CVAS IN SCOTLAND AND THE R3 MODEL

Time for a rethink?

ADDLESHAW GODDARD

TIME FOR A RETHINK?

Company Voluntary Arrangements (CVAs) are an insolvency procedure established under the Insolvency Act 1986 which allow a struggling company to reach a compromise on debts due with a sufficient majority of creditors, thereby avoiding a formal insolvency.

They have primarily been used only by large high street retailers and are not often considered, particularly in Scotland, a realistic option for small and medium companies (SMEs).

In the face of the COVID-19 pandemic and with a new model available, we believe it is time for a rethink.

A CVA generally involves either or both of:

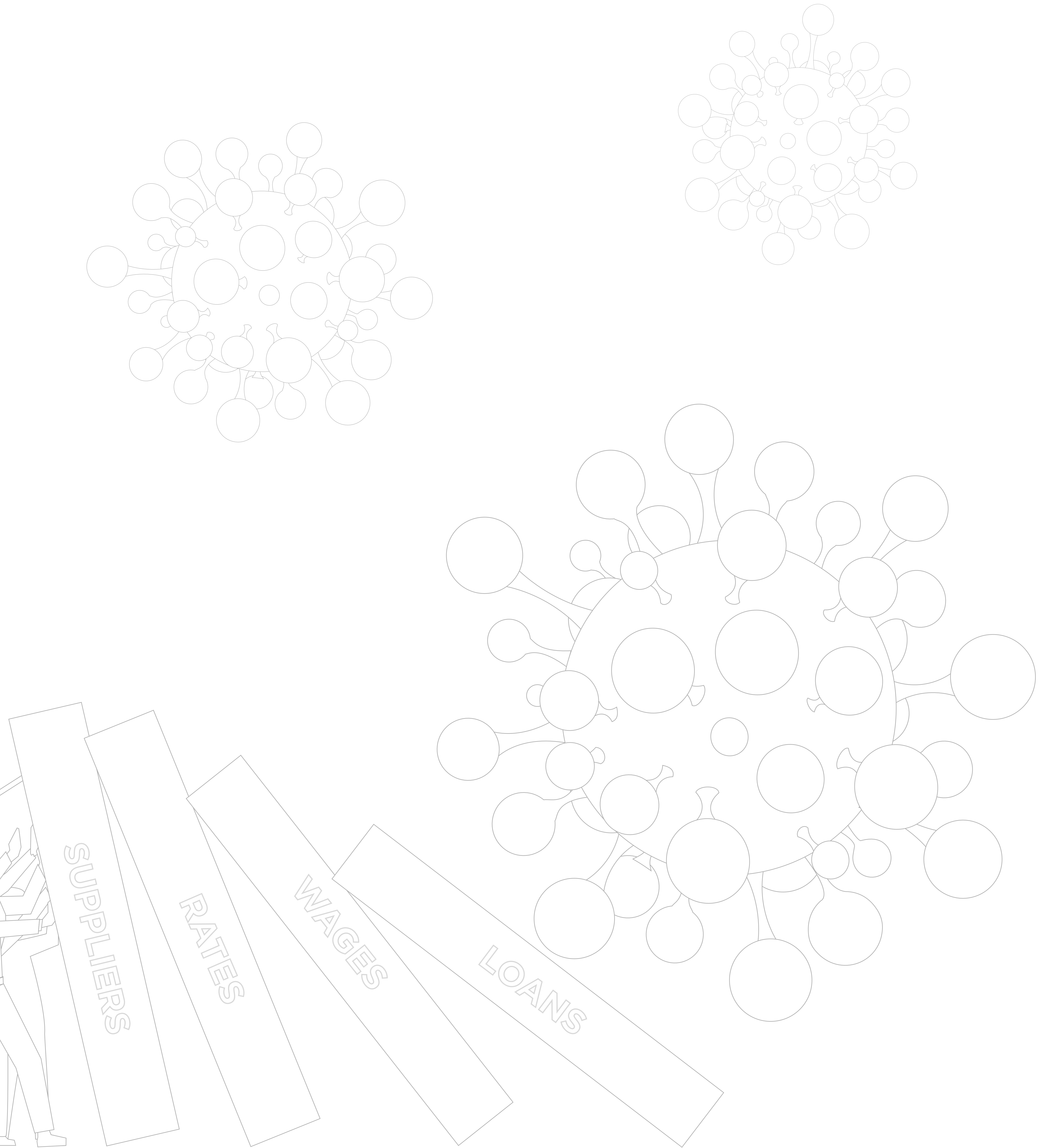
1. Breathing space period, during which the company can trade without repaying its debts; and/or
2. Composition of debts, where the debts of certain creditors (or classes of creditor) are reduced.

They have been most widely used as a tool for the reorganisation of the rental obligations of large, multi-site retailers (recent examples include Pizza Express, Jamie's Italian, Debenhams, and House of Fraser).

On the other hand, their use in the rescue of SMEs has been much less enthusiastic. In Scotland, a market where the SME remains dominant, they account for only a handful of recorded restructurings each year.

The reasons for this appears to be rooted in a widespread perception across the market that CVAs are better suited for complex, multi-creditor and multi-site restructurings, require a great deal of negotiation and documentation, and incur significant legal and insolvency practitioner fees.

The lack of an automatic statutory moratorium is also undoubtedly to blame, although this has now been partly addressed by a new moratorium of general availability under the Corporate Insolvency and Governance Act 2020.



COVID-19'S IMPACT

Many SMEs, particularly those across the hospitality, entertainment and retail sectors, will continue to face significant challenges into 2021.

These challenges include new and unexpected liabilities, long periods of reduced income, and an inability to service existing debt. For most companies, these will be temporary and a direct result of the pandemic's effects, rather than due to systemic issues within their business or market.

While the UK Government has introduced a range of protective measures, including temporary insolvency law provisions, the furlough scheme and a package of emergency business loans, the impact of COVID-19 cannot be prolonged indefinitely.

As the Government's measures wind down, CVAs, being primarily intended to facilitate a business rescue through use of a breathing space period, could be an ideal insolvency tool for deployment in the post-COVID recovery efforts of many SMEs.

In brief, a CVA could give businesses much needed time to get back to trading normally and profitably, before then turning to discharge their accrued debts.

THE R3 MODEL

In order to address historic reticence and facilitate the wider use of CVAs by companies hit by COVID-19, R3 – the UKs leading association for restructuring and insolvency professionals – has prepared a model CVA that can be used by any company seeking to enter into a CVA with its creditors (R3 Model). The suite of documents includes a CVA Proposal and a set of Standard Conditions and was drafted in consultation with the UK Government and HMRC.

It is hoped that the availability of the R3 Model can ensure time and costs savings and therefore allow CVAs to be more accessible to the SME market than ever before, perhaps allowing the insolvency market to rethink their historic approach.

Addleshaw Goddard led on the development of the Scottish versions of the R3 Model, and we are pleased to make house-version of the R3 Model available via the links below. However, the R3 Model is a standard form document which should only be used as a starting point to be discussed with insolvency practitioners and legal advisers.

It is not a substitute for tailored and professional advice.

PROBLEMS. POSSIBILITIES.
COMPLEXITY. CLARITY.
OBSTACLES. OPPORTUNITIES.
THE DIFFERENCE IS IMAGINATION.

Our Scottish restructuring team would be happy to take a call to discuss the best use of the R3 Model in the recovery of any specific business.

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