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High Court Rejects New Look Landlords' CVA Challenge in Landmark Decision

The decision confirms that company voluntary arrangements remain a flexible tool for restructuring leasehold portfolios.

Key Points:

The judge rejected each of the landlords' arguments, confirming that:

- A CVA may provide for different outcomes for different groups of creditors.
- No rigid test exists for "basic fairness" that requires a landlord to receive at least market rent, or that contractual rent should be interfered with to the minimum extent necessary.
- If a landlord is entitled to terminate the lease and receive a better outcome than in the alternative, any automatic unfairness from changes to the terms of the lease is negated.
- Whether a CVA is unfairly prejudicial depends on all the circumstances of the case.
- The fact that the statutory majority to approve a CVA is achieved by the votes of unimpaired creditors or those who receive substantially different treatment is not necessarily unfairly prejudicial (though it is a highly relevant factor in considering unfair prejudice).

Background

The applicants sought to challenge rent reductions and lease modifications imposed on landlords of UK retail chain New Look Retailers Limited (New Look) under a company voluntary arrangement (CVA).[1] The CVA was approved in September 2020 by 81.6% by value of creditors voting, including almost 60% of landlords. The CVA was one pillar of a wider restructuring that contained three inter-connected pillars: the second being a scheme of arrangement (Scheme) to implement a debt-for-equity conversion of claims by holders of senior secured notes (SSN Holders), whilst the third pillar involved an agreement between New Look and its banks to extend existing super senior working capital and operational funding lines available to the company and which were important to the ongoing viability of the business.

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The applicants argued that:

1. The CVA proposal did not constitute a composition or arrangement within the meaning of Section 1(1) of the Insolvency Act 1986[2] (IA 1986) (Jurisdiction Challenge).

2. The applicants were unfairly prejudiced by the CVA (Unfair Prejudice Challenge).

3. Material irregularities existed in relation to the CVA (Material Irregularity Challenge).

Following extensive argument over a six-day hearing, each of the landlords' heads of challenge failed.

Jurisdiction Challenge

Meaning of "arrangement"

The applicants argued that a CVA cannot encompass different deals with different groups of creditors, and the CVA in this case involved separate arrangements on substantively different terms with at least three different creditor groups. To buttress this position, the landlords also sought to argue that as a matter of statutory interpretation, a CVA can only constitute a "composition" or an "arrangement" if all of the creditors would fall into a single class if the terms of the proposal were contained in a scheme of arrangement under the Companies Act 2006 (CA 2006). Both of these contentions were rejected.

The High Court noted that the first argument was a "difficult starting point" in that it ran contrary to established practice and previous cases. The Court also rejected the statutory interpretation argument, holding that it was not correct to limit a CVA to an arrangement under which all creditors would form a single class. A clear distinction exists between a scheme (which may have one or more classes) and a CVA (under which all unsecured creditors vote together). The statutory wording reflects this distinction, as there is no reference to "class" in Section 1(1) IA 1986.

The judge in the case, Mr. Justice Zacaroli, therefore reaffirmed the established position that as a matter of jurisdiction, a CVA may provide for differential treatment of different sub-groups.

"Give and take" between New Look and creditor groups

The applicants argued that New Look provided insufficient "give" to the landlords, since the CVA provided only minimal rights and New Look was obliged to offer such rights to the landlords irrespective of the CVA. (For example, the landlords argued the termination rights granted to them were not considered a "give," since the landlords already had termination rights under the leases.) The Court dismissed this argument, holding that there was sufficient "give and take" to satisfy the "relatively low jurisdictional hurdle" in an arrangement that "takes" from the creditors their contractual rights and "gives" them a return that is at least as good as that which the company could offer in the relevant comparator (i.e., an administration followed by a "pre-pack" sale). The termination rights conferred by the CVA were "new" rights granted by the CVA and without such rights, the CVA would preclude the landlords from terminating unless the new, reduced rent was not paid. The new termination right enabled landlords to terminate notwithstanding that the reduced rent continues to be paid.

In relation to the SSN Holders, the Court held that the CVA had to be seen in the context of the wider restructuring, including the Scheme, and that under the Scheme the SSN Holders had given up their security (and right to be repaid a proportion of their claim in an insolvency) in exchange for a share in equity and a subordinated shareholders' loan.

Termination rights infringed property rights of landlords

The landlords sought to argue that the new termination rights granted to New Look improperly interfered with their property rights as the release of all liability to pay rent and other sums due under certain leases had the effect of surrendering the tenancy. The Court rejected this argument on the basis that it is not an essential requirement of a lease that the tenant is obliged to pay rent, and therefore the lease had not been surrendered. The amended terms did not impose a requirement for the landlords to accept an offer of surrender, merely an opportunity for them to do so.

