BULLETIN

RESTRUCTURING | FAVOURING TENANTS OVER LANDLORDS

Do the recent court decisions on Company Voluntary Arrangements look to favour tenants over their landlords?

BY MATTHEW RICE

It is indisputable that the Covid-19 pandemic and the various lockdowns have been tough - particularly on landlords. But does a new breed of Company Voluntary Arrangements ("CVA") look to push landlords even further?

The recent court decisions in New Look and Regis make some unsettling reading for landlords. The prospect of a tenant's being able to force through a new lease arrangement without consent is certainly a troubling one.

I will provide an overview of these judgments, but also see our most recent Insolvency Update which is available at amblaw.co.uk/documents along with all our other bulletins and updates.

New Look

On 13 May 2021 Zacaroli J handed down his judgment on the New Look CVA. This matter arose following a challenge made by a group of New Look's landlords who viewed New Look's CVA proposals as going far beyond the use intended by their jurisdictional basis.

The landlords' key arguments were:

1. that the CVA proposals were not a compromise or agreement within the meaning of s. 1(1) Insolvency Act 1986 because they included multiple "arrangements" on different terms for different creditors;
2. there was no provision or ability for landlords to participate in any upturn of New Look's business;
3. the CVA proposals were unfair because the requisite approving majority were unimpaired creditors; and
4. the proposals constituted improper interference with the landlord's proprietary rights.

In short, each of these arguments was roundly rejected by Zacaroli J who sought to confirm that it was not for the court to assess the 'fairness' of certain clauses and highlighting the importance of the right of the landlords to agree a surrender of the lease rather than agree to the CVA proposals.

In respect of the key arguments Zacaroli found as follows:

1. the jurisdictional scope for CVAs in s. 1(1) of the Act allowed for the differential treatment of sub-groups of creditors;
2. The requirement for 'give and take' (i.e. the landlords' right to participate in an upturn in the underlying business) was a low jurisdictional hurdle and only required the court to compare what creditors would get in the 'relevant alternative';
3. the discounting of unimpaired creditors for the purpose of statutory majorities was not envisaged by the legislation (and indeed in the judge's view would require the entire re-writing of the Insolvency Rules 2016). Accordingly it could not follow that the CVA was inherently unfairly prejudicial on this basis; and
4. the CVA provided landlords with a termination right to agree a surrender of the property rather than accept the terms of the CVA and accordingly there was not interference with their proprietary rights.

Interestingly (and further bad news for landlords) is that the judge also found that there was no general principle that prevents a CVA from reducing rents to a below market rent.

The judgment is clearly a rebuke of the overriding theme of the landlord's arguments that CVAs are meant to be a compromise with a company's creditors rather than a restructuring tool.

Regis

The Regis challenge was similar in context but different in substance to that made by the New Look landlords. The Regis CVA looked to group landlords into a number of sub-groups (numbered 1 to 5) whereby those in sub-group 1 would be unimpaired and the others would suffer a reduction in their arrears and rent going forward.

The CVA was challenged in 6 key areas:

- there had been inadequate disclosure relating to a number of antecedent transactions;
- there were inadequacies with the statement of affairs and the estimated outcome statement which in particular failed to include a value for recoveries in respect of potentially reviewable antecedent transactions;
- that the landlords were unfairly prejudiced by Regis' classification of intercompany loans as 'critical creditors' which resulted in no impairment to their claims against Regis;
- that the landlord's voting and participation rights had been reduced by 75%;
- that Regis' proposals to modify the terms of the lease and in particular the landlord's termination rights were unfairly prejudicial; and
- that in light of the above deficiencies the nominee had breached his or her duties.

Aside from point 3 (and in part point 4), the court rejected the landlord's challenges and together with the judgment in New Look confirms that the CVA can continue to be used as a flexible restructuring tool.

On point 3, the court agreed that the categorisation of inter-company loans as critical creditors was unfairly prejudicial and that the nominees should have questioned this within the report (although did not deprive the nominees of their professional fees). On the issue of reducing the landlords' voting rights the court did not consider this issue but commented that the reduction had not been adequately justified on the facts.

Key Takeaway

Whilst the clarification of the jurisdictional points raised in the challenges will of course be welcomed by the professional community the judgments will clearly be ill-favoured by landlords. Some silver lining is that it appears that the court will be prepared to intervene where a voting reduction is made on a blanket or inadequately justified basis and where a CVA looks to remove a landlord's termination rights.

Landlords should carefully review the proposals and take advice early to encourage a more agreeable consensual process between them and their tenants, AMB Law stands ready to continue to advise our clients on these issues.

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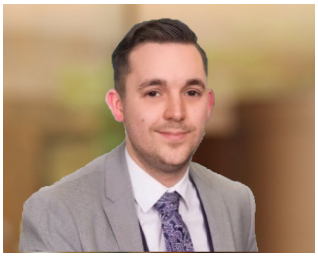

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