

FortyTwo Talks:
IVAs and CVAs: Compromise Instead of Collapse
Iris Ferber KC & Alex Bailey

Iris Ferber KC: Welcome to *FortyTwo Talks*. This mini-series covers topics relating to insolvency, and this is the last episode in this series.

I'm Iris Ferber KC.

Alex Bailey: And I'm Alex Bailey, and today we are talking about voluntary arrangements.

Now, the first question I want to ask is why should someone who doesn't work in insolvency care about voluntary arrangements? That's a CVA or an IVA.

What's the relevance to day-to-day practice, Iris?

Iris Ferber KC: Well, they come up everywhere, don't they, Alex? Property lawyers see them when a residential tenant proposes an IVA, or a commercial tenant proposes a CVA, and banking lawyers need to know what a voluntary arrangement can and can't do to their client's security.

Private client lawyers see IVAs when a client's finances fall apart, and of course, litigators often find a judgment debtor has proposed some sort of voluntary arrangement.

Alex Bailey: And so, they really do go into everything.

Now, you and I have talked about insolvency options before, one being winding up, that meant the death of a company, but insolvency doesn't always have to mean the end, does it?

Iris Ferber KC: Sounds like a song, Alex.

No, it definitely doesn't, and one of the big changes in modern insolvency law is to recognise that there are circumstances in which preserving an individual's economic activity or allowing a company to continue trading can actually produce a better outcome for everyone, and that is where voluntary arrangements come in.

Alex Bailey: So rather than a company being wound up or an individual becoming bankrupt, would it be right to say that an IVA or a CVA can save them from financial doom?

Iris Ferber KC: Yes, absolutely, a voluntary arrangement essentially takes the opposite approach to a winding up or a bankruptcy.

Alex Bailey: And how do they work, Iris?

Iris Ferber KC: Well, an IVA or a CVA is a statutory compromise, you'll also hear it called a scheme of arrangement. That's between the debtor and the creditors, and under that arrangement, creditors agree to accept repayment on revised terms. Usually, when we say revised terms, we mean accepting less than the full amount that is owed, or accepting the repayment over a longer time, or most commonly a combination of both of those things.

Alex Bailey: Well, that doesn't sound very attractive to a creditor, less money being repaid and over a longer time.

Iris Ferber KC: Very true, but it all depends on the alternative. With an IVA or a CVA, creditors could end up recovering more if they allow the debtor to continue operating than they would, possibly, by insisting on their full rights and forcing the debtor into a terminal insolvency procedure.

Alex Bailey: Well, if it's that good why isn't everyone doing this then instead of winding up a company or simply going bankrupt?

Iris Ferber KC: Well, the arrangements are not suitable for everyone, and it depends on the circumstances of the debtor, the commercial viability of the proposal, and most basically, it depends on the willingness of creditors to support it.

Alex Bailey: So, let's take a more detailed look at how IVAs and CVAs operate, when they might be appropriate, how they are approved, and ultimately, whether they do offer a better alternative to bankruptcy and liquidation.

Shall we start with IVAs?

Iris Ferber KC: Yes let's.

An IVA is a formal, legally binding arrangement, it stands for Individual Voluntary Arrangement, between an individual debtor, a person, rather than a company, and their creditors.

The statutory framework is Part 8 of the Insolvency Act and Part 8 of the Insolvency Rules, and shall we get into this, Alex, by describing an example of where an IVA might be appropriate?

Alex Bailey: Yes, absolutely.

So, we've got an individual, let's call him Ben Crupt, and Ben has accumulated about £100,000 in unsecured debts.

Iris Ferber KC: Now, does Ben own a property, Alex, because that could be important?

Alex Bailey: Yes, Ben does own a property, he's also employed, and he earns a reasonable salary, but his level of debts has just reached a point where he can't meet his monthly repayments.

Now, at the end of the month, he has around £400 left but without some intervention, Ben is going to go bankrupt.

Iris Ferber KC: And here is where the IVA comes in, doesn't it, in our example, Alex? Because instead of bankruptcy, Ben goes to see an insolvency practitioner and makes a proposal to his creditors, an IVA proposal, to pay £400 a month to an IVA supervisor and the supervisor would then distribute that amongst the creditors regularly, monthly, for say a term of five years. That's quite a common term for individual voluntary arrangements.

And at the end of the five years, the arrangement could include Ben remortgaging his house to make a final additional payment.

Alex Bailey: Now, Iris, there's some mention there of Ben's house, that's obviously going to be important to him. So, will Ben keep his house if he goes for an IVA?

