When a group has grown up through mergers and acquisitions the resulting security structures are often overly complex. In trying to overhaul or even just simplify these structures such groups have, to date, had to pay special attention to the problems raised by the financial assistance rules of the Companies Act – S151 et seq. However, both Company Voluntary Arrangements (CVAs) and S425 Schemes of Arrangement can offer valuable exemptions to S151. We have recently used the CVA process to perfect security where otherwise the grant of such security would have been unlawful financial assistance.

This multinational group had given security as part of the funding arrangements for the purchase of a UK Intermediate Holding Company (HoldCo) and Operating Company (OpCo). Under the group facilities, this security was now required to be renewed. However, as part of this process a charge had to be given over both the HoldCo’s shareholding in the OpCo and the inter company debt due from the OpCo to the HoldCo. Because of the previous transaction history of the group, the renewal of the security would fall under the financial assistance provisions of the Companies Act.

This meant that to be able to grant the security legitimately, the HoldCo prima facie needed to comply with the “whitewash” provisions of the Companies Act. This involves the directors making a declaration of solvency which is then reported on by the company’s auditors.

Although the HoldCo and the OpCo were able to pay their current trade creditors in full, their directors were not sufficiently confident of the overall group position to be able to give the statement of solvency, and would not have been able to obtain an auditors’ report confirming that the auditors had no reason to disagree with the statement of solvency.

There was a real risk that the poor trading performance of parts of the group would mean that there would be a default by some other company within the group. If the bank lending were to be called in as a result of this, the primary borrower would not have been able to repay it all at once. This could have led to a call from the parent company to recover funding loaned to the HoldCo which had been on-lent to the OpCo.
The OpCo would not have been able to repay the funds immediately. The HoldCo would only have been able to repay the debt if it were to sell the OpCo, and an immediate disposal of the OpCo would have been likely to be on a forced or discounted sale basis.

The HoldCo was therefore unable to grant the security unless a way could be found to deal with the financial assistance point. If the HoldCo did not grant the security, the group would be in breach of its banking facilities. Thus the HoldCo needed to find a way to cure the default, without breaching the financial assistance legislation.

The method

The method finally chosen was to propose and implement a CVA over the HoldCo alone, leaving the remainder of the group, in particular its subsidiary OpCo, untouched. The key, and indeed only, terms of the CVA were that all creditors would be paid in full in the normal course of business and the security granted.

Usually in a CVA the creditors are compromised, by suffering a reduction in the amount of their debt which will be paid and/or having it paid over a longer period. This was therefore an unusual use of the process: a CVA is, after all, an insolvency procedure and insolvency normally implies that a company cannot pay all of its debts. The secured creditors were reassured that their rights were not impaired, because a CVA cannot affect the rights of secured creditors without their explicit consent.

The short notice period for calling the meetings to approve a CVA (14 – 28 days) allowed the implementation of the arrangement less than four weeks after the agreement to pursue this method. By contrast, a S425 Companies Act Scheme of Arrangement would have taken at least six to eight weeks longer and would have incurred more costs due to the court hearings required before and after the meeting of creditors.

The CVA lasted only a short time while the directors gave the security and the period for any creditor to challenge it passed. None did. The security was perfected, the CVA completed and the group cured the breach of its lending covenants, thus improving its relationship with its lenders. Ordinary creditors continued to be paid in full in the ordinary course of business and there was little, if any, disruption to the operations of the group.

This was not, however, a way of circumventing the requirements of the Companies Act. In order to be confident that this was a legitimate use of the CVA process, Counsel’s advice was obtained to enable the Nominee to be satisfied that this proposal constituted a scheme of arrangement of the HoldCo’s affairs within the meaning of S1 of the Insolvency Act 1986 (one of the two alternative types of CVA). Counsel agreed that it was such an arrangement, given that there was a real risk to the creditors of the HoldCo should the security not be given, which risk would be removed or substantially reduced by giving the security.

Conclusion
The flexibility, rapid implementation and short duration of the CVA made it an excellent solution to this difficult commercial situation. This highlights yet again that the progressive use of insolvency procedures can add real value in restructuring situations.