FALCON CHAMBERS PROPERTY SEMINAR, BRISTOL

28 SEPTEMBER 2022

Company Voluntary Arrangements - What steps can a landlord take to protect its position when a tenant proposes a CVA?

Philip Sissons

Introduction

1. Unfortunately, the current economic outlook is particularly gloomy. On 22 September, the Bank of England Monetary Policy Committee warned that the UK might already have entered negative growth and therefore was either in, or headed for, a recession. The committee also predicted that inflation is likely to remain at or above 10% for at least the next few months, fuelled by the soaring costs of energy. Already, the latest monthly statistics produced by the Insolvency Service show that in August the number of registered companies entering into insolvency was 43% higher than in August 2021.

2. All indications are, therefore, that businesses (perhaps, in particular, the high street retailers and hospitality chains that survived the pandemic) are in for a tough winter. Sadly, therefore, it is only realistic to expect that landlords with commercial property portfolios will see tenants resorting to insolvency measures, including company voluntary arrangements.

3. Recent years have seen the approval of a number of large CVAs, by high profile companies including, to name just a few, Debenhams, Pizza Hut, Caffé Nero and New Look. These have resulted in challenges by tenants to the validity of the arrangements, some of which I will consider in due course, but also general industry concerns about the fairness of CVAs from the point of view of commercial landlords.

4. In response, the Government, via the Insolvency Service, recently commissioned research in an effort to answer the question of whether landlords are equitably treated as compared to other creditors in large business CVAs. The research has been published in a report dated 28 June 2022, which makes for interesting reading, though little comfort for landlords.

5. The conclusion, based on research covering 59 CVA proposals made between 2011 and 2020, was that in 93% of the cases considered, landlords were compromised (that is to say, they received less than the amount to which they were contractually entitled) as compared to the next single compromised class, which was intercompany creditors coming in at only 51%. The average amount of compromise for landlords (including for landlords whose debts were not compromised at all) was 43% of their total entitlement.

6. The report itself acknowledges that even these apparently stark figures do not tell the full story, since the research was not able to capture other liabilities above future rent likely to be compromised by CVAs, such as existing arrears of rent (as opposed to rent accruing in the future), service charges or dilapidations claims.

7. Nevertheless, despite these findings, the report concludes that landlords are, broadly, equitably treated compared to other classes of unsecured creditors. This conclusion appears to be based not on the quantitative evidence of the outcomes achieved by the CVAs studied, but rather the procedural checks and safeguards.

8. The measures cited in the report include the voting threshold of 75%, the requirement for involvement by a registered insolvency practitioner, the ability of the landlord to retake possession of the premises in preference to accepting the CVA terms, the entitlement of creditors to challenge the CVA in court and the advantages over the alternative outcome if the company becomes insolvent.

9. The report concludes that a CVA "*offers a flexible and cost-effective solution bridging the gap between informal negotiations and the formal insolvency procedures of administration and liquidation*."

10. There is, therefore, no proposal for legislative reform, only recommendations that the CVA proposals ought to be made shorter and clearer and that there should be an effort to engage in wider consultation (including with the British Property Federation) before a CVA proposal is put forward.

11. It appears, therefore, that there is no immediate prospect of reform. With the dark clouds of recession hovering on the horizon, it seems to be an appropriate time for a refresher as to what steps a landlord can be take where a CVA is proposed, or after one is entered into.

12. The legislation governing CVAs (and related insolvency arrangements, such as the recently introduced Restructuring Plans under Part 26A of the Companies Act 2006, introduced as part of the Government's response to the Covid Pandemic) is lengthy and complex. Certain areas, in particular the grounds of challenge based on unfair prejudice, are the subject of a substantial body of case law.

13. Accordingly, given the time constraints, I intended to provide only a general overview of the CVA and the various steps that might be taken in response. I will first provide a brief explanation of how a CVA operates in practice and then look at three possible options open to a landlord whose property is included within a CVA. These are:

    1) Bringing a challenge to the validity of the CVA in court;

    2) Seeking to re-take possession of the premises;

    3) Pursuing third party guarantors for any shortfall created.

CVAs; the basics

i) The statutory framework

14. Schemes of arrangement have been a feature of the Companies Acts since 1948. The current provisions for CVAs are contained in Part I of the Insolvency Act 1986, as subsequently substantially amended and added to by the Insolvency Act 2000 and now supplemented by the possibility of schemes of arrangements under Parts 26 and 26A of the Companies Act 2006.

