STATEMENT OF INSOLVENCY PRACTICE 3 (E&W)

VOLUNTARY ARRANGEMENTS

ENGLAND AND WALES

1. Introduction

1.1 This statement of insolvency practice is one of a series issued by the Council of the Society with a view to harmonising the approach of members to questions of insolvency practice. It should be read in conjunction with the Explanatory Foreword to the Statements of Insolvency Practice and Insolvency Technical Reminders issued in June 1996.

1.2 The statement has been prepared for the sole use of members in dealing with both company and individual voluntary arrangements in England and Wales. Members are reminded that SPI Statements of Insolvency Practice are for the purpose of guidance only and may not be relied upon as definitive statements. No liability attaches to the Council or anyone involved in the preparation or publication of Statements of Insolvency Practice.

1.3 The Insolvency Act 1986 (IA 1986) and associated Rules set out a procedure which enables the directors of a company to make a proposal for a voluntary arrangement (CVA) with its creditors. A similar procedure is set out which enables a debtor to make a proposal for a voluntary arrangement (IVA) with his creditors. In the latter case, The Insolvency Rules 1986 (the Rules) specify two types of debtor:

"Case 1": an undischarged bankrupt;

"Case 2": not an undischarged bankrupt.

The CVA procedure is also available to insolvent partnerships.

In the case of both CVAs and IVAs the arrangement must take the form of a composition in satisfaction of the company's or individual's debts or a scheme of arrangement of their affairs.

1.4 The objective of this statement is to set out best practice in relation to the work carried out by members in connection with voluntary arrangements (VAs). Due to the similarities in the law and practice of CVAs and IVAs, this statement is intended to apply to both types of VA, except where otherwise specifically indicated.

The statement has been prepared primarily to address the circumstances where a proposal for a VA is made by the directors of a company or by an individual debtor, but it should also be applied as appropriate where the proposal is made by an administrator or liquidator.

1.5 Members should refer to the relevant legislation, which for a CVA is contained in sections 1-7 (inclusive) of the IA 1986 and rules 1.1-1.30 (inclusive) of the Rules, as amended by the Insolvency (Amendment) Rules 1987. IVAs are dealt with at sections 252-263 (inclusive) of the IA 1986 and rules 5.1-5.30 (inclusive) of the Rules, as amended by the Insolvency (Amendment) Rules 1987.

In relation to CVAs for insolvent partnerships members should refer specifically to Part II of The Insolvent Partnerships Order 1994 which applies Part I of the Act (Company Voluntary Arrangements) with appropriate modifications.

2. Basis of the Arrangement

2.1 The terms of the VA will be contained in the proposal, as modified, which is eventually approved by the creditors. A comprehensive and accurately drafted proposal is therefore fundamental to the arrangement. In view of the importance of the proposal the member should, where the circumstances are complex, consider whether it should be prepared or approved by a lawyer. The contents of the proposal are given further consideration in section 5 and the Appendix.

2.2 In dealing with a VA the member should bear in mind his overriding duty to ensure a fair balance between the interests of the company/debtor, the creditors and any other parties involved. In considering whether to accept appointment as either nominee or supervisor the member should have regard to the ethical guidelines of his authorising body.

3. Initial Contact with the Directors/Debtor

3.1 The directors/debtor should be advised at the initial interview of the member's requirement to maintain independence. The nominee should consider the need for separate representation of any third parties who intend to inject funds or who are otherwise affected by the VA.

3.2 **[IVA]** Where there is a possibility that a VA may adversely affect a spouse, for example in relation to the matrimonial home, the spouse should be advised to take independent advice.

3.3 The member should explain his role as nominee in relation to the directors'/debtor's proposal and of his duty to perform an independent, objective review and assessment of the proposal for the purposes of reporting his opinion to the court and generally balancing the interests of the company/debtor and the creditors. This duty of independence and objectivity arises irrespective of the extent of the member's involvement in drafting the directors'/debtor's proposals. The member should make it clear to the directors/debtor that his duties as nominee cannot be fettered by any instructions of the directors/debtor or any third party.

