

CVAs – Legal Essentials

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CVAs – Legal Essentials

- *What is a CVA?*
- *Controversies*
- *A typical structure of a large retail CVA*
- *Landlords and tenants – are their perspectives reconcilable?*
- *Basic fairness v unfair prejudice following the Debenhams CVA*
- *A minority procedure – CVAs currently account for 2% of company insolvencies – with circa 40 large retail CVAs in the last 10 years (circa 93% are small companies)*

What is a CVA?

- *Legal definition – s.1(1) Insolvency Act 1986*
“...a composition in satisfaction of its debts or a scheme of arrangement of its affairs”
- *Composition – “an agreement to pay part of a debt in satisfaction of the whole”*
- *Scheme of Arrangement – “...is different from a composition and involves something less than the release or discharge of creditors’ debts” – e.g. – a moratorium*

Inland Revenue Commissioners v Adam & Partners [2000] BPIR 986

Wide meaning of the term “voluntary arrangement”

“...the legislature had given to the creditors the power to determine what was or was not in their interests ...There was no restriction in the provisions on the type of arrangements which could be approved by the creditors, provided that they were reasonably capable of being described as a composition or a scheme of arrangement within the meaning of section 1(1).....a creditor who considered that he had been unfairly prejudiced by the voluntary arrangement could make an application to the court challenging the Proposal of the creditors under section 6.”

Requirements for Approval

- *Members*
 - *In accordance with rights under company's articles*
- *Creditors*
 - *Every creditor, secured or unsecured, is entitled to vote in respect of its debt*
 - *Unliquidated and unascertained debts are to be valued at £1 unless chair agrees higher value*
 - *Only unsecured element of debts have value for voting purposes*
 - *Requisite majority is 75%+ of those responding, with not more than half of total value of unconnected creditors voting against*

Limitations on Approval

- *CVA may not:-*
 - *affect right of secured creditor to enforce security except with its concurrence*
 - *Provide for any preferential debt to be paid otherwise than in priority to non-preferential debts except with the concurrence of the preferential creditor concerned*

Challenges to Approval

- *Unfair prejudice*
 - *Vertical comparator – CVA vs alternative process*
 - *Horizontal comparator – treatment of creditors under CVA*
- *Material irregularity*
- *Can be brought by member or creditor entitled to vote*
- *Application to court shall not be made after 28 days from making of report to court of the result of members' meeting and creditors' decision*
- *Court may revoke or suspend approval of CVA or direct further meeting of company's members or decision from the creditors (including whether to approve any revised proposal)*

Controversies

- *Is it “automatically unfairly prejudicial for a CVA to reduce rent payable under leases”?*
 - *Salvage (Lundy Granite) principle – where a company in liquidation or administration uses premises for the benefit of the insolvency the full value of the outstanding rent is recoverable*
- *Contagion – profitable tenants asking for rent cuts as well*

Controversies

- *“Most CVAs are terminated without achieving their intended aims”*
 - *But assessing success or failure is not straightforward*
 - *Company Voluntary Arrangements: Evaluating Success and Failure (May 2018)(Walton, Umfreville & Jacobs) <https://www.icaew.com/-/media/corporate/archive/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx>*

Typical Structure of Large Retail CVA

- *Common factors – large lease portfolios with (frequently) wide geographic spread*
- *Landlords – range from sophisticated institutions owning large shopping centres to private individuals with single premises in a market town*
- *Wide range of financial performance from “jewels in the crown” to “absolute lemons”*
- *Value of individual premises to the company not necessarily the same as value to the landlord*

Typical Structure of Large Retail CVA

- *Value of premises to the company will be set out by its category in the CVA proposal*
- *No set number of categories – but the total number of leases held by the company will likely determine the number of categories*
- *Spectrum of categories will likely range from no changes to contractual terms (the jewels) to rent reductions, early termination and release from dilapidation claims (the lemons)*

Reconciling the Interests of Insolvent Lessees with Landlords

- *Statement of Insolvency Practice (SIP) 3.2*
 - *IP should be satisfied that Proposal for CVA is achievable and that a fair balance is struck between the interests of the company and the creditors*
 - *IPs reports should provide sufficient information to enable the company's shareholders and creditors to make informed decisions in relation to the proposal and the CVA, and report accurately in a manner that aims to be clear and useful*

Reconciling the Interests of Insolvent Lessees with Landlords

- *British Property Federation – CVA Best Practice*
<https://www.bpf.org.uk/sites/default/files/resources/CVA%20best%20practice.pdf>
- *Provides for consultation between the CVA Nominee and BPF*
- *Share late stage draft of Proposal for CVA with a member of the BPF Insolvency Committee*
- *Protocol identifies list of key issues that may need to be addressed*

The Debenham's CVA Challenge

<https://www.bailii.org/ew/cases/EWHC/Ch/2019/2441.html>

- *6 (associated) landlords challenged the approval of the CVA on the following grounds:*
 - *Landlords' claim for future rent did not make them "creditors" within the meaning of s.1 IA 1986*
 - *In reducing rent payable the CVA was unfairly prejudicial to the landlords (the Basic Fairness Argument) – i.e. that a company which makes beneficial use of premises let to it must pay the full contractual rent regardless of what the market rent may be*

The Debenham's CVA Challenge

- *Removal of the landlords' right to forfeiture abrogated their proprietary rights*
- *Landlords treated less favourably than other unsecured creditors without proper justification*
- *Failure to comply with IR 2016 being a material irregularity*

Debenhams CVA Challenge – The Outcome

- *4 of 5 grounds rejected by Norris J*
- *Future rent can be included in a CVA*
- *Retention of property by the tenant at less than the **contractual rent** does not inevitably transgress basic fairness – variation of existing obligations rather than creation of new ones. Lundy Granite principle has no direct application and not suggested by landlords that under the CVA it would receive less than the **current market rent** for the premises*

Debenhams CVA Challenge – The Outcome

- *Right of forfeiture is a proprietary right that cannot be altered by a CVA*
- *Differential treatment of landlords (at above market rates but below the contractual rates in the leases) is justified by the need for business continuity*
- *On the facts (where CVA voted in favour by 94.71% in value of £1.044bn of creditors voting and 82.07% in value of landlord creditors) any irregularity was not “material”*

Debenhams CVA Challenge – The Outcome

- *Most of the landlords appeared to accept that they would be better off under the CVA than they would under an administration*
- *Court exercised its discretion to remove the forfeiture restraint provisions from the CVA but also declared that so modified the CVA is valid and remains enforceable*
- *Permission to appeal granted in February 2020 – likely to be heard by the Court of Appeal in late 2020*

Any questions?
Contact me...



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