15. In basic terms, CVAs provide a mechanism by which a company which is in financial difficulties can restructure its debts and liabilities, in an effort to stave off insolvency. The statutory provisions facilitate a compromise or variation of contractual obligations owed to creditors. The mechanism is a very flexible one, since it is for the directors of the company to put forward a proposal in such terms as they see fit and the statute does not proscribe the form that the proposal must take.

16. There are some procedural and substantive safeguards for creditors, but as we shall see, at least form a landlords' perspective, these are not especially robust.

17. By s. 1 (1) of the 1986 Act, a CVA must be proposed by the directors of a company. The proposal must be supported by an opinion by a nominee, who is required to be a licensed insolvency practitioner. The nominee must provide an independent opinion that the proposal represents a better outcome for the creditors affected than the alternative of administration or insolvency. As the Insolvency Service report notes, however, the nominee is chosen by the company and almost always puts together the proposal, so it is dubious whether there can be a meaningful degree of independence.

18. The rules require that the proposal must be published and notified to creditors together with prescribed information. In order to take effect, the proposal must then be approved by at least 75% of the company's creditors by value, at a meeting held in accordance with rule 15.34 of the Insolvency Rules 2016.

19. Once approved, the CVA is binding upon all creditors of the company who received, or were entitled to receive, notice of the meeting.

20. The statutory provisions do not mandate the form that the proposal must take, nor the extent to which claims should be compromised. However, in recent years, a relatively standard model of CVA has emerged, impacting heavily on landlords.

i) *The typical structure of a 'landlord' CVA*

21. The Debenhams CVA is typical of the way in which landlord CVAs are structured and involved the following features:

    a) The leasehold properties owned by the company were divided into different categories by reference to the financial performance of the particular outlets. This model will generally separate:

        (i) units that are performing well and which the company wants to retain;

        (ii) poorly performing units that the company would prefer to divest;

        (iii) moderately performing units which it is considered can be made profitable if a reduced rent is paid.

    b) In the Debenhams CVA, the units which were performing well were identified as Category 1 properties. The CVA did not reduce or impact on these properties save to change payment of rent from quarterly to monthly.

    c) Other units were separated into Categories 2 – 5, with category 5 including the worst performing stores.

    d) In relation to category 2 – 4, the contractual rent was reduced to 75%, 65% and 50% respectively, each for a period of 5 years, whereupon there would be rent review to the higher of the market rent or the reduced rent.

e) Category 5 landlords would remain entitled to receive the rent in full for 6 months, when the leases would be terminated.

f) All landlords were given a one-off entitlement to terminate the leases (in whichever category). The right had to be exercised by serving not less than 60 days written notice expiring within 90 days of the next date on which rent became payable under the relevant lease.

g) The CVA also excluded any liability on the part of the tenant in respect of dilapidations, where a lease expired during the term of the CVA

h) The CVA also purposed to prevent all landlords from exercising any right to forfeit which was triggered by the CVA.

22. These features, with variations as to the gradation and number of categories, the level of rent reduction and the procedure for termination, are mirrored in many of the larger CVAs that have been approved in recent years.

23. Although the basic model of allocating premises to more or less profitable categories, is now common, the precise terms might vary significantly. For example, the Pizza Hut CVA (which was approved in September 2020) offered Category 2 and Category 3 landlords the option of moving to a 'pure' turnover rent or electing for a base rent (of 50% or 40% of the contractual rent) plus a lower percentage of net sales.

24. A common, indeed probably now an essential feature in light of the case law which I will consider shortly, is that landlords are given the option to terminate the leases and recover vacant possession. However, the precise manner in which this achieved (e.g. a one-off or rolling break, the notice period, the earliest termination date) will obviously vary from case to case.

Voting

25. If a landlord is unhappy with the terms which are proposed in a CVA, then the first (and most obvious) step available is to vote against the approval of the CVA at the creditors meeting. As already noted, the relevant threshold is relatively high, requiring at least 75% support, by value, of the creditors affected by the proposal.

26. In contrast to other corporate restructuring schemes (most obviously the provisions for arrangement under Part 26A of the Companies Act 2006) a CVA cannot be imposed on creditors by the court if the requisite majority of the creditors by value do not vote in favour.