3.4 It is advisable that the member send a letter of engagement to the directors/debtor setting out in writing their respective duties and responsibilities in relation to the proposal in order to minimise the scope for misunderstandings.

3.5 **[CVA]** In instances where the assets are not already protected by the presentation of an administration petition or by an administration or winding-up order, the member should give consideration to the need for early action to protect the assets. The procedure for a CVA, unlike that for an IVA, does not provide for the court to grant an Interim Order (IO) so as to stay actions and proceedings against the company. Where a stay of proceedings, execution and other legal processes is sought in the interim period, pending consideration of the proposal by the meetings of creditors and members, this would normally entail an application for an administration order but may exceptionally entail a petition for the winding up of the company and the appointment of a provisional liquidator. If, however, a winding-up petition has been presented against the company an application may be made for the court to stay actions and proceedings against the company under section 126 IA 1986

3.6 **[IVA]** Where the assets are not already protected by a bankruptcy order the member should give consideration to the need for early action to protect the assets. This could involve the preparation of an estimated statement of affairs and an embryonic proposal so as to expedite the application for an IO and any other appropriate orders.

4. Statement of Affairs and Obtaining Additional Information

4.1 The statement of affairs should detail the nature and amount of all the company's/debtor's assets and liabilities, including the liabilities set out in paragraph 4.3(a)(i) - (vii) below. A misstatement of the amount of the assets and liabilities can constitute a 'material irregularity' (within the meaning of sections 6 and 262 IA 1986) being a ground on which an approved VA may be challenged by an aggrieved creditor. In addition, a director/debtor commits an offence if he makes any false

representations or commits any other fraud for the purpose of obtaining the approval of the creditors to the proposed arrangement. The directors/debtor should be informed of these dangers.

4.2 **[IVA]** It should be noted that a Case I debtor who has delivered a statement of affairs under section 272 or section 288 need not deliver a further statement unless so required by the nominee.

4.3 The member's approach should cover the points listed below:

(a) Creditors

The member should require the directors/debtor to provide details of all known or possible liabilities including:

(i) claims which are fully or partly secured: the status of the accounts and the existence of any arrears should be established;

(ii) preferential claims;

(iii) guarantee liabilities;

(iv) claims for breach of contract, including claims in respect of faulty and incomplete work and hire purchase and leasing agreements;

(v) creditors who are:

[CVA] persons connected with the company ('connected persons', as defined in section 249 IA 1986);

[IVA] 'associates' (as defined in section 435 IA 1986);

(vi) guarantors of the company's/debtor's debts, including connected persons/associates;

(vii) debts for an unliquidated amount or any debt whose value is unascertained, including particularly:

contingent liabilities;

the potential for liabilities arising under property leases (of both present and past tenancies).

He should also:

(viii) identify any creditors who have commenced execution or any other legal process;

(ix) consider the possibility of early informal discussions with the key creditors, including government departments, to establish their views;

(x) obtain independent confirmation from any bank or other financial institution of their intention to continue to provide financial support to the company/debtor where this is necessary for the purpose of the arrangement;

(xi) establish whether connected persons/associates may consider withdrawing or deferring their claims.

(b) Assets

The member should take steps to satisfy himself that the value of the assets is appropriately reflected in the statement of affairs. Where the value of an asset is material to the outcome of the arrangement consideration should be given to obtaining corroborative evidence as to its value. The member should also ensure that a comprehensive schedule of non-trading assets in which the company/debtor has an interest has been prepared together with explanatory notes. If there is a business, the member should consider, in conjunction with the directors/debtor, the manner in which that business is to be dealt with.

If the business is to be continued by the company/debtor, a 'business plan' should be produced to justify this decision stating the assumptions on which it is based, and in appropriate detail having regard to the circumstances and size of the undertaking. The member should satisfy himself that the plan has a reasonable chance of success.

