

CVAs are a useful tool in the restructuring tool kit, and may prove extremely helpful to retailers or hospitality companies as a means of supporting those businesses as they emerge from the pandemic. The flexibility of a CVA and the ability to shape the terms of a proposal to meet the specific needs of a business have seen an increasing number of consumer led businesses use CVAs, and they have become popular as a means to restructure businesses that have a significant lease portfolio. However, with landlords often being the primary creditors whose claims are compromised under the CVA proposal, this has also led to an increase in CVA challenges – most recently those challenging the *New Look* and *Regis* CVAs.

However, those challenges have not curtailed the value of the CVA as a restructuring tool, and CVAs may prove useful in the coming months/year as a mechanism to support a business that has struggled through the pandemic or that has not seen the bounce back to “normal” that perhaps it might have been expecting.

This alert looks at the CVA landscape post *New Look* and *Regis*, outlining, in particular, how a CVA can (or cannot) be used to modify and restructure leases. This could be useful to a number of businesses:

- Those that have accrued rent arrears during the pandemic
- Those whose business model has changed as a consequence of a change of consumer behaviour, i.e. a reduced need for real estate
- Those whose rent payments are above market rents
- Those with other accrued debts (such as bank loans, tax liabilities, government-backed lending)
- Those whose return to normal is perhaps slower than hoped/envisaged

## Rent Reductions

Simply put, a CVA can compromise both rent arrears and future rent.

Depending on the specific financial circumstances of a business, future rent can be reduced to below market rent, to a nil amount or switched to a turnover rent.

- **Market rent** – it is not inherently unfair if a CVA reduces rent below market rent, including during any notice termination period provided the vertical comparator test is met.
- **Turnover rent** – switching contractual rent to turnover rent is likely to be increasingly more common. It is not inherently unfair for a CVA to propose turnover rents, provided, again, that the vertical comparator test is met and the landlord is given a right to terminate.

- **Nil rent provisions** – an option to terminate is also key here. If a landlord has the option to terminate (and, therefore, a choice whether to accept such a modification) a provision that releases the company from all of its obligations, including an obligation to pay rent, is not inherently unfair.

A CVA is not, therefore, automatically unfair to a landlord if it proposes any of the above terms, provided that the landlord receives at least what they would receive in the relevant alternative (the vertical comparator test), and is given a right to terminate. The right to terminate is key, and we consider this further below.

## What Is the Vertical Comparator Test?

Each CVA will explain what is likely to happen to the company if the CVA is not approved. In most cases, it is likely to enter into liquidation or administration. Administration could be a trading administration, a pre-pack sale or shut down. When considering whether the landlord will receive at least what they would do in the relevant alternative, the company will need to know (usually with advice from an insolvency practitioner) what would happen to the company if a CVA is not approved. This will then help determine what a landlord would receive in an alternative insolvency process – this is often referred to as the vertical comparator test.

If a landlord is no worse off under the CVA than in the relevant alternative, it is unlikely that a CVA term will be unfair.



## Can a CVA Impose a Term That Requires a Landlord to Be Paid Nothing?

Recent CVA proposals have included provisions that enable the company (perhaps if the store does not meet certain performance criteria) to bring its obligations under the lease to an end, including the obligation to pay rent. In return, the landlord is usually given the option of agreeing a surrender, or leaving the lease in place.

This type of provision was challenged in *New Look* on the basis that it interfered with a landlord's proprietary rights, but the court did not agree that this was analogous to a surrender. The landlord had a choice between taking the property back or leaving the lease in place.

It is important to ensure that such provisions do not interfere with a landlord's proprietary rights, which cannot be interfered with. Previous case law has established that a CVA cannot interfere with a landlord's right to forfeit or force a landlord to accept a surrender of a lease. However, a provision that releases the company from all of its obligations, including the requirement to pay rent is permissible, provided the landlord is given a right to terminate.

### Termination Rights

When assessing the fairness of a CVA proposal, it is clear, following *New Look* and *Regis*, that the ability to terminate will be a **key consideration**.

