Voluntary Arrangements
Retail Sector Restructuring – The New Blacks

Richard Ascroft & Jeremy Bamford, Guildhall Chambers

A. Introduction

1. Only the unobservant would have failed to notice that one of the main topics hitting the headlines in the insolvency, property and national press over the last year has been that of High Street retail CVAs, e.g.

    1.1. Stylo (Barratt and Priceless shoes) - rejected by creditors 13 February 2009,
    1.2. Sixty UK Ltd (Miss Sixty and Energie clothing brands) approved by creditors 2 April 2009,
    1.3. JJB Sports - approved 27 April 2009,
    1.4. Focus DIY - approved 23 August 2009,
    1.5. Blacks Leisure - approved 23 November 2009,
    1.6. Speciality Retail (Suits You, Racing Green) - approved 23 February 2010.

2. KPMG in particular have led the way in promoting the use of CVAs in the retail sector by their successful negotiation and implementation of the CVA in JJB Sports, which received widespread press coverage and complimentary praise from creditors. Delegates may have been fortunate to hear presentations on the topic by Richard Hill and Josie Richardson at the R3 South West & Wales Regional Meeting[1] or Brian Green at the ILA Annual Conference in Chester[2].

3. Those talks have, understandably, concentrated on the practicalities of successfully obtaining the agreement of creditors, in particular the landlords, to the CVA and the implementation of the CVA. Given the resurgence of interest in CVAs following JJB Sports and the continued increase in use revealed by the Insolvency Service's statistics[3], weaim to:

    3.1. recap briefly the relevant statutory provisions, including an update on recent cases, including 2 important cases on the implementation of CVAs as regards the decision by supervisors on proof and time bars;
    3.2. summarise the JJB Sports model and subsequent developments; and
    3.3. look, during the talk, at an example from practice where things have gone awry, which raises issues on construction, impact on guarantors and unfair prejudice.

    Whilst concentrating on CVAs, many of the points have analogous application to non-vanilla IVAs.

B. OVERVIEW OF STATUTORY PROVISIONS – PART I OF THE INSOLVENCY ACT 1986

4. A company voluntary arrangement ("CVA"):
    - is a statutorily recognised binding arrangement between a company and its creditors for the composition of its indebtedness
    - has the force of a statutory contract
    - may take effect notwithstanding a dissentient minority of creditors (who will, subject to successful challenge in the ways considered below) be bound by its terms.

5. The statutory source for CVAs is Part I of the Insolvency Act 1986 ("IA"). See also rr 1.1 to 1.54 of the Insolvency Rules 1986 ("IR").

6. Those who may propose a CVA are the company's directors (where the company is not in administration or being wound up) or any administrator or liquidator: s 1(1) and (3) IA.

---

[1] 2nd February 2010
[2] 27th March 2010. ILA members can access the slides from that talk at http://www.ilauk.com/conferences/conference_papers/conference_papers_2010
[3] The statistics for the 4th quarter of 2009 show 219 CVAs approved compared to 149 for the same quarter in 2008, a 47% increase. Such figures are dwarfed by the statistics for IVAs, which continued to show a substantial increase in volume for the 4th quarter of 2009 at 13,219, compared with 10,467 for the same quarter in 2008: http://www.insolvency.gov.uk/otherinformation/statistics/201002/index.htm

Guildhall CHAMBERS

7. A proposal for a CVA under Part I is one which provides for some person ("the nominee")[4] to act in relation to the voluntary arrangement either as trustee or otherwise for the purpose of supervising its implementation: s 1(2) IA.

8. The contents of the relevant proposal for a CVA are specified in r 1.3 IR. Creditors and members are invited to vote on the proposals at meetings convened on not less than 14 days' notice: s 3 IA.

9. A CVA requires the approval of a majority in excess of three-quarters in value of the creditors present in person or by proxy and voting on the resolution: r 1.19(1) IR.