(c) Antecedent Transactions

The member should enquire as to:

(i) possible transactions at an undervalue (sections 238, 339 and 423 IA 1986);

(ii) payments which may be preferences (sections 239, 340 IA 1986);

(iii) **[CVA]** floating charges which would be invalid in the event of administration or liquidation (section 245 IA 1986);

(iv) **[CVA]** charges which would be void against a liquidator, administrator or creditor in the event of liquidation or administration (section 395 CA 1985);

(v) liabilities which may be extortionate credit transactions, both those outstanding and paid (sections 244, 343 IA 1986).

(d) General

The member should also consider:

(i) whether the person(s) making the proposal is/are credible and making a full disclosure. The member should explain the consequences of making false representations;

(ii) whether (any of) the directors/debtor has been involved in any previous business failure, either individual or corporate, and if so the details of that failure and the person's responsibility for it;

(iii) the timetable for the VA.

The extent of the member's enquiries into these issues is likely to vary according to the particular circumstances of the case but should be such as will enable the member to properly discharge his duty to report to the court as nominee (see section 6 below).

5. Consideration of the Proposal

5.1 Throughout his consideration of the above factors the member should be forming his opinion of the appropriate method of dealing with the company's/debtor's affairs. Although this will be partly a subjective review of the factors already referred to, the member should take into account:

(a) the directors'/debtor's attitude;

(b) the likelihood of the company/debtor adhering to the terms of the proposal;

(c) the extent of the control over the assets exercised by the company/debtor as opposed to the supervisor of the proposal, bearing in mind that in a VA the assets do not automatically vest in the supervisor by operation of law;

(d) the removal/absence of the restrictions otherwise imposed by formal winding up/ bankruptcy.

5.2 In view of the importance of the contents of the proposal the member should, prior to submitting his report and supporting comments to the court, satisfy himself that the proposal, as modified, is structured and drafted in such a way that the terms of the VA can be clearly understood and that the arrangement is likely to proceed to a successful conclusion.

5.3 The member should ensure that the proposal addresses all those matters prescribed by the Rules. The member should also consider the inclusion of appropriate other provisions in order to facilitate the practical implementation of the arrangement (see Appendix) but should bear in mind that the terms of a proposal cannot extend or fetter the jurisdiction of the court. The proposal should also set out what action is to be taken in the event of deviation from, or failure of, the arrangement.

6. The Nominee's Report and Comments

6.1 In the case of *Re A Debtor (No 140 IO of 1995), Greystoke v Hamilton-Smith and Others* ([1996] 2 BCLC 429; [1997] BPIR 24) the court set out three tests which the nominee should apply before concluding that a meeting should or should not be summoned and held that he should satisfy himself on all three counts. They are:

(a) that the company's/debtor's true position as to assets and liabilities is not materially different from that which it is represented to the creditors to be;

(b) that the directors'/debtor's proposal has a real prospect of being implemented in the way it is to be represented it will be;

(c) that there is no already-manifest yet unavoidable prospective unfairness.

6.2 If the nominee cannot satisfy himself that the above three conditions are met but still recommends that a meeting should be held, he should explain in his comments the basis on which he is making that recommendation and qualify his comments so that the fact that the conditions are not met is conspicuously brought to the attention of the court.

6.3 If the nominee reports that a meeting of creditors (and **[CVA]** the company) should be held he is required to set out his comments on the proposal and to annex them to his report to the court. The matters upon which the nominee will wish to comment will vary from case to case but they should normally include:

(a) the extent to which the nominee has investigated the company's/debtor's circumstances;

(b) the basis upon which assets have been valued;

(c) the extent to which the nominee considers that reliance can be placed upon the directors'/debtor's estimate of the liabilities to be included in the VA;

(d) information on the attitude adopted by the directors/debtor with particular reference to instances of failure to co-operate with the nominee;

(e) the result of any discussions between the nominee and secured creditors or other interested parties upon whose co-operation the performance of the VA will depend;

(f) information on the attitude of any major unsecured creditor which may affect the approval of the arrangement by creditors;

(g) details of any previous history of failures in which (any of) the directors/debtor has been involved, in so far as they are known to the nominee;

(h) an estimate of the result for the creditors if the VA is approved, explaining why it is more beneficial for creditors than any alternative insolvency proceeding;

(i) the likely effect of the proposal's rejection by the creditors;

(j) details of any claims which have come to his attention which might be capable of being pursued by a liquidator/administrator/trustee in bankruptcy if one were appointed;

(k) where the conditions set out in paragraph 6.1 above have not been met, the basis on which the nominee is recommending that a meeting be held.