Unfair Prejudice Challenge

After reviewing historic case law and considering the development of the principles of good faith and equity, the Court concluded that whether unfair prejudice exists depends on all the circumstances. Four points were of particular relevance to the facts of this case:

1. Whether there was a fair allocation of the assets available within the CVA between the compromised creditors and other sub-groups of creditors. Zacaroli J acknowledged that this question would require the Court to consider whether a different allocation would have been possible. This stance bears some resemblance to Trower J's approach to the exercise of the power to effect a cross-class cram-down in *Deep Ocean*,[3] in which the Court considered whether a restructuring plan contained a fair allocation of the "restructuring surplus" between groups of creditors. This is a departure from the position taken in relation to schemes of arrangement, where the Court does not concern itself with whether the scheme is the best or fairest scheme.

2. The nature and extent of the different treatment, the justification for that treatment, and its impact on the outcome of the creditors' meeting.

3. The extent to which others in the same position as the objecting creditors approved the CVA.

4. A finding of unfair prejudice ought not to be precluded merely because the same result might have been achieved in a restructuring plan under Part 26A CA 2006.

Unfair modifications to the terms of the leases

In objecting to turnover rent and long-term lease modifications, the landlords asserted that a rigid test had been set in *Debenhams*,[4] which stated that "basic fairness" required the CVA to: (i) provide that a landlord should receive at least market value rent; and (ii) only interfere with contractual rent to the minimum extent necessary to achieve the purpose of the CVA. Zacaroli J disagreed that *Debenhams* had set any such test, holding that whether a CVA is unfairly prejudicial can only be decided by reference to all the circumstances.

Importantly, the landlords' rights under the CVA to terminate the leases would negate any automatic unfairness caused by the lease modifications, provided that the terms offered to the landlords upon exercise of that termination right were at least as beneficial as in the relevant alternative. In this case, the CVA offered all compromised landlords the choice between (i) terminating their lease and accepting a financial return that was better than in the relevant comparator and (ii) continuing the lease but on reduced rent and modified terms. The inability to pay future rents was caused by New Look's insolvency, and the reduction in rent and other modifications would apply only if the landlords chose not to terminate. In other words, the CVA outcome was not "forced" upon them.

The fairness of the amended lease terms per se was not something for the Court to evaluate as part of an unfair prejudice challenge, but a factor that each landlord could assess in exercising the choice the CVA presented (i.e., whether to terminate or continue with the modified lease). That the landlords were offered a choice to terminate or accept the modified lease terms, and the nature and extent of the proposed lease modifications, were matters to consider when assessing the differential treatment between the landlords and other creditors (as would any differences in terms between sub-groups of landlords).

Requisite majorities at creditors' meeting secured with votes of unimpaired creditors

In the Court's view, the fact that the statutory majority to approve a CVA is achieved by the votes of unimpaired creditors or those who receive substantially different treatment is not necessarily unfairly prejudicial to a sub-group of compromised creditors (though it is a highly relevant factor in considering unfair prejudice). The case law illustrates that to be unfair there must be "something more" than just differential treatment (e.g., bad faith).

In light of the cross-class cram-down power introduced by the Corporate Insolvency and Governance Act,[5] the landlords could not successfully argue that there was an "incontrovertible principle" that creditors should not have their debts compromised by a statutory majority unless the majority and minority shared sufficiently similar rights that they could consult on the proposal with a view to their common interest.

Compromised creditors received differential treatment

The landlords argued that there was no adequate justification for the differential treatment of the SSN Holders and that it was inherently unfair that the "wholly unimpaired" SSN Holders' votes were critical to obtain the statutory majority required to approve the CVA.

Zacaroli J rejected this argument by reference to the wider circumstances: (i) it was necessary to see the CVA as an integral and interdependent part of the wider restructuring which included the Scheme, under which the SSN Holders' rights were in fact substantially impaired as they had exchanged their secured debt (at the top of the priority waterfall) to equity (at the bottom of the priority waterfall); and (ii) by statute, a CVA cannot affect the right of a secured creditor to enforce its security without their agreement, so the impairment of their rights was only possible by agreement as part of the CVA process. Therefore, their impairment could be viewed as a consequence of the CVA despite not being a term of the proposal itself. The Scheme was required to bind the few SSN Holders whose express consent could not be obtained.

In Zacaroli J's view, the differential treatment of the SSN Holders was explained and justified due to the fact that they were secured creditors (albeit not wholly secured). In the absence of the CVA, there would have been no return for unsecured creditors (aside from the prescribed part), since the value broke in the secured debt. Further, without the CVA, the SSN Holders could have enforced their security over the entirety of New Look's assets. The equity and subordinated debt granted to the SSN Holders under the Scheme were the *quid pro quo* for the release of their security.

The landlords also argued that they were unfairly prejudiced by the fact that the statutory majority vote was reached due to the votes of the SSN Holders, who were treated substantially differently. This argument was rejected on the basis that the SSN Holders were entitled to vote the unsecured portion of their debt, despite being incentivised to do so because the CVA was essential to the success of the Scheme under which they received their equity and subordinated debt. Where a CVA is designed to rescue a viable business, the survival of that business will always increase the value of security held over that business — therefore a partially secured creditor would always be incentivised to vote in favour. That could not of itself cause unfair prejudice, because the IA 1986 expressly permits secured creditors to vote their unsecured portion.