10. Under r 1.19(4) IR any resolution is invalid if those voting against it include more than half in value of the creditors, counting only those:
    - to whom notice of the meeting was sent
    - whose votes are not to be left out of account because no written notice of claim was given to the chairman or convenor of the meeting or where the claim is secured or part of its secured
    - who are not, to the best of the chairman's belief, persons connected with the company.

11. Once approved, the CVA:
    - takes effect as if made by the company at the creditors' meeting (s 5(2)(a) IA);
    - binds (under s 5(2)(b) IA) every person who in accordance with the rules-
        (i) was entitled to vote at that meeting (whether or not he was present or represented at it), or
        (ii) would have been so entitled had he had notice of it, as if he were a party to the CVA.
    - may still be challenged in the 28 day period following the result of the meetings being reported to the court.

12. In the context of retail restructuring, it is well settled that a landlord's claim for future rent due under a lease with the debtor company is capable of being encompassed in a CVA (see *Re Cancol Ltd* [1996] 1 All ER 37 and *Doorbar v Alltime Securities Ltd* [1996] 2 All ER 948). Where, however, the company intends to continue trading from the relevant premises, it is not to be expected that the landlord's claim would include an element reflecting the future rental stream as the tenant company would be expected to pay the full rental as the price of continuing occupation: see *Thomas v Ken Thomas Ltd* [2007] 1 EGLR 1; *In re Cotswold Company Ltd* [2009] EWHC 1151 (Ch); [2009] 2 BCLC 371.

C. MEANS OF CHALLENGE

Section 6 IA 1986 – challenge of decisions at meetings

13. Section 6(1) IA identifies two statutory grounds for challenging the outcome of the meetings necessary to approve a CVA, namely:
    (1) that a CVA which has effect under s 4A (following approval at the required meetings) unfairly prejudices the interests of a creditor, member or contributory of the company (s 6(1)(a) IA);
    (2) that there has been some material irregularity at or in relation to either of the meetings (s 6(1)(b)(IA).

14. Those who may apply under s6(1) are identified in s 6(2) as:
    (1) a person entitled, in accordance with the rules, to vote at either of the meetings (s 6(2)(a));
    (2) a person who would have been entitled, in accordance with the rules, to vote at either of the meetings (s 6(2)(aa));
    (3) the nominee or any person who has replaced him under s 2(4) or 4(2) (s 6(2)(b)); and
    (4) if the company is being wound up or is in administration, the liquidator or administrator (s 6(2)(c)).

[4] Who must be a qualified licensed insolvency practitioner or authorised to act as nominee.

Guildhall CHAMBERS

15. Any application under either of the grounds in s 6(1) is subject to a statutory time limit of 28 days. More particularly, s 6(3) provides:

An application under this section shall not be made-
- *(a) after the end of the period 28 days beginning with the first day on which each of the reports required by s 4(6)*[5] *has been made to the court; or*
- *(b) in the case of a person who was not given notice of the creditors' meeting, after the end of the period of 28 days beginning with the day on which he became aware that the meeting had taken place,*

but (subject to that) an application made by a person within s 2(aa) on the ground that the voluntary arrangement prejudices his interests may be made after the arrangement has ceased to have effect, unless it came to an end prematurely.

16. Compliance with the statutory time limits is important as the court has no power to extend time, whether under the CPR or otherwise (*cf* IVAs to which s 376 IA apply): *Re Bournemouth & Boscombe Athletic Football Club Co Ltd* [1998] BPIR 183. In computing the 28 days, that day on which the reports were made to the court is, (as the natural reading of the statutory language makes clear) the first day was confirmed in *Bournemouth & Boscombe*.

17. If satisfied that either of the grounds in s 6(1) is made out, the court may do either or both of the following:
    - revoke or suspend any decision approving the CVA (s 6(4)(a) IA)
    - give a direction to any person for the summoning of further meetings to consider any revised proposal or a further meeting to reconsider the original proposal (s 6(4)(b) IA).

