

# How CVAs affect landlords

15 January 2019

## Company voluntary arrangements have become a significant issue for retail landlords ? but do they always entail having to take a loss?

---

Company voluntary arrangements, or CVAs, used to be a fairly uncommon insolvency procedure. Recently, however, the trickle of cases has become a flood, with big names such as House of Fraser, Carpetright and New Look proposing such arrangements.

The increased popularity of online shopping, business rates, uncertainty over Brexit and a squeeze on household spending have all been putting pressure on the retail sector, and the fate of Toys 'R Us and Poundworld show that these are no theoretical concerns. However, with a range of insolvency procedures available, including administration, the fact that times are tough for retailers cannot itself explain the growth of CVAs. Whether justifiable or not, CVAs have increasingly become the go-to restructuring tool.

A CVA allows an insolvent company to enter into a binding arrangement with its unsecured creditors. This usually involves rescheduling or reducing its debts, and can also involve changing the wider contract terms between a company and its creditors.

In theory, the flexibility of this process can be used to address the causes of insolvency rather than simply dealing with its effects; it is also less invasive than any other insolvency process. If a CVA is entered into without the company also going into administration, it continues to exist and trade, and its directors remain in office and responsible for trading. While an insolvency practitioner implements and supervises the CVA, their role is much more limited than it is if the company has gone into administration. CVAs thus help reduce the costs of the process, and therefore the impact on creditors.

While less invasive, the CVA process is also intended to be less damaging to creditors. The CVA will not even proceed without the creditors agreeing, and the proposal will usually involve a significantly better outcome for the creditors as a whole than liquidation or even administration. Unlike most other forms of insolvency, a CVA does not result in an automatic moratorium preventing creditors from taking action against the debtor while the proposal is under consideration. Small companies can obtain a CVA moratorium, but this is relatively uncommon.

### Creditor controversy

The most controversial aspect of the CVA process is that it allows for proposals that do not result in the unsecured creditors being paid in proportion to their debts. Under a CVA different creditors can be paid on different terms, as long as a sufficient number are in favour of the proposals.

This is important because only 75 per cent of the creditors, by debt value, that attend the creditors' meeting need to vote in favour of the proposal. While at least 50 per cent of the

creditors by debt value that vote in favour have to be unconnected to the company, this often allows significant connected party involvement.

A party is connected if it or its associates ? such as spouses, civil partners, business partners, employees, directors and relatives ? control one-third or more of the voting power of the shares or those of a parent company, or if the board of the company is accustomed to following the directions of the creditor or its associates.

In many cases, the largest creditor is the company owner, and they will have a significant say in whether or not to accept the CVA proposal. Furthermore, the owner stands to gain if the CVA is approved and is successful because they will preserve the value of their shares, whereas in most other insolvency procedures the owners lose this entirely. This has led to concerns that CVAs can be more about returning or preserving the shareholders' investment than genuinely rescuing companies in financial difficulty.

*CVAs have become more widespread as big-name retailers on the high street seek ways of dealing with insolvency*

From an insolvency point of view, the landlords are in an unusual position. They do not normally take security for the obligations owed to them by their tenants, so count as unsecured creditors. However, landlords do have other ways to protect against tenant default; particularly important is their right to forfeit, which gives them an advantage over other creditors when dealing with financially pressured tenants that are still trading. Even if a tenant goes into administration, it is often the case that its rent obligations are up to date, and that the business and lease are swiftly sold to a solvent company. As such, the landlord will escape relatively unscathed, and other unsecured creditors will bear the brunt of the insolvency.

In a CVA, this situation is reversed. A CVA proposal may seek to restructure the company's lease obligations by reducing future rent and preventing landlords from exercising their usual rights. Furthermore, creditors such as banks and suppliers have a vote on the terms proposed; these do not affect them, but they may have a major impact on landlords, who have no vote.

In the case of retailer CVAs, typical proposals now place premises into different categories. There will be a group of profitable premises where no changes or only minor ones are proposed to the leases. The second group are marginal premises where substantial renegotiation of leases is required. The third group is unprofitable premises that will close. Often, creditors other than landlords will be paid in full.

Landlords have options under the CVA process if they act quickly. By seeking a consensus with other creditors, particularly other landlords, they may be able to put together a sufficient bloc to resist the imposition of a CVA. Even if not, by making representations the landlord may be able to negotiate improved terms ? for example, reinstating the full rent if the CVA fails. This may also help prevent particularly controversial proposals going ahead, such as removing a landlord's right to forfeit a lease.

In terms of voting rights, a particular problem for the landlord is that part of their claim will relate to future rent arrears and dilapidations. The claim will by default be unascertainable for the purpose of calculating voting rights, and will thus be prescribed a value of only ?1. Independent evidence may help here in seeking to ensure that the landlords' claims are

valued more realistically and they have a greater chance of blocking unattractive CVA proposals.

Above all, constructive engagement is important. Landlords will not always lose out under CVAs, particularly compared to the alternatives. Some proposals, such as the JJB Sports CVA, have in fact attracted wide support from landlords.

## Options for objection

There is also a procedure for creditors to mount a legal challenge to a CVA. This can either be brought on the grounds of unfair prejudice to the interest of a creditor or material irregularity in the CVA process.

The former is an objection to the proposal's substance. When determining whether there has been unfair prejudice, the court will look at whether the creditor has been treated differently to others ? the so-called horizontal comparison ? and whether the creditor's position is worse than it would have been without the CVA ? the vertical comparison. However, prejudice alone is not enough to bring a claim; it is also necessary to show that this is unfair. In most cases, CVAs are put forward on the basis that the prejudice suffered by some landlords is necessary to ensure that the business can be rescued.

Material irregularity relates to defects in the procedure followed. Whether such an irregularity has occurred depends on the specific circumstances, though the mere fact of a breach will not be enough.

As concerns about abuse of CVAs have risen, so too have calls for reform. However, although there is widespread concern that the CVA process is being misused, settling on definite proposals is more difficult. Any insolvency process will have winners and losers, and pre-pack administrations have also attracted their share of controversy.

While some reform of CVAs is possible, it seems likely this will be restricted to curbing obvious abuses. However controversial, landlords and their advisers should assume that CVAs will be a feature of the retail sector for some time to come.

**Nathanael Young is a senior associate at [SA Law](#)**

## Further information

- Related competencies include: [Corporate recovery and insolvency](#) ; [Landlord and tenant](#)
- This feature was taken from the [RICS Property Journal](#) (January/February 2019)
- Related categories include: [Owning and managing commercial property](#)