27. A decision must be made quickly, since the rules provide that the minimum notice period for the 'decision procedure' for creditors is just 14 days. The proposals and supporting information can be extremely lengthy and it is not always straightforward to ascertain the precise impact on the landlord.

Challenging the CVA

28. Pursuant to s. 6 (1) of the 1986 Act, a creditor who is entitled to vote on the CVA proposal is also entitled to apply to court to challenge the CVA on one or both of two grounds:

    (1) The CVA unfairly prejudices the interests of a creditor, member or contributory of the company;

    (2) That there has been some material irregularity at or in relation to the meeting or decision procedure.

i) Material irregularity

29. The 2016 Rules set out in considerable detail the information that must be contained in a CVA proposal and how and when this information must be notified to the creditors. There are also detailed regulations about the conduct of the decision procedure and the creditors meeting.

30. However, whilst breach of these rules might raise an argument of material irregularity, the threshold for a successful challenge one these grounds is a high one. Not all irregularities in the information supplied (or the procedure) will be material. The test is whether there is a substantial chance that the creditors would not have approved the CVA in the form in which it was presented, if the irregularity had not occurred (see Re Trident Fashions (No. 2) [2004] 2 BCLC 35, per Lewison J at [46]).

31. In Discovery (Northampton) Limited v Debenhams Retail Ltd [2020] BCC 9, the court rejected a challenge based on material irregularity. The creditor argued that the CVA proposal had failed to contain sufficient information about certain specific claims that might be made in the event of the company's insolvency (specifically under s. 239 (relating to preferential creditors) and s. 245 (floating charges) of the IA 1986). The judge concluded that it was improbable the inclusion of further information about these matters would have made any difference (not least because the CVA was supported by 94.71% of the creditors voting).

32. Most recently, in Young v Nero Holdings Ltd [2021] EWHC 2600, a creditor sought to challenge a CVA on the grounds of material irregularity. Various alleged defects in the procedure were relied on including a decision not to postpone the vote on the proposal to allow consideration of an offer to buy the company, a failure by the nominee to update the report to refer to this offer and supposed shortcomings in the announcement of the proposal to creditors. The challenge was rejected by Michael Green J on the basis that a margin of appreciation was allowed to the nominee in relation to the provision of information and any decision about timing. The material provided was reasonable and not misleading and any omissions would not have affected the outcome of the vote.

33. Only rarely has a challenge to a CVA succeeded on grounds of material irregularity. One such example is Re Gatnom Capital & Finance Ltd [2010] EWHC 3353, in which Roth J upheld a challenge on the basis that two contracts purportedly entered into by the company were shams, designed to confer voting rights on a party, without whose support the CVA proposal would not have received the necessary majority support. This case really only demonstrates that fairly spectacular irregularity in the process is likely to be required for the challenge to succeed.

34. Accordingly, whilst the proposal and supporting information should be reviewed and checked against the requirements of the Insolvency Rules 2016, in order to identify any potential grounds for challenge, the prospects of successfully challenging a CVA on the grounds of material irregularity are therefore likely to be generally low.

ii) Unfair prejudice

35. The second potential ground of challenge is that the CVA has unfairly prejudiced one or more compromised creditor. A full treatment of the insolvency law concept of unfair prejudice is outside the scope of this talk. In very basic terms, however, an allegation that a creditor has been unfairly prejudiced by the terms of a CVA will involve considering two comparators.

36. First, the so-called 'vertical' comparator, which compares the position of the creditor under the CVA with the position that is likely to be arrived at if no CVA was put in place (which, generally, involves comparing the position under the CVA with what would happen in the event of the tenant's administration or insolvency). The landlord will almost always be better off under the CVA then in that scenario.

37. Second, the 'horizontal' comparator, considering how the creditor (or class of creditor) is treated in comparison to other creditors. For example, does the CVA result in an unfair treatment of landlords to the benefit of other company creditors, such as trade suppliers.

38. For a helpful discussion of these concepts see the judgment of Zacaroli J in Lazari Properties 2 Limited v New Look Retailers Ltd [2021] EWHC 1209 (Ch).

39. Although there are a handful of cases in which the court has upheld a challenge to a CVA on the grounds of unfair prejudice, again the great majority of such challenges have failed.

40. One important principle has emerged from the authorities. Attempts to argue that it is fundamentally or in principle unfair to permit a company to occupy premises at a reduced rent, at the expense of landlords, whilst trading for the benefit of other creditors, have not found favour.

