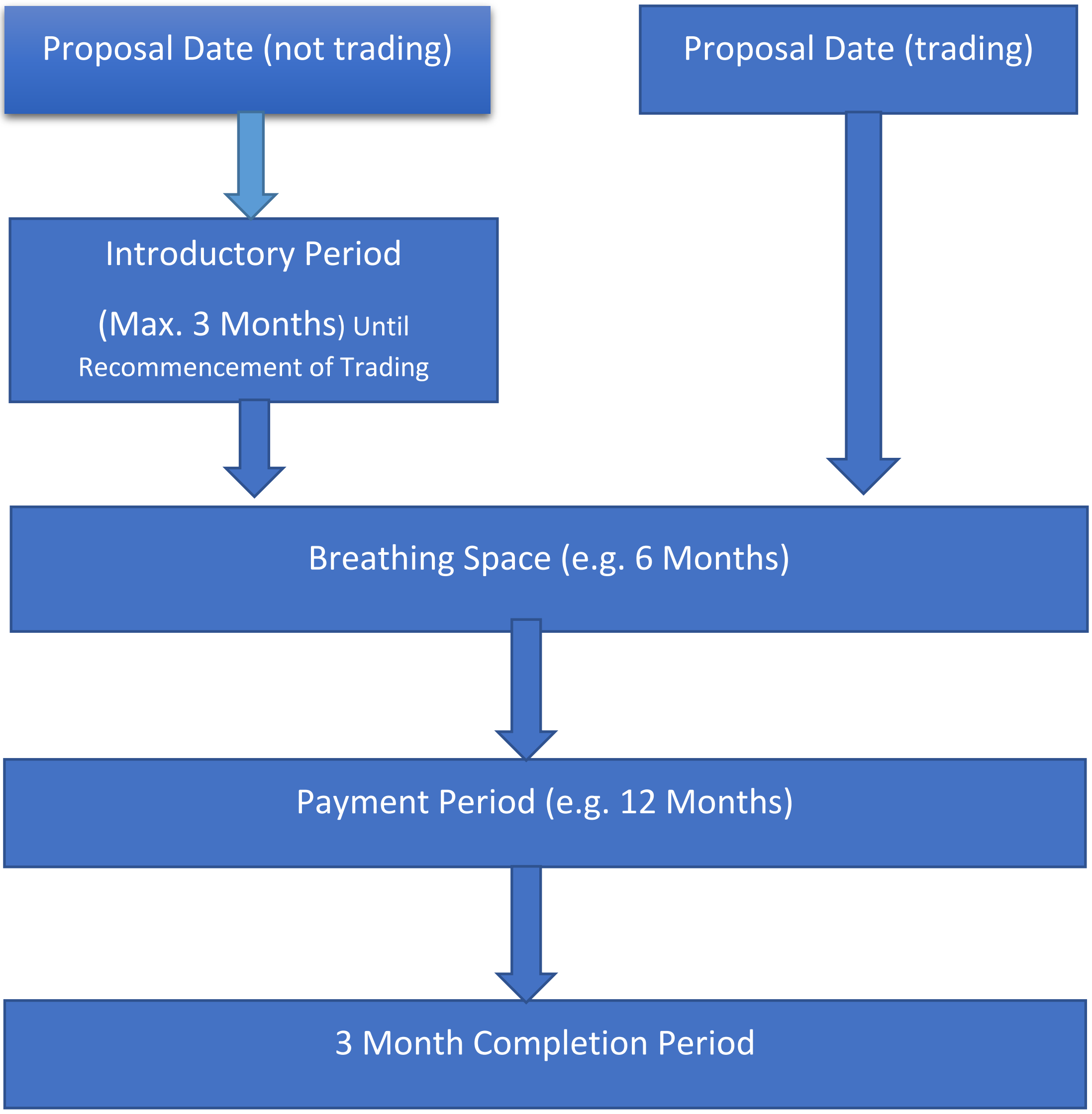
The Standard Form provides for a breathing space period followed by a delayed payment of the company's debts. Creditors with pre-CVA debts are prevented from enforcing their debts against the company while the CVA is in operation. Trading costs incurred during the CVA are paid out of new trading income. Continuation of the business permits regular contributions to be made to the CVA supervisor out of operational cash flow which are used to pay off pre-CVA debts. The terms of the Standard Form are familiar to major creditors including HMRC and the major banks.

