Tenant insolvency - how landlords should approach a CVA

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Political and economic uncertainty in the aftermath of the referendum result in the UK has dampened sentiment on the high street and hit consumer confidence.

According to the National Institute of Economic and Research, there is an "ever" chance of Britain falling into recession by the end of next year and the Bank of England has significantly reduced its growth forecast for 2017.

With the retail industry traditionally vulnerable in challenging economic times, landlords must be prepared and know how to deal with financially distressed tenants. Recent bricks-and-mortar retail insolvencies have, to varying degrees, cited high property costs as a partial cause of business failure and tenants have increasingly turned to company voluntary arrangements (CVAs) as a method of trying to restructure their businesses and reduce such costs. Recent examples include BHS and Austin Reed (although in both cases, the CVA proved insufficient to stop the companies entering administration).

In the current climate, aligning commercial landlords’ and retail tenants’ interests is increasingly difficult. Landlords must be mindful of the effect that the terms of a CVA proposed by a tenant might have for them, particularly given the "cramming down" effect of a CVA on dissenting creditors, as discussed below.

What is a CVA?

A CVA is an insolvency and rescue procedure under Part 1 of the Insolvency Act 1986. It allows for a company in financial distress to enter into a legally binding arrangement or compromise with its unsecured creditors. Typically a CVA will involve a rescheduling or reduction of the company’s debts, but a CVA can also change the wider contractual terms between a company and some or all of its creditors.
A CVA is a flexible and relatively cheap process requiring limited court involvement, albeit a qualified insolvency practitioner (known as a “nominee” before the CVA is approved and a “supervisor” once the CVA is effective) is required to implement and supervise the CVA. The supervisor does not take control of the company. The directors remain in office and are responsible for the ongoing trading of the company.

For a CVA to be approved, it must be voted for by at least 75 per cent by value of those of the company’s creditors who attend a creditors’ meeting (in person or by proxy) to consider the CVA proposal (and at least 50 per cent in value of the supporting creditors must be unconnected to the company).

It is important that landlords are aware that once approved (and subject to limited circumstances in which a challenge can be made), a CVA will bind all unsecured creditors regardless of whether they voted for or against the CVA and whether or not they attended the meeting. No unsecured creditor can take any step against the company to recover any debt that falls due within the scope of the CVA, once it is effective.

How might a CVA affect landlords?

In a retail context, landlords do not often take security for the obligations owed by their tenants and so will usually be unsecured creditors of a company. A CVA can offer a mechanism that allows a tenant company to restructure its rent obligations or change the terms of its leases across some or all of its premises, often to the significant detriment of its landlords (and possibly without the consent of all of the affected landlords).

Landlords have had something of a love/hate relationship with CVAs. They are typically promoted by tenants on the basis that the CVA will offer them more than they would otherwise get if the tenant were to enter a more terminal insolvency process such as liquidation. The tenant will look to the positives of a CVA, such as its stores being kept open, rates continuing to be paid (so that the landlord is not having to pay business rates) and the landlord getting payment of some rent, which is better than no rent at all.

However, despite the majority of CVAs being successful—JJB Sports being an example of where the CVA proposal received overwhelming support by landlords and was seen as reasonable and transparent—there have been some where landlords have raised concerns, suggesting that the process was being exploited at their expense and being used to “dump” failing premises.

The flexibility of the CVA tool means that a tenant’s proposals might include anything from a reduction in future rent or amendments to particular covenants in a lease, to more controversial proposals, such as seeking to remove a landlord’s right to forfeit a lease or depriving them of valuable guarantee rights which they might have against a solvent parent company or third party. This last example of “guarantee stripping” was proposed in the Powerhouse CVA. Whilst, in that case, it was successfully challenged by its landlord creditors, the court did acknowledge that it would be conceptually possible for a CVA to compromise a landlord’s right to claim against such third parties.

Practical advice for landlords

- Landlords must be mindful of the implications that the terms of a CVA proposed by a tenant will have for them. The CVA provides a framework for a binding arrangement (even on those who do not consent), but does not dictate the content or shape of a deal. If a landlord is faced with the prospect of one of its tenants entering into a CVA, it should do the following:
  - Act promptly. A company proposing a CVA only has to give 14 days’ notice to creditors of the meeting at which the creditors will consider and vote on the CVA proposal.
  - Carefully review the CVA terms. Landlords should analyse the impact of the CVA in comparison with alternative insolvency regimes, such as liquidation. Every CVA will (to some extent) be unique, so careful scrutiny of its terms is key. A CVA can, under limited circumstances, be challenged within 28 days of its approval being reported if it unfairly prejudices a creditor (in the context of the overall effect of the CVA).
  - Obtain the maximum value of any claim for the purposes of voting. A landlord’s claim will usually comprise (i) a claim for arrears of rent (if any) that exist at the time of the CVA meeting; and (ii) a claim for future rent which has not yet fallen due and dilapidations. For the purposes of voting in the CVA meeting, the second element of a claim, being an unascertainable sum, will be prescribed a value of only £1.00, unless the CVA proposals state otherwise or the chairman of the creditors’ meeting agrees to put a higher value on it. Landlords should be prepared to submit evidence for a higher value to be placed on this second element, for example where it is

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proposed that the company will vacate the premises, expert evidence of how long it is likely to take to be able to re-let the premises or, for dilapidations claims, a schedule with an independent assessment of the costs for remedying the issues.

- Consider (where possible) taking action against the tenant to recover possession of a premises before the CVA is approved. This may not be possible where the tenant is already in administration and the CVA is being proposed by the company’s administrators or where the tenant is a small company, as such companies can seek the protection of a moratorium as part of its proposing a CVA. This would prevent the landlord from taking steps to enforce any claim against the tenant (pending consideration of the CVA proposal).
- Seek out other like-minded landlords/creditors with whom it might be possible to act in concert, to reject or seek modifications to, a tenant’s proposals.
- Inspect carefully the conduct of the CVA process and the creditors’ meeting. In addition to a challenge for “unfair prejudice”, a CVA can also be challenged (within the same time period) if there has been a “material irregularity” in relation to the conduct of the creditors’ meeting or the CVA process.
- Perhaps most importantly, know its rights. CVAs are not always successful, so it is important that landlords know their rights in the event of a failure of the CVA and/or the tenant subsequently entering liquidation or administration.

A landlord’s attitude to a particular CVA will differ from proposal to proposal and will depend (amongst other factors) on (i) the scale of the proposed changes; (ii) the market for its property; and (iii) the likely rental levels which may be obtained on a re-letting. However, to get the best protection and outcome when a CVA proposal is made by a tenant, landlords should consider and participate in the approval process for the CVA and fully exercise their rights to make representations and vote.

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