41. In Thomas v Ken Thomas, Neuberger LJ had expressed the view that it would generally be wring in principle that a tenant should be able to trade under a CVA for the benefit of its past creditors, at the present and future expense of its landlord. This was based on the familiar principle that where a tenant which is in administration continues to make use of property, the rent for that property is payable as an expense of the administration and, therefore in priority to other creditors (see Jervis v Pillar Denton [2015] Ch 87). In the administration context, the contractual rent is payable for so long as (but only for so long as) the company continues to keep the landlord out of possession.

42. However, challenges to CVAs founded on this principle have not, so far, had any great measure of success. In Discovery v Debenhams, it was conceded by the landlord that any unfairness involved in requiring the landlords to accept a reduced rent (to the benefit of other creditors) was met by the option given to the landlord to recover possession of the premises, which they could then re-let at the market rate. This appears to overlook the considerable difficulties that might be involved in taking this course of action, particularly in a falling rental market. The landlord might be left with a vacant unit and liability for business rates. Even if a tenant can be found this is likely to involve marketing costs and rent free periods.

43. However, in the Lazari case, the judge concluded that the concession had been correctly made:

"[218] *In relation to the broader argument that the long-term modifications were unfair, I consider (in agreement with the concession in Debenhams) that the answer is provided in the landlords' right to terminate, provided that the terms offered to landlords upon exercise of that termination right are at least as beneficial as in the relevant vertical comparator.*

219. This can be tested by reference to a simple case, where the vertical comparator is a liquidation, in which leases would be disclaimed and there would be only a very small return to landlords (in respect of the Disclaimer Damages Claim and any arrears) and to all other creditors in respect of their unsecured claims. It would be difficult to find unfair prejudice in a CVA, against that background, which compromised the claims of landlords to future rent, for a percentage return which, though small, was better than the return in a liquidation, and which gave all other unsecured creditors the same percentage return."

44. The thrust of the reasoning in Lazari was that the loss of future rent was not forced on the landlords by the CVA, but was, rather the consequence of the company's insolvency. Accordingly, given that the appropriate vertical comparator was liquidation, with the disclaimer of leases and a very small if any return for the landlords, a percentage return on rent could not be considered unfairly prejudicial.

45. So, it seems that provided the CVA offers landlords an opportunity to recover vacant possession of their premises, any complaint of unfair prejudice due to reduced rents is likely to fall on deaf judicial ears. It is difficult to square this with the position under an administration, where rent is payable in full for so long as the premises are used for the benefit of other creditors.

46. A second important principle is that differential treatment of creditors is not always or necessarily unfairly prejudicial. What matters is whether any differential treatment is justified based on what is required to rescue the company from insolvency. Thus, it has been held that in the case of a football club, it is fair for a CVA to compromise all creditors whilst continuing to pay the platers in full, since otherwise the club would be ejected from the league and would therefore inevitably fail.

47. This type of argument will therefore turn on the particular facts of any case and the importance to the business in question of the class of creditors which are, or are not, compromised. In the Debenhams case, for example, it was argued that it was wrong to treat landlords differently to other trade creditors (who were not compromised at all). The judge rejected this contention on the basis that compromising such creditors would likely lead to suppliers refusing to supply goods and services needed to keep the business running. There was, therefore, sufficient justification for not compromising their claims in preference to the landlords' entitlement to rent.

48. The only recent example of an unfair prejudice challenge succeeding (in part) is in Carraway Guildford (Nominee A) Ltd v Regis UK Ltd [2021] EWHC 1294. In that case, a CVA approved for Regis was the subject of challenge on a large number of grounds, including alleged material irregularity. These were all dismissed save for one ground. A particular creditor of Regis was treated by the nominee as being critical to the success of the CVA in the sense that it would not support the business unless the existing debt was paid in full. Accordingly, that creditor was left out of the CVA altogether. The judge held that this was not justified and that accordingly the creditor had received preferential treatment resulting in unfair prejudice to the other creditors.

49. Again, however, the facts of this case appear to be exceptional and such grounds of challenge are unlikely to be available in the vast majority of cases. The conclusion is, again, that the scope for a successful unfair prejudice challenge is very limited.

Terminating the Lease

50. If the prospects of a successful challenge under s. 6 (1) are remote, the next option for the landlord may be to try and recover possession as swiftly as possible, so as to return to obtaining a market rent.