Unfair prejudice

18. This ground of challenge is the subject of considerable jurisprudence, much of it relatively recent. A useful review of what must be established to make good the ground was undertaken by Warren J in *SISU Capital Fund Ltd v Tucker* [2005[EWHC 2170; [2006] BCC 463. Reference may also be made to the judgment of Etherton J in *Prudential Assurance Co Ltd v PWG Powerhouse Ltd* [2007] EWHC 1002 (Ch); [2008] 1 BCLC 289; [2007] BCC 500. To summarise:

    18.1. any CVA (IVA) which leaves the relevant creditor in a less advantageous position than before the CVA – looking at both the present and the future – will be prejudicial (though not necessarily unfairly so);
    18.2. the onus in on the applicant to demonstrate that the voluntary arrangement which he challenges unfairly prejudices his interests;
    18.3. the relevant prejudice must arise in the applicant's capacity as a creditor of the debtor and not in any other capacity;
    18.4. the unfairness prejudice must arise out of (be caused by) the terms of the voluntary arrangement itself;
    18.5. the existence of unequal or differential treatment of creditors of the same class will not of itself constitute unfairness, but may give cause for enquiry and explanation;
    18.6. there is no single and universal test for judging unfairness in this context; determination of the existence of unfairness requires consideration of all of the circumstances including, as alternatives to the arrangement proposed (not only liquidation but a fairer scheme) and the practical consequences of a decision by the court to confirm or reject the arrangement;
    18.7. unfairness may be assessed by comparative analysis from a number of different angles including vertical comparison (i.e. with the position on winding-up or, in the case of individuals, bankruptcy) and horizontal comparison (with other creditors or classes of creditors);
    18.8. in the context of horizontal comparison a useful guide (in the case of a CVA) is comparison with the position if, instead of a CVA, there had been a formal scheme of

[5] After the conclusion of either meeting in accordance with the rules, the chairman of the meeting shall report the result of the meeting to the court, and, immediately after reporting to the court, shall give notice of the result of the meeting to such persons as may be prescribed.

arrangement under s 899 of the Companies Act 2006 on which different classes of creditors would have been required to meet and vote separately;

18.9. as to vertical comparison with the outcome on a winding-up (or bankruptcy), a court is overwhelmingly likely to interfere with a CVA (IVA) which would result in creditors or some of them receiving less than they would in a winding-up (bankruptcy), assuming the return by that process would in reality be achieved and within an acceptable time-scale;

18.10. comparison with a winding-up or bankruptcy is not, however, always conclusive as to unfair prejudice as a wider view of the impact of the CVA (IVA) may demonstrate;

18.11. depending on the circumstances, differential treatment may be necessary to ensure fairness or to secure the continuation of the company's business which underlies the arrangement (e.g. where it is necessary to pay some suppliers in full);

18.12. it is not for the court to speculate whether the terms of a proposed CVA (IVA) which were put forward by an office-holder were the best that could have been obtained, or whether it would have been better if it had not contained some of the terms which it did contain;

18.13. unless the court is satisfied that better terms or some other compromise would have been on offer, the comparison must be between the proposed compromise and no compromise at all judging matters as of the date of the vote on the CVA;

18.14. if an office-holder puts forward a proposal which he considers to be fair, then unless it is established that he acted other than in good faith or that he is partisan to the interests of some only of the creditors, the court should not speculate about what other proposals might have gained acceptance *and* been capable of implementation;

18.15. because the statutory scheme envisages that different creditors might have different views on whether an arrangement should be approved and provides for the minority to be bound by the majority (subject to protection in cases of "unfair prejudice"), what the court is seeking to identify is disproportionate prejudice on one side or the other;

18.16. if a reasonable and honest man in the same position as the applicant might reasonably have approved the CVA under challenge, the challenge will in all probability fail but the fact that no reasonable and honest man in the same position as the applicant would have approved the CVA is not necessarily conclusive in favour of the applicant.