6.4 If the nominee reports that meetings should not be held he must give his reasons for that opinion.

7. The Meeting of Creditors (and [CVA] of Members)

7.1 Notice of the meeting must be given to all creditors whether or not they are intended to be bound by the arrangement. There must be strict compliance with the Rules as to notice of the meeting(s) to ensure that all parties intended to be bound by the arrangement are so bound. The minimum notice period of fourteen days excludes the day of sending the notice and the day of the meeting.

7.2 An approved VA may not be binding on a creditor who claims not to have received notice of the creditors' meeting. When sending out notice of VA meetings the member should consider either obtaining certificates of postage (forms available from the Post Office) or himself providing a certificate under Rule 12.4(3) so that he can prove when and to whom notice was sent.

7.3 Before the creditors' meeting the nominee should take the following steps:

(a) record all proxies received in advance of the meeting, and details of claims;

(b) complete the meeting record as far as possible detailing the names and voting value of creditors;

(c) discuss with the directors/debtor any modifications suggested by creditors prior to the meeting;

(d) review the proposal in the light of creditors' responses and possible changes in circumstances;

(e) prepare a brief report for presentation at the meeting, summarising the proposal, outlining the likely effects of acceptance and rejection and giving details of any changes in circumstances which have arisen since the proposal was sent to creditors;

(f) consider voting rights and requisite majority.

7.4 The chairman must decide the amount for which creditors are to be allowed to vote. Particular care needs to be exercised in relation to debts for an unliquidated amount or whose value is not ascertained (e.g. contingent claims under property leases). Creditors have no voting entitlement in respect of such claims, and are thus not bound by the VA in respect of such claims, unless the chairman has admitted them to vote having placed upon them, in good faith, an estimated minimum value for voting purposes. Proxies and statements of claim to be used at the meeting may be lodged at any time, even during the course of the meeting (although the courts have taken the view that they have discretion to make orders varying the statutory provisions if the circumstances of the case require).

7.5 After the chairman has presented his report to the creditors' meeting he should allow creditors an opportunity to make comments, ask questions or propose modifications to the proposal.

7.6 **[IVA]** The nominee should request the debtor to attend the creditors' meeting in order to answer questions and to give consideration to proposed modifications. If the debtor is not available to consider modifications which are proposed, the meeting will have to be adjourned as his consent to them is required by law.

7.7 **[CVA]** Although it is not a statutory requirement for directors to consent to modifications, it is recommended that the nominee should find out and report to the meeting their views on any proposed modifications which they may be required to implement if approved.

7.8 If modifications are proposed by a creditor the chairman should give careful consideration to the manner in which he will use specific instructions given to him by creditors to vote for either the acceptance or the rejection of the original proposal. If the words in the proxy form allowing the exercise of discretion in the absence of specific instructions have not been deleted so as to entitle the proxy holder to vote only as directed, the proxy holder is entitled to vote or abstain on any modification at his discretion.

7.9 However, the chairman should consider most carefully the impact of the exercise of his discretion upon the expressed intentions of any creditor who has completed a proxy requiring a vote on any particular resolution. He should bear in mind that, if a creditor is aggrieved that a vote on proposed modifications has been taken and a decision reached which might have been different if creditors represented by proxy had been present at the meeting or had been given the opportunity of amending their proxy, the aggrieved creditor may challenge the decision by an application to the court (sections 6 and 262 IA 1986). Accordingly, the chairman should consider an adjournment or suspension of the meeting to give him an opportunity to explain the circumstances to the creditor or creditors from whom he holds a proxy and to obtain their further instructions.