51. As already noted, CVAs routinely offer landlords the opportunity to terminate the lease, indeed, based on the reasoning in Lazari, it appears this is an essential element if the CVA is to avoid unfair prejudice challenges.

52. The precise way in which this is achieved will vary. In the Debenhams CVA this took the form of introducing a landlord only break clause, operable in accordance with tightly defined conditions. In other CVAs, only some categories of landlord are offered the right to break.

53. Whether it is commercially attractive to a landlord to exercise these break rights (where offered) will, of course, depend on the landlord's assessment of the market and the potential for re-letting or otherwise disposing of a vacant unit as compared with the terms which will be imposed under the CVA.

54. If the landlord does wish to exercise the rights conferred by the CVA, then, as ever with a break notice, great care must be taken to ensure that the correct form of notice is served and that this is done in time. The termination provisions are not always clearly drafted and, where the CVA only offers a "one-off" termination right, the consequences of getting the notice wrong can be significant.

55. In addition, to any new rights to break conferred by the CVA, the landlord may wish to exercise a right to forfeit the lease. This might be the preferred approach, if the terms of the break rights conferred by the CVA are unattractive or, indeed, if they fall within a category of landlord which is not given any such right.

56. The great majority of well-drafted commercial leases will include a provision which entitles a landlord to re-enter if the tenant becomes insolvent. A well-drafted clause will include, as a triggering event, the tenant company proposing or entering into an arrangement or composition with its creditors. Accordingly, the mere fact that the tenant has *proposed* a CVA, regardless of whether it is then approved at the creditors meeting, might confer on the landlord a right to forfeit. Plainly, whether or not this is the case will depend on the precise language used in the proviso for re-entry.

57. Some CVAs have purported to preclude landlords from exercising a pre-existing right to forfeit, either in respect of the proposal itself, or as a result of the shortfall in rent accruing as a result of the compromise, or indeed both.

58. The effect of a CVA is to prevent a landlord from forfeiting for arrears of the contractual rent which have been compromised by the CVA, once approved. In Thomas v Ken Thomas Ltd [2007] L & TR 21, Neuberger LJ held that, notwithstanding some apparent indications to the contrary in earlier case law, a landlord could not forfeit for non-payment of rent.

59. However, whilst the CVA can validly alter the terms upon which the right to forfeit can be exercised (by, for example, reducing the amount of rent payable), it cannot exclude that proprietary right altogether.

60. In Discovery (Northampton) Limited v Debenhams Retail Ltd [2020] BCC 9, Norris J held that because a right of re-entry or forfeiture is a proprietary right, entitling the landlord to recover possession of his or her own property, it could not properly be considered a security interest. The existence of that right did not turn the landlord into a creditor for the purposes of a statutory scheme of arrangement. Accordingly, his lordship said at para. 99:

> *"The right of re-entry is property belonging to the landlord (not a security right created by the tenant over his own property). It arises out of the relationship of landlord and tenant because (i) it defines the estate which the landlord has granted in creating the term of years and (ii) neither its existence nor its exercise is dependent upon any state of indebtedness as between landlord and tenants. A tenant who had paid all his rent to date but faces insolvency may still have his lease forfeit. The CVA can modify any pecuniary obligation upon breach of which the right of re-entry may be exercised; and the right will then be exercisable only in relation to the pecuniary obligation as so modified. But it cannot modify the right of re-entry itself. It can alter the covenant but must leave the reservation (or condition upon which the lease is granted) untouched."*

61. This reasoning was followed by Zacaroli J in Re Instant Cash Loans Ltd [2019] EWHC 2795. This case concerned a scheme of arrangement under the Companies Act 2006. The scheme provided for the surrender of leases to the relevant landlords. The judge held that this went beyond the proper scope of a scheme of arrangement since it would effect a substantial change in the nature of the landlords' proprietary interests.

62. The position, therefore, is that:

    (a) If the lease includes an entitlement to forfeit on the basis that the tenant has proposed or entered into a CVA, the CVA cannot remove that right;

    (b) The CVA can, however, validly compromise the amount of rent or performance of other obligations under the lease and the exercise of the right to forfeit for non-payment of rent or breach of covenant will be varied accordingly.

63. If a landlord wishes to exercise the right to forfeit as a result of the CVA then a number of considerations are likely to arise.