Iris Ferber KC: Yes, that is an important aspect. As long as Ben keeps up the payments that have been agreed as part of the IVA, he will keep his house. The IVA, if it is complied with, protects his home.

Alex Bailey: And at the end of the five years, what happens then?

The remaining debts are written off?

Iris Ferber KC: They are, yes, but only as long as Ben has maintained the payments.

Alex Bailey: And what about the mortgage on the house or any other type of secured creditor?

Iris Ferber KC: Right, secured creditors are different, and this is important.

Unless they consent, they don't go into the IVA. The IVA can still happen, but if the secured creditors don't want to go into the IVA, then they remain outside it, and that means in practice that Ben has to keep making his payments to those creditors, his secured creditors, on top of his IVA payments and if he doesn't, they can take steps to enforce their security. So, his mortgage of his home means he could lose his home.

Alex Bailey: So, Ben has got to keep paying his mortgage throughout the term of the IVA, and I think that's very important. But say, for instance, what if Ben didn't own his own home and instead, he was renting, but he had substantial rent arrears?

What then?

Iris Ferber KC: That's a bit different, the past rent arrears, that's a debt, and that can go into the IVA but what that can't do is stop the landlord from pursuing possession of the rented property, and that's because possession proceedings don't necessarily go away when rent arrears are paid off. Landlords can still seek possession for, for example, persistent late payment of rent or all sorts of other things.

Alex Bailey: Okay. Now let's say that we have a situation where an IVA looks like it could work. What's the process?

Iris Ferber KC: The process usually begins with the debtor getting the advice from an insolvency practitioner, which we've mentioned before. Insolvency practitioner is usually shortened to IP.

So, Ben goes and sees an IP, if in discussions with the IP an IVA seems appropriate, the IP then acts as the nominee, in other words, they assess and prepare a report on the IVA proposal for Ben.

Alex Bailey: Okay. So can Ben, as the debtor, impose an IVA on his unsecured creditors?

That seems a bit unfair to me, or is it the case that instead this is a proposal, and they then need to give their approval?

Iris Ferber KC: Yes, exactly, that's right.

The next stage after the proposal is the creditors have to vote, and they vote about approving or not approving the IVA. Approval generally requires at least 75% by value to vote in favour, and 'by value' means by value of the debt, of the sums owed. There's also an important additional protection for creditors who are not associates of Ben.

Associates are family members or companies that the debtor is connected to and that additional protection is this, that the IVA also can't be approved even if by value more than 75% have voted for it, can't be approved if more than half in value of non-associated creditors vote against it. So, there are two votes effectively going on, and in simple terms, Ben's mum and dad can't outvote his other creditors.

Alex Bailey: So, it's an additional, protection there.

Now, turning to the weight of the vote again, that's based on the value of the debt, so doesn't matter about number of creditors.

Iris Ferber KC: Correct and the simplest way to think about this is that if you owe more than 75% of your debt to one person in terms of the amount of your debt, they're going to have the deciding vote.

Alex Bailey: So that's the 75%, but what happens to the remaining 25% or those creditors who vote against it?

Iris Ferber KC: Well, if the IVA is approved the arrangement will bind all the creditors who are covered by the statutory scheme as a matter of law, that includes the creditors who voted against it.

The big exception, as we've already said, is that that rule does not apply to preferential and secured creditors, they can choose to be bound by the IVA, but if they don't consent, they will not be bound.

Alex Bailey: And so, it's a qualifying majority, not a unanimous vote.

Iris Ferber KC: Exactly.

Alex Bailey: And finally, Iris, who is an IVA suitable for?

Iris Ferber KC: Well, of course, there isn't a statutory formula for that, as you'd expect, it would be a very long list with a lot of exceptions if there was.

Generally, as a matter of practice, it's most effective for debtors like our Ben. People who have a regular income, because essentially an IVA involves making regular single payments to the IVA supervisor, who then distributes them amongst the creditors. It's particularly valuable, as well as for debtors that have regular income, for debtors who have assets that they want to protect, and debtors who have a professional reputation that going bankrupt would damage.

Now, in our example, if Ben didn't have a house that he owned, if he didn't have assets to protect, and certainly if Ben did not have a regular income from which he could make his regular payments, then he's realistically going to be considering other options, not IVA.

Alex Bailey: Yes, and we should also mention the fact that IVAs can be challenged by creditors, there being two grounds: unfair prejudice and material irregularity in the procedure.

Iris Ferber KC: Okay, and finally, should we talk a bit about what happens when an IVA fails?

Because around a third of IVAs do fail, and almost all of those in the first three years and by fail, we mean the creditor defaults on the agreed payments.