7.10 If a majority for approval of the VA is not obtained at the creditors' meeting, the chairman may adjourn the meeting, and must adjourn it if it is so resolved. The maximum period for adjournment is 14 days from the original meeting date, but within this period there can be more than one adjournment. The chairman must give notice to the court that the meeting is adjourned. He should also consider the need to inform creditors of the adjournment and, where substantial modifications are proposed, of those modifications.

7.11 **[CVA]** If the chairman thinks fit for obtaining the simultaneous agreement of the meetings to the proposal, the meetings may be held together. There shall be no adjournment of either meeting unless the other is also adjourned to the same business day.

7.12 **[IVA]** In the event of an adjournment the chairman should consider the need to apply for an extension of the IO.

8. Implementation Following the Meeting of Creditors

8.1 The supervisor's main duty is to ensure that the VA proceeds in accordance with the terms of the agreed proposal. In order to do this he should maintain regular contact with the directors/debtor, obtaining reports as may be appropriate to the case. If the supervisor or directors/debtor consider that the terms of the arrangement may not be achieved then the supervisor should take steps to discuss the situation with the directors/debtor. If actual events suggest a deviation from the terms of the arrangement, the supervisor should take appropriate action. Such action should correspond to further detailed provisions of the proposal. If he is authorised to exercise discretion in any area, and that discretion is exercised, the supervisor should explain the circumstances to creditors (and **[CVA]** members) at the next available opportunity.

9. Conclusion/Termination of the Arrangement

9.1 Where the arrangement has been fully implemented the supervisor should conclude his administration as expeditiously as possible.

9.2 In circumstances where the implementation of the arrangement becomes frustrated or the anticipated distribution to creditors is to be materially different from that indicated in the proposal, it will be necessary to consider how matters should proceed. The term 'failure of the scheme' or 'failure of the arrangement' is not an expression found in the Act or Rules and it is essential, as stated in paragraph 5.3 above, that the proposal should have set out in specific terms the circumstances in which it shall be deemed to have failed and state what action the supervisor is required to take in the event of failure. Where failure has occurred the supervisor should notify the creditors accordingly and advise them what action he has taken or proposes to take.

9.3 **[IVA]** Where the debtor commits an act of 'default' (within the meaning of section 276(1) IA), the supervisor is empowered by the Act to initiate bankruptcy proceedings against the debtor. Whilst 'failure' and 'default' will often be synonymous, this will not always be the case.

9.4 In the event of failure particular care must be taken to ascertain who is entitled to the remaining assets, and in the event of the presentation of a winding-up or bankruptcy petition, whether disposal of the assets would be void under section 127 or 284 of the Insolvency Act 1986.

9.5 Where a supervening winding-up/bankruptcy order is made against the company/debtor, the supervisor should advise the official receiver of the circumstances. If the effect of the order is that the VA is terminated, the supervisor should arrange for the prompt handover of assets, funds, books and records to the official receiver or liquidator/trustee in bankruptcy as appropriate.

9.6 So far as the supervisor's final account is concerned, the Rules envisage a situation whereby a VA is concluded essentially in accordance with what was proposed. If the VA 'fails', the notice to be sent to creditors (and **[CVA]** members) under the Rules that the VA has been 'fully implemented' should be modified to reflect the circumstances giving rise to termination of the VA.

