SQUIRE PATTON BOGGS

Making Sense of Company Voluntary Arrangements (CVAs) Post New Look and Regis

A UK Landlord's Perspective

Voting and Disclosure

UK – July 2021

Following our previous alert that considered rent reductions and modifications to lease terms post *New Look* and *Regis*, this alert considers what those CVA challenge cases tell landlords about calculating a landlord's claim for voting purposes and the disclosure requirements.

In both cases, the landlords alleged that there was unfair prejudice and material irregularity in relation to how the landlords' claims had been valued for voting purposes and in respect of the level of disclosure provided in the CVA. As a reminder, a CVA can be challenged within 28 days post approval if it is unfairly prejudicial to a creditor or if there was a material irregularity in the process.

Although the findings in the cases are fact-specific, there are some useful pointers for landlords to note.

Discounting of Landlord Claims for Voting Purposes

It is usual for a landlord's claim to be valued for voting purposes based on a formula that applies certain assumptions, for example, in relation to re-letting and void periods. It is also usual for a discount to be applied to the claim, usually between 25% and 75%, to arrive at the "estimated minimum value" of the landlord's claim.

Is there a material irregularity if a landlord's claim is calculated using a formula?

It is acceptable for landlords' claims to be valued based on a formula, but if a landlord thinks their claim should be valued at a higher amount, they should provide evidence to the insolvency practitioner (IP) to support that, and the IP must then consider the information provided and value the landlord's claim accordingly.

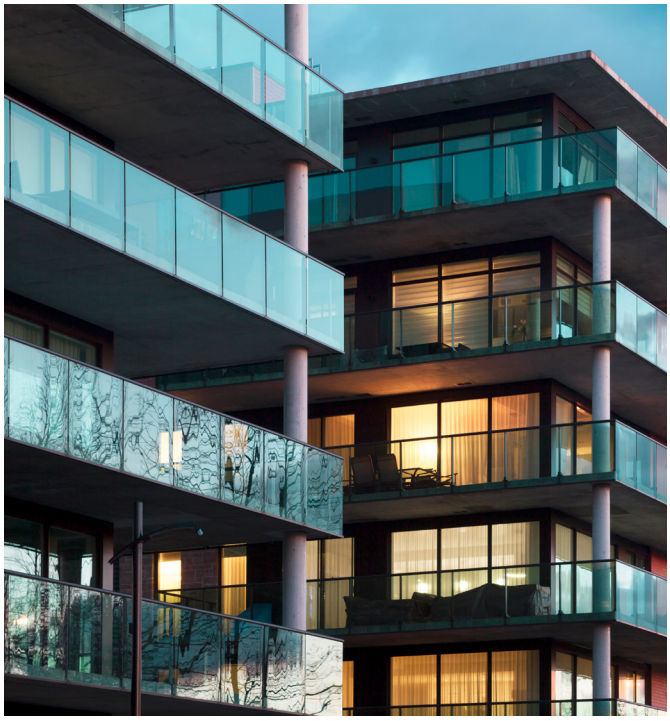
If the IP does not, then a landlord may be able to challenge the outcome of the CVA based on material irregularity.

What amounts to a fair discount?

There is no hard and fast rule when it comes to what is an appropriate discount, save that the bigger the discount, the more that it will need to be justified.

That said, if the same discount is applied to all landlord claims (whether they vote in favour or not), it is unlikely to result in a material irregularity. The outcome of the meeting would be the same because the value of each landlord's claim would all be adjusted in the same way.

What we are likely to see post *New Look* and *Regis* is perhaps a more tailored formula that is applied according to the particulars of the lease, rather than a blanket formula that is applied to all landlord claims. This approach has been seen in "newer" CVAs and helped justify the percentage discount applied to the landlord claims in *New Look*.



How should a claim be valued?