64. First, the landlord would be well advised to act quickly by taking steps to forfeit, if possible, before the creditors meeting takes place. Once a proposal is made then the landlord will have knowledge of the matters giving rise to the right to forfeit and will therefore be at risk of inadvertently waiving that right. It might, for example, be argued that by exercising the right to vote at the creditors meeting, the landlord has waived the right to forfeit. The better view is that this step would not involve an unequivocal acknowledgment of the continued existence of the lease, but the contrary may well be arguable.

65. There is a difficult question (not resolved by the authorities) as to whether it is necessary to serve notice under s. 146 of the Law of Property Act 1925 before exercising a right to forfeit in these circumstances. S. 146 (1) says that a notice is required in order to exercise a right of re-entry *"for a breach of any covenant or condition in the lease…"*

66. Subsections (9) and (10) of s. 146 deal specifically with the case of a condition for forfeiture on the bankruptcy of the lessee, but do not appear to apply where a CVA is proposed.

67. As a matter of ordinary language, it is not apt to describe a proposal to enter into a CVA as a breach of any covenant or condition in the lease; the standard clause does not impose an obligation on a tenant not to propose a CVA, it merely entitles a landlord to re-enter should the tenant take that step. My view, therefore, is that no s. 146 notice is required before the exercise of the entitlement to forfeit. However, in the absence of clear authority on the question, it may be prudent to serve a s. 146 notice (without prejudice to any contention that this is not required) if time permits.

68. Second, the tenant will be entitled to seek relief from forfeiture.

69. If the premises in question have been characterised as poorly performing (and the rent substantially reduced accordingly) then, in practice, it is unlikely that this right would be exercised. If, however, the premises are performing well, the landlord might well face a battle to recover vacant possession if it elects to do so for whatever commercial reason.

70. It is not at all clear how the court would balance the competing interests on an application for relief from forfeiture in these circumstances. On the one hand, it is generally said that in order to be granted relief from forfeiture, it must be possible to put the landlord back into the position it was in prior to the breach of covenant or, in other words, to ensure that the landlord is no worse off as a result of relief from forfeiture being granted. Generally, this is achieved by imposing conditions requiring the tenant to remedy any outstanding breaches or to pay compensation (see *Woodfall, Landlord & Tenant*, Vol. 1, para. 17.165, Rose v Spicer [1911] 2 K.B. 234).

71. If a landlord forfeits following a CVA proposal, then the resulting harm consists of the reduced rent and/or other compromises of the landlord's contractual rights. It is hard to see how this could be 'unpicked' by conditions imposed when granting relief from forfeiture without undermining the statutory purpose of a CVA and the 'rescue culture' which it is intended to serve.

72. On the other hand, allowing the tenant relief from forfeiture without addressing these matters, would appear to effectively deprive the landlord of the proprietary right to forfeit conferred by the express terms of the lease and, therefore, reverse the effect of the Debenhams case.

Pursuing Guarantors

73. One final alternative, which could easily be overlooked, is the possibility of pursuing third party guarantors in respect of any shortfall of rent which is created by the CVA proposal.

74. It appears that the variation of the company's liability by the CVA will not affect the liability of an original tenant or guarantor (assuming, of course, that those parties remain otherwise liable in accordance with the Landlord and Tenant (Covenants) Act 1995.

75. In decision handed down only last month, Oceanfill Ltd v Nuffield Health Wellbeing Limited [2022] EWHC 2178, Deputy Master Arkush granted an application for summary judgment in favour of a landlord in a claim for rent arears against an original guarantor.

76. In that case, the subject premises, a gym, had been let to Nuffield in 1998. The Defendant, Cannons, stood as guarantor for the tenant's obligations. The lease was later assigned to Virgin Active Limited, with the benefit of an authorised guarantee agreement, by the original tenant and guarantor.

77. In 2021, Virgin Active proposed a restructuring plan pursuant to Part 26A of the 2006 Act. The plan was not approved by the requisite majority of certain classes of creditors but was subsequently approved by the High Court under s. 901G of the 2006 Act. This section confers power on the court to sanction an arrangement, even if one or more classes of creditor dissents, provided that there is at least one class that approves the scheme. The court has that power if satisfied that none of the members of the dissenting class would be any worse off than in the event of the relevant

alternative occurring. The relevant alternative means the likely outcome if the plan is not sanctioned; usually said to be administration or insolvency.