If that happens, the IVA supervisor or any creditor bound by the arrangement has a special right to petition for bankruptcy.

Alex Bailey: Right.

Let's move on now to CVAs, Company Voluntary Arrangements, which are in Part 1 of the Insolvency Act.

Iris Ferber KC: Okay, these are the same structure, but because it's a company, not a person, some of the detail is different.

First thing that's different is that a CVA proposal usually comes from the directors of the company, although an administrator or liquidator can propose one as well.

Then there is a nominee report, as with an IVA, but then there are two votes, not one. You remember we talked about a creditor's vote where there is a 75% threshold and a 50% threshold, well with a CVA, there is the creditor vote, and then separately there is the member vote as well.

In other words, a vote of shareholders.

Alex Bailey: Yes, and what about the thresholds for getting a CVA agreed?

Iris Ferber KC: Well, they are the same as what I just mentioned for IVAs, so 75% by value for creditors, subject to the same unconnected creditor 50% safeguard.

The members vote is different, that is a simple majority vote by shareholding, so if holders of more than 50% of the shares vote for, then that's a carried majority vote.

And importantly, Alex, if members and creditors vote differently it's the creditor's decision that counts and the other thing that's different is that a member is another type of person that can apply to court to challenge a CVA, and obviously with an IVA, there's no shareholder, so there's no right like that.

Alex Bailey: Yes, and the challenges are on the same grounds again, so that's procedural irregularity or unfair prejudice.

So, Iris, I ask this question again, but when will a CVA be appropriate?

Iris Ferber KC: Well, this is sort of analogous to the IVA answer, but of course because it's a company, not an individual, it is slightly different.

We're then talking about whether the business is fundamentally viable, which is kind of similar to does an individual have a regular income, isn't it?

Is this a company which has cashflow, which has a viable business, but it's accumulated historic debts that it isn't currently managing to pay from its cashflow?

Alex Bailey: So, it protects businesses that are viable from being forced into liquidation, where stores might close, employees would lose their jobs, and creditors might recover only a small proportion of what they are owed, if anything?

Iris Ferber KC: Yes, exactly.

A CVA offers an alternative to all of that. The company could propose that its creditors accept, for example 40p in the pound (£) payable over a period of three years.

That then gets weighed up by the creditors, and they assess whether that 40p in the pound (£) is better than the likely distribution in a liquidation.

Alex Bailey: What about commercial tenants who are struggling on the high street with high rents? We often see that.

Should they be considering CVAs?

Iris Ferber KC: Well, I expect property lawyers listening to this podcast will know that situation very well, the retail landlord CVA or the retail CVA.

These used to be standard tools for high street businesses with too many unprofitable stores. There was a time when there were a lot of these around, perhaps at the moment there are a bit less, but the basic idea is that the lease gets compromised, this is the common way of doing it.

Lease is compromised, the rent is cut or even switched to turnover-based rent. Particular stores might be closed, and the controversy about this was that landlords complained very loudly that they were the ones bearing the brunt of the downsides of these CVAs. They were being forced into these arrangements, and they fought back, and there were several high-profile unfair prejudice challenges by commercial landlords.

Alex Bailey: Yes, and that fight back by the landlords seemed to reach its high point in 2019 in the case of *Discovery (Northampton) v Debenhams*.

Now, in that case, the High Court did uphold that particular CVA, but it also clarified that CVAs couldn't strip landlords of their proprietary right to forfeit the lease.

Iris Ferber KC: Yes, you said Alex, that was the high point, and I think that's right because a couple of years later, 2021, we had *Lazari Properties v New Look*, which was not a good day in court for commercial landlords. That was the High Court case which decided that treating landlords differently from other creditors was not an unfair prejudice for two reasons, main reasons.

Firstly, compromising the lease was what made the rescue of the company viable, possible. So, it was important that the lease, was compromised in order to make the CVA work and secondly, again very importantly, the landlord was no worse off under the CVA than it would've been with a company administration.

So, the takeaway is this - a well-reasoned CVA with a clear comparison against realistic insolvency alternatives is actually very hard to challenge.

Alex Bailey: Let's again turn to the company's secured and preferential creditors.

What about those?

Iris Ferber KC: Well, that's just the same as the IVA.

They are only bound by the terms of the CVA if they choose to consent, and for companies in financial trouble, perhaps more than with individual bankruptcy situations, that's a significant issue with CVAs

because for companies it is often the secured lender that is the main problem for the company.

If that is the situation and the secured lender is not willing to be included in the CVA, then a CVA might not work.