(ii) Timeline for a Standard Form Covid-19 CVA

The flow chart below shows in outline the timeline for the Standard Form CVA (in unamended form). It recognises the inherent flexibility of a CVA with its inclusion of clauses on its front page with blanks which require completion. Not all of the clauses will be appropriate in each case. It recognises that businesses may or may not yet be operational following an interruption due to Covid-19.

[5] Relevant documentation may be found at: https://www.r3.org.uk/technical-library/england-wales/technical-guidance/r3-standard-form-covid-19-cva-proposal/

[6] It is intended that the Standard Form will be amended to become fit-for-purpose for the various different companies that may employ it. Depending upon individual circumstances, a company may find it necessary to amend the proposal to allow for a debt composition immediately. Lexis has drafted standard amendments to the Standard Form to allow for a debt composition. The Lexis variation is freely available at: https://www.lexisnexis.com/uk/lexispsl/restructuringandinsolvency/document/393748/612X-5JS3-GXFD-8137-00000-00/Appendix-2%3A-Amendments-to-R3-Standard-Form-COVID-19-CVA-proposal-for-a-debt-waiver



If the CVA proposal is made before the company's business has re-started, the Standard Form provides for an Introductory Period of up to 3 months during which the business remains inactive.

If no Introductory Period is required, or it has elapsed, the Standard Form contains a Breathing Space Period which provides a payment break in relation to debts owed prior to the approval of the CVA. The length of the Breathing Space Period is set by completing the blank on the first page. New debts incurred in the ordinary course of business during the CVA will be paid during the Breathing Space Period but CVA debts, those owed prior to the commencement of the CVA, will not be payable during the Breathing Space Period. The Breathing Space Period may last, for example, for 6 months during which time the company's business is intended to return to normal profitable day-to-day trading (and to the extent necessary to rebuild a working capital buffer).

Once the Breathing Space Period has elapsed, the company will begin to pay back its debts in the Payment Period. The Standard Form assumes that the company will be in a position to repay 100% of its debt but this may require amendment in a particular case. Such amendment may be needed either prior to commencement of the CVA or as a variation part way through the CVA. The Standard Form suggests an indicative Payment Period of 12 months but a longer or shorter period may be more appropriate on the facts of a particular case. Monthly payments will be made by the company to the Supervisor (a regulated insolvency practitioner overseeing the debtor company's compliance with the CVA) to distribute amongst the creditors according to their respective entitlements.

Once the Introductory Period, Breathing Space Period and Payment Period have elapsed, there will be a final Completion Period of three months to enable any final formalities and payments to be completed.

During the CVA period, a number of restrictions apply to the company's operations. The Standard Form provides that the company may not declare any dividends or increase directors' salaries. Borrowing or sales of the company's business or its assets (save in the ordinary course of business) may not be completed without the consent of the Supervisor or creditors. If the company's business is sold, the proceeds will be paid first to secured creditors, then to pay debts incurred during the CVA and finally to pay debts covered by the CVA.

The Standard Form allows the Supervisor to extend the CVA period for up to 6 months and it will be a breach of the CVA if the company fails to meet its post-CVA trading liabilities or breaches the restrictions imposed under the CVA. Upon breach, the Supervisor may take steps to terminate the CVA and petition to wind up the company.

The Standard Form is supported by the Standard Conditions. These are based to a large extent upon the popular and well-used R3 Standard Conditions for Individual Voluntary Arrangements (used by consumers) with amendments appropriate for companies. They are incorporated into the Standard Form by inclusion in Appendix 1. Any agreed amendments to the Standard Conditions will appear in Appendix 2 to make it easier for creditors with multiple debtors to compare their proposals.

IV. WILL IT MAKE A DIFFERENCE?

It is impossible to predict whether or not the Standard Form will make a significant difference to financially distressed companies. With the passing of the Corporate Insolvency and Governance Act 2020, Parliament has introduced new measures to increase the range of business rescue options available to insolvency practitioners when advising their clients. So far, these changes appear to be having only a very modest take-up. Initial reactions from the profession suggest the Standard Form CVA, with its emphasis on saving costs and time, may be at least as effective a tool as the recent statutory additions, and will help the profession save companies and jobs as the economy looks to bounce back.