78. Following the approval of the scheme, the landlord, Oceanfill, claimed the unpaid rent from the guarantor, pursuant to the AGA. The claim was defended on various grounds, including on the basis that the approved scheme had varied the provisions of the lease and the guarantor was entitled to rely on that variation so that the rent had not in fact fallen due.

79. This argument was rejected. The judge concluded that a restructuring plan under either Part 26 or Part 26A takes effect by operation of law and did not re-write the lease. At para. 26 of his judgment, Deputy Master Akush explained:

> "*I would therefore conclude that a restructuring plan under Part 26A , takes effect by operation of law. To the extent that it provides for a tenant to be released from future obligations under a lease, as the Plan did in this case, it does so by means of a statutory scheme that releases or discharges the tenant from liability. In my view it is not correct to say that the Plan re-writes the Lease. It is more correct to say that it releases the Plan Company from future liability under the Lease terms by providing that the rent and other liabilities are not payable on its part. Alternatively, to the extent that this can be described as re-writing the Lease, it is a re-writing only as between the landlord affected by the Plan and the Plan Company. It leaves unaffected the rights of the landlord against third party guarantors. As between them, the Lease remains valid and subsisting*."

80. This decision therefore provides a glimmer of light for landlords. However, it should be noted that the arrangement with which this case was concerned was one made under Part 26A of the 2006 Act and not a CVA made pursuant to the 1986 Act.

81. Whether a guarantor is effectively released may depend on the precise wording of the CVA in question. It is entirely possible, particularly if a guarantor is a related or connected company, that the guarantor's ongoing obligations may be expressly compromised or released by the CVA.

82. In Prudential Assurance Co Ltd v PRG Powerhouse Limited [2007] EWHC 1002, it was held that an attempt to release the company's guarantors from liability was unfairly prejudicial and therefore susceptible to challenge. In principle, a guarantor could not directly benefit from a CVA, since a CVA represented a hypothetical bilateral agreement between each creditor and the company and the guarantor was not, therefore a party to it. However, the CVA in that case provided that a creditor must not take steps to enforce an obligation of a third party, which might give a right of recourse against the debtor company; the so-called "richochet effect". This obligation was, therefore, in principle enforceable.

83. However, in that case, it was held that the attempt to release the guarantors was unfairly prejudicial. It the company had been placed into insolvent liquidation, the creditors would have retained their rights against the guarantors. The attempt to release those rights under the CVA was therefore unfairly prejudicial.

84. A similar conclusion was reached in Mourant & Co Trustees Ltd v Sixty UK Ltd (In Administration) [2010] BCC 882. Again, the judge acknowledged that in principle a CVA could result in the loss of the ability to pursue a guarantor, but considered it would be a rare case where this could properly be justified. Henderson J said:

> "*In times of commercial and financial turmoil, the ability to enforce the terms of the existing leases against the guarantor for a further seven and a half years was a most valuable right, and there was no sufficient justification for requiring any of the guaranteed landlords (let alone just one of them) to accept a sum of money in lieu. At a time of market uncertainty it will be difficult, if not impossible, to determine what sum will fairly compensate the landlord for the loss of such rights, and in the absence of a compelling justification a landlord should not be forced to accept a sum which is based on numerous assumptions (for example about the landlord's ability to re-let the premises) which may or may not prove to be well-founded. To adopt such a procedure, in circumstances where the solvency of the guarantor is not in issue, is to undermine the basic commercial function of the guarantee, and to force the landlord to accept a commercially inferior substitute for it*."

85. So, in summary, whilst everything will depend on the particular circumstances and the precise wording of the CVA, it is unlikely that "guarantee stripping" provisions in a CVA will be enforceable. The possibility of looking to an existing guarantor to meet any shortfall created by the CVA scheme may therefore be a valuable one in many cases.

Conclusion

86. The options available to landlords faced with a tenant entering into a CVA are limited and they may well need to act swiftly to protect their position.

    (1) The grounds for challenge are tightly constrained and the authorities suggest a low prospect of success;

    (2) Break rights conferred by the CVA must be strictly complied with;

    (3) Whilst landlords retain pre-existing rights to forfeit, the approach of the courts to relief from forfeiture applications is as yet unknown;

    (4) It is unlikely attempts to use a CVA as a means of "guarantor stripping" will succeed, so consideration should be given to the possibility of pursuing third parties.