What is clear is this:

- A landlord's claim is treated for voting purposes as unliquidated and unascertained.
- The starting point is that the claim for future rent is valued at £1 unless the chair decides to put a higher value on it.
- Formulas can be used to value a landlord's claim for voting purposes.
- The duty of the chair is to consider the available evidence and, if that evidence leads to the conclusion that they can safely attribute a different estimated minimum value, they must do so. A landlord should, therefore, provide evidence for the IP to consider if it disagrees with the calculation.

If a landlord is unhappy with the outcome of the meeting, it is likely to be difficult to challenge the approval of the CVA on the basis of unfair prejudice or material irregularity if, ultimately, there would have been no difference to the outcome of the meeting. If the CVA would have been approved if a different discount or formula had been used, then even if there might have been an irregularity in valuing a landlord's claim or with the level of discount applied, that irregularity is not material.

Counting the Unimpaired Creditor Votes

More often than not, a retail CVA will compromise the claims of landlord creditors, but trade and other creditors will be paid in full. Usually, this differential treatment is justified based on maintaining business continuity.

One of the primary grounds of challenge in *New Look* was that the votes of unimpaired creditors (i.e. trade creditors) should not be counted towards the vote, essentially because they would be paid in full and, therefore, it was unfair to include their votes when the proposal that did not impact them.

Although *New Look* confirms that unimpaired creditor claims should be counted in the vote, the judge said that if a CVA is approved as a consequence of including the votes of unimpaired creditors, that is a highly relevant factor in determining whether there is unfair prejudice.

When might unimpaired creditor voting be unfair?

Unfortunately, this question is difficult to answer. The only indication of where the line might be drawn was given in the *New Look* decision where the judge said if "a large swathe" of unimpaired creditors vote in favour, this may give rise to a challenge based on unfair prejudice. However, if there is only a small number in value of unimpaired creditors voting in favour, it is less likely for there to be unfair prejudice.

There were, however, a few useful pointers about how the court might approach the answer to this question. Although the below is not definitive, the court may consider:

- The circumstances that would be taken into account in exercising the discretion to sanction a scheme of arrangement
- The circumstances that would be taken into account when exercising the discretion to cram-down a class in a restructuring plan
- Whether there is a fair allocation of the assets available within the CVA between the compromised creditors and other sub-groups of creditors
- The nature and extent of any different treatment, the justification for that treatment and its impact on the outcome of the meeting
- The extent to which others in the same position as the objecting creditors approved the CVA

It is also worth noting that it is not enough to mitigate the potential unfairness of unimpaired creditors being included in the vote, by justifying why those creditors are treated differently and ensuring that the landlord is no worse off than they would be if the company entered into a different insolvency process. The extent of "vote swamping" will be relevant and all the circumstances will need to be considered.

Disclosure

Creditors are entitled to sufficient information to enable them to make an informed decision about a CVA proposal in order for them to decide whether they should vote in favour of it or not.

In recent CVA challenges, including *New Look* and *Regis*, the extent of that disclosure has been questioned. The challenges in *New Look* and *Regis* did not succeed, but what amounts to sufficient information?

This will depend on the particular circumstances, and each case will be different, but creditors should be given:

(a) Enough detail to allow them to make an informed decision

(b) Sufficient information to make further enquiry if they think that the answer is relevant to their decision of whether to vote in favour or not

The position of equity stakeholders should be addressed and if anyone promoting the CVA has an incentive to do so, the CVA should also give information about this. In addition, where there is a wider restructuring, it is necessary to view the CVA and the information provided in the CVA in that context.

Largely, creditors can take comfort that an IP is required to exercise professional independent judgment when considering whether a proposal is feasible, that the IP should have made enquiries of the company to satisfy themselves of that, and reached a conclusion that the CVA should be put to creditors.

However, it is also important to note that if there is non-disclosure, this will only constitute a material irregularity if there is a substantial chance that the non-disclosed material would have made a difference to the way in which creditors voted at the meeting.

Summary

Practically speaking, we do not expect the manner in which landlords' claims are valued for voting purposes to change significantly following *New Look* and *Regis*, although there may be a more focused approach to how the formula is used and to the level of discount that is applied.

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