Provided a CVA proposal offers the landlord choice – a right to terminate and take the property back, or accept the terms and be bound – a court is unlikely to find any modifications to lease terms unfair, provided that, on exercising a right to terminate, the landlord would be no worse off than in the relevant alternative.

If a landlord can choose between opting to accept the modified lease terms or take the property back, then it is up to the landlord (not the court) to determine whether it considers the terms fair. If the landlord does not like the terms or does not think they are fair, then they can terminate the lease.

It is, therefore, important to ensure that a landlord is given sufficient opportunity to take its property back if the CVA proposes to modify lease terms. This will give the landlord an opportunity to weigh up at the outset the consequences of taking the property back (such as liability for business rates and insurance) and opportunity (such as re-letting to a new tenant) against the proposed CVA terms.

## How Much Notice Is a Landlord Entitled to?

It is common for a CVA to give landlords (or at least some of them) 90 days or 3 months from the date the CVA is approved to decide whether to terminate the lease. Is this sufficient or should the landlord be given a rolling right to terminate?

90 days' notice is likely to be sufficient even if a landlord cannot find a new tenant or re-let within the initial termination period, provided the terms offered to the landlord met the vertical comparator test.

Further, when offering a right to terminate, there is no requirement on the company to make this a rolling right. There may be reason not to do so, such as business continuity. The decision rests with the landlord as to whether to continue the lease in the absence of such a provision.

## During a Notice Termination Period, How Much Rent Should a Landlord Be Paid?

Although most CVAs provide for a landlord to receive contractual rent during a termination notice period, the Judge in *New Look* said that "even in relation to rent reductions during a termination notice period"; Debenhams did not set a test that rent should be at least market rent.

Therefore, there is no minimum threshold, which means that a CVA could propose a rent payment that is lower than contractual rent or even lower than market rent for this period, provided, again, that the landlord will be paid at least the same as they would be if the company entered a different insolvency process.

## How Does a Right to Terminate Work if a Landlord Has Multiple Leases?

Following the reasoning in *New Look* and *Regis*, we would expect a CVA proposal to allow landlords with multiple leases to be given an option to terminate leases on an individual basis. Typically, it has been the case that a landlord is given a choice between terminating all or none of them. However, this provision restricts the landlord's choice, and choice was an important consideration in both challenge cases.

There may be some properties that the landlord wishes to re-let, and others where the better option is to leave the lease in place. Having the choice to decide which leases to terminate, rather than a more arbitrary choice between all or none, helps address the question of fairness and reduced the chance of challenge.





## Can a CVA Grant the Company a New Right to Terminate That Is Not in the Lease?

Yes, although such a term needs to be carefully considered in order that it does not interfere with the landlord's proprietary rights.

A CVA that gives the company a right to serve a Notice to Quit or a new right to terminate (the effect of which is to reduce rent to nil or release the company from its obligations under the lease) is not an interference with a landlord's proprietary rights but one that forces a landlord to accept a surrender would be.

## Does a CVA Proposal Have to Include a Profit-share Fund?

No, the Judge in *New Look* said that just because other CVAs have proposed a profit-share fund, did not mean that all CVAs must include one. However, the availability of a profit-share fund or other uplift mechanism may be an answer to fairness if creditors are treated differently. It is not always the case that differential treatment (even if justified) will overcome a finding of unfair prejudice, so this should be considered in appropriate cases.

## Summary

The findings in *New Look* and *Regis* highlight that the key to mitigating the (un)fairness of modified lease terms will be the ability of the landlord to terminate the lease. It is up to a landlord to assess whether rent reductions and other modifications to lease terms are fair, not the court. However, the proposed terms have to be considered in light of all of the circumstances and, most importantly, whether the landlord has a right to terminate, which, upon exercising that right, means that the landlord is no worse off than if the CVA was not approved and the company entered a different insolvency process. However, it should be noted that the landlords were given permission to appeal the *New Look* judgment, but unless the findings in *New Look* are overturned, CVAs remain a viable and useful tool for businesses in retail and hospitality.

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