Material Irregularity Challenge

Calculation of the landlords' claims for voting purposes

The landlords' principal objection was to the 25% discount applied to the claim of each landlord for voting purposes. They argued that: (i) the discount fettered the chair's duty to put an estimated minimum value on the claims for voting purposes; (ii) the discount involved double discounting to the prejudice of the landlords; (iii) the discount did not account for the possibility of the valuation methodology in the CVA resulting in an under-estimate of the claim; (iv) the 25% figure was arbitrary; and (v) the 25% figure was unfair compared to the treatment of the SSN Holders (whose claims were not discounted).

In rejecting the landlords' arguments, the Court emphasized that the starting point under the Insolvency Rules[6] (Rule 15.31(3)) is that a claim of an unliquidated or unascertained amount is to be valued at £1 unless the chair decides to put upon it an estimated minimum value for voting purposes, and the chair is under a duty to consider the available evidence when assessing minimum value. The evidence of the chair was that he agreed with the formula for calculating the claims of landlords and would have taken into account any evidence submitted otherwise by the landlords; however, on the facts, no landlord put forward evidence in support of a different conclusion.

New Look had taken expert advice as to the prospects of re-letting and the likely market rent for each landlord. The expert advice supplied a single figure (rather than a range of values) for the landlords' claims. The discount of 25% was a proxy for identifying the lower end of the range, which was held to be consistent with the chair's duty to place an estimated minimum value on the claim and did not involve double discounting (had the figure been supplied as a range, then applying a further discount to the lower end of the range may have resulted in a different decision). Zacaroli J noted that "there was no particular science" behind the adoption of the 25% discount, but this was not a material irregularity given the inherent uncertainty involved in estimating the quantum of future liabilities.

In any event, the application of the 25% discount had no impact on the outcome of the meeting given that it was applied equally and that on aggregate a greater number of landlords voted for the CVA than against it.

It would not have been appropriate for the SSN Holders to be subjected to the same discount, as theirs was a claim for a liquidated certain sum (contingent only on a payment default by the notes issuer). In respect of the portion of the SSN Holders' claims that were unsecured, Zacaroli J held that there was no "fair comparison" with the valuation of the landlords' claims, such that Rule 15.31(3) was not engaged — rather, the SSN Holders' under-secured claims were dealt with under Rule 15.31(5).

Omissions and inaccuracies in the CVA proposal

The landlords raised several concerns over inadequate disclosure, including: (i) the identity of the parties to the lock-up agreement; (ii) the value of the equity interests to be provided to the SSN Holders; (iii) the exit process for the SSN Holders; and (iv) the management incentive plan. All the concerns were found to be non-material issues that would not have caused a material difference to a creditor's assessment of the CVA or caused them to suffer prejudice. The Court did note, however, that a valuation of the equity interests to be received by the SSN Holders was relevant information and that details of the management incentive plan (or any benefit accruing to directors of a company promoting a CVA) ought to be disclosed.

Looking Ahead

The lengthy and well-reasoned decision in this case addresses several key objections that landlords have raised in connection with CVAs, and will have ramifications for ongoing CVA challenges (including *Clarks* and *Pizza Express*).

Whether landlords will continue to challenge rent reductions and lease modifications under CVAs or seek to settle outstanding challenges remains to be seen. Market participants will keep a close eye on developments, including whether the New Look landlords will seek to appeal the decision, as well as the outcome of the *Regis* case (judgment pending). Following the comprehensive rejection of the New Look landlords' arguments, commercial leverage may have shifted to debtor entities; regardless, at least for unfair prejudice challenges, the outcome will depend on all the circumstances. How the Court would treat a CVA that only passes due to the votes of a truly unimpaired class remains to be seen.

For tenant companies seeking to restructure, the recently sanctioned Virgin Active restructuring plan highlights another tool: the Part 26A restructuring plan. For Virgin Active, this plan provided for cross-class cram-down of landlords' claims, despite fierce objections from an ad hoc group of landlords. *National Car Parks* is also seeking to use this option to restructure its liabilities.

Tenant companies seeking to restructure will have to determine which tool is preferable, factoring in the nature of the liabilities it seeks to address, the costs, the likelihood of support from other creditors (including secured financial creditors), and the potential for challenge.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Yen Sum
yen.sum@lw.com
+44.20.7710.1046
London

Jessica Walker
jessica.walker@lw.com
+44.20.7710.3068
London

Oliver E. Browne
oliver.browne@lw.com
+44.20.7710.1825
London

Quentin A. Gwyer
quentin.gwyer@lw.com
+44.20.7710.4744
London

James Hollingshead
james.hollingshead@lw.com
+44.20.7710.1108
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Endnotes

[1] Lazari Properties 2 Ltd (and others) v New Look Retailers Ltd (and others) [2021] EWHC 1209 (Ch).

[2] Insolvency Act 1986 c. 45.

[3] 1 UK Ltd [2021] EWHC 138 (Ch).

[4] [2019] EWHC 2441 (Ch).

[5] Corporate Insolvency and Governance Act 2020 c. 12.

[6] The Insolvency (England and Wales) Rules 2016