Alex Bailey: So, to summarise, you want to firstly ask is there a viable, profitable business that is weighed down by debt or onerous contracts?

Are the pressing creditors mainly unsecured?

If the answer to both of those questions is yes, a CVA may well work, but if the business model is fundamentally broken, a CVA just delays the inevitable and can actually act to increase the debts.

Iris Ferber KC: Okay, so when considering voluntary arrangements, you can probably tell from what we've been talking about, Alex, that we're always comparing the voluntary arrangement with the alternative, the terminal procedures of bankruptcy or liquidation, so let's talk about that.

What are the advantages of voluntary arrangements by comparison, and what are the disadvantages?

Well, start with the advantages.

First, continuity, particularly for companies. Trading, employment contracts continue, commercial contracts continue, the company is preserved as a going concern.

Alex Bailey: Yes, and in the right circumstances there should be better returns for creditors than the alternative, and that's really the commercial argument for creditors to vote yes.

Iris Ferber KC: There's also flexibility in CVAs and IVAs, isn't there?

It's ultimately a sort of contract backed by statute, the terms are bespoke. You can include payment holidays, deferrals, particular asset disposals that take place at particular stages, arrangements amounting to debt for equity swaps, all sorts of things that you can include in there.

Alex Bailey: Yes, and something else that can be really significant is lower insolvency costs and less court involvement than bankruptcy, administration, or liquidation when the costs can be enormous.

Iris Ferber KC: And there are all sorts of collateral consequences of bankruptcy and liquidation that don't apply to voluntary arrangements.

Obviously for individuals there's all sorts of restrictions when you're declared bankrupt, and particularly for companies when there is a liquidation there will be automatically an office holder's conduct report on the directors of the company, and that does not happen with a CVA.

Alex Bailey: And finally, the binding effect. A dissenting minority cannot block the deal.

Okay, so we've been through the positives.

What about the drawbacks?

Iris Ferber KC: Well, the big one, of course, is the inability to force the secured and preferential creditors into the voluntary arrangement. We've talked about that during the course of this podcast, that's the most important problem.

There is also a patchy protection in terms of moratorium from enforcement. For some types of voluntary arrangement, there isn't any statutory bar on creditors enforcing at all and for companies, there is a solution to that, which is that Part A(1) of the Insolvency Act contains a statutory moratorium procedure, so companies could consider both a CVA and a statutory moratorium.

Alex Bailey: And another issue is fragility, multi-year arrangements, as it's been said, often fail, and a failed IVA can end up in bankruptcy anyway.

Iris Ferber KC: The other thing that's rather different and important is that IVAs and CVAs have weaker powers of investigation. A voluntary arrangement supervisor does not have the powers of a trustee or a liquidator to investigate transactions, and indeed to reverse transactions, such as transactions that are undervalue that have taken place before the insolvency event.

So, if creditors suspect misconduct, they might actually prefer terminal procedures, even if that means less realisation.

Alex Bailey: There is also that challenge risk, unfair prejudice, and material irregularity applications can unwind the arrangement.

Iris Ferber KC: So, is it fair to say, do you think, Alex, that in short it's a trade-off?

Alex Bailey: Absolutely yes.

Iris Ferber KC: And terminal procedures give what? Finality, full investigation, but especially for companies, they destroy value. Voluntary arrangements preserve value, but they do depend on creditor support, viable future, and everyone sticking to the deal.

Alex Bailey: Yes. So, shall I try and do a summary in one minute or under?

A voluntary arrangement is a statutory compromise. The debtor stays in control, it binds all creditors entitled to vote, but importantly, it needs 75% by value of creditors voting in favour, and 50% by value of those unconnected creditors also voting in favour.

Now, for CVAs, members vote too, but the creditor's vote makes the decision.

Secured and preferential creditors are not bound unless they choose to consent, and voluntary arrangements can be challenged, but only for unfair prejudice or material irregularity and if you are challenging, you have to act quickly.

Iris Ferber KC: And one final practical tip, if a client receives an IVA or CVA proposal, don't just file it away - check how your client is going to be treated by comparison with other creditors in the proposal, compare the proposal to the insolvency alternatives, and note the deadlines, the voting deadline and the challenge deadline.

Alex Bailey: Thank you, Iris. That's been very helpful and thank you everyone for tuning into this last episode of our mini-series on insolvency.

We hope you also found it helpful and enjoyed the episode, and indeed, the whole series.

Iris Ferber KC: We do hope you'll tune into our next series coming up in the new year, which is all about charging orders and enforcement.

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Thank you for listening.