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Appendix

Voluntary Arrangements: Contents of the Proposal

The proposal should include sections covering the following:

(a) the background to the arrangement, including details of the circumstances in which the company/debtor has become insolvent and including any relevant personal circumstances of the directors/debtor;

(b) the statement of affairs, which should include full details of business assets and business liabilities (and **[IVA]** also personal assets and liabilities). Creditors should be provided with a clear comparison of the estimated outcomes of the VA and of winding up/bankruptcy including comparative costs;

(c) the actual financial proposal to be put to the creditors. This section should include:

(i) details of assets to be realised for the benefit of creditors and details of those which are to be excluded from the proposal, together with the reasons for the exclusion and whether alternatives are to be suggested;

(ii) proposals regarding after-acquired assets and windfall gains;

(iii) proposals regarding future profit/ income over a specific period;

(iv) details of any contributions from the debtor (e.g. from future earnings) including the amounts (or the basis on which they are to be computed) and frequency;

(v) whether third party funds are to be injected;

(vi) **[IVA]** the debtor's specific proposals with regard to any interest he may have in his dwelling house;

(vii) details of creditors to be included in the arrangement. It is important that every creditor or potential creditor including preferential creditors, who will invariably form part of the arrangement, should be considered, to minimise the possibility of some creditors not being bound by the terms of the VA. Secured creditors should also be included if they are to form part of the proposal. If they are not, they should be provided with a copy of the proposal, since if this adversely affects such a creditor's security, their consent must be obtained. The date to which claims are to be calculated should be stated together with details of arrangements with regard to, if appropriate, secured creditors and hire purchase or leasing agreements;

(d) the intentions with regard to any business operated by the company/debtor stating in particular whether the business is to be continued, and if so, the extent to which, if any, the supervisor shall exercise any degree of control over the business. If the supervisor is not to exercise any degree of control, this should be specifically stated in the proposal. The purpose or aim of continued trading should be stated: have new opportunities been created that will generate profits to pay creditors; is the trade being wound down to generate funds from asset realisations or is the business being marketed (and if so, how) as a going concern? Consideration should be given to including a summary cash flow projection;

(e) the powers, duties and responsibilities of the supervisor. This will need to deal with the question of admission or rejection of claims, the manner in which funds are to be distributed to creditors and the basis on which the supervisor is to report to creditors;

(f) miscellaneous matters which under the Act or Rules need to be included.

Other matters which the member should consider in order to facilitate the practical implementation of the proposal:

(g) whether a committee of creditors is to be appointed and if so what will be its powers, duties and responsibilities;

(h) what will happen to surplus funds arising, for example, from more beneficial trading than was originally envisaged, when the VA is concluded;

(i) confirmation that when the terms of the VA have been successfully completed the creditors will no longer be entitled to pursue the company/debtor for the balance of their claim: that the VA is in full and final settlement of their liabilities;

(j) what will happen to unclaimed dividends or unpresented cheques when the VA is concluded;

(k) how to deal with creditors who have not made claims;

(l) the power of the supervisor to summon ad hoc meetings of the VA creditors for the purpose of obtaining their views and in particular for obtaining their approval to proposed modifications to the VA;

(m) the requisite majorities required to pass resolutions at ad hoc meetings of creditors (and **[CVA]** members) summoned during the course of the VA;

(n) **[IVA]** the position with regard to maintenance orders or attachment of earnings orders in favour of the debtor's spouse, and with regard to fines;

(o) in view of the fact that the assets do not automatically vest in the supervisor it may be advisable for the proposal to provide for such vesting or for the supervisor to be granted a charge over assets, or to be given some other suitable form of security or for a declaration of trust or power of attorney to be executed;

(p) the attitude to be adopted with regard to contingent creditors;

(q) the situation with regard to overseas creditors;

(r) the circumstances in which the supervisor is to present a petition for a winding-up/bankruptcy order;

(s) the situation with regard to tax liabilities arising on disposal of the company's/debtor's assets, or the future income of or gifts to the company/debtor from a third party, that are applied towards the payment of creditors' claims;

(t) the approach to be adopted in respect of creditors who inadvertently do not receive notice and are therefore not bound;

(u) the inclusion of power for the supervisor or any creditor's committee to be able to determine that a VA has no future and petition for winding up/bankruptcy and authority to retain and use funds from the VA for such costs.

When considering these issues the member should have regard to any relevant decisions of the court which have clarified points of law where the statutory provisions are either silent or ambiguous.