19. Unfair prejudice in the context of retail sector restructuring arose directly in *Prudential Assurance Co Ltd* where the core elements of the relevant CVA were:

19.1. the establishment of a fund by the debtor company's New Zealand parent company (PGR) to pay a dividend of 28p in the £ to those who were creditors (including employees, landlords, local authorities and others) in respect of 35 underperforming retail stores;

19.2. the release by the relevant creditors of all claims against the company related to the closed stores;

19.3. the release of any guarantees or indemnities given by PGR to the closed store landlords.

20. Having considered the terms of the CVA, Etherton J expressed himself in no doubt that the proposed CVA was unfairly prejudicial to the applicants (landlords with the benefit of guarantees from PGR). Why? Because:

20.1. the landlords with the benefit of PGR guarantees ("Guaranteed Landlords") were left in a worse position that without the CVA, being obliged (under the CVA) to give up the right to enforce the guarantees;

20.2. the removal of that right deprived the Guaranteed Landlords of any negotiating position to persuade PGR to pay something for the loss of that right;

20.3. there was no evidence showing any benefit to the Guaranteed Landlords arising out of early recovery of the relevant premises (e.g. possibility of re-letting at higher rent);

20.4. a comparison of the treatment of the Guaranteed Landlords with that of other creditors supported the conclusion of unfair prejudice as all closed premises landlords were to receive 28p in the £, whether or not they had the benefit of PGR guarantees meaning the Guaranteed Landlords received nothing extra for the loss of the benefit of the PGR guarantees, guarantees which the court had found had real value;

20.5. on a liquidation the Guaranteed Landlords would have retained the benefit of the valuable PGR guarantees whereas all other unsecured creditors would receive nothing;

20.6. the Guaranteed Landlords were the class or group of unsecured creditors that would suffer the least, if at all, on an insolvent liquidation of the company but the class or group which is most prejudiced by the CVA;

20.7. in effect the votes of those unsecured creditors who stood to lose nothing from the CVA and everything to gain from it, inevitably swamped those of the Guaranteed Landlords who were significantly disadvantaged by it.

Material irregularity

21. An irregularity would include any failure to comply with the statutory code contained in the IA and the IR in putting forward the proposal and in connection with its consideration by members/creditors. It is clear that a "material irregularity" is not confined to one arising in the convening and conducting of the relevant meetings. An irregularity will not, however, be material, if had the correct procedure been followed, there would have been no difference in outcome: see *Cadbury Schweppes PLC v Somgee* [2001] 1 WLR 615; *Re Trident Fashions PLC (in administration) (No. 2)* [2004] EWHC 293; [2004] 2 BCLC 35; *Tradition (UK) Ltd v Ahmed* [2008] EWHC 2946 and 3448 (Ch); [2009] BPIR 626 at para [208].

22. Examples of material irregularity would or could include:
    - failure to supply appropriate information to creditors
    - failure to notify change of venue of meeting
    - rejection by the chairman of the meeting of a faxed proxy form
    - failure by the meeting chairman properly to apply the rules relating to voting

Appeal of chairman's decisions at creditors' meeting – r 1.17A(3) IR

23. Rule 1.17(3) IR affords a further route of challenge (beyond the material irregularity route in s 6(1)(b) IA) by way of appeal to the court against the chairman's decisions in respect of the ascertainment of those entitled to vote at the creditors' meeting and the admission or rejection of their claims.

24. Such an appeal, which may be brought by ay creditor or member of the company (r 1.17A(3)), is subject to the same 28 day time limit as is contained in s 6(1)(3)(a) IA.

25. If, on an appeal the chairman's decision is reversed or varied, or votes are declared invalid, the court may order another meeting to be summoned or make such order as it thinks just: r 1.17A(5). The court's power to make an order under this provision is exercisable only if it considers that the circumstances giving rise to the appeal give rise to unfair prejudice or material irregularity: *ibid*.

26. It is usual for challenges to a chairman's decision at the meeting of creditors in relation to voting rights to be the subject an application under s 6(1)(b) IA combined with an appeal under r 1.17A(3).

27. On an appeal under r 1.17A(3) the parties are not confined to the evidence which was before the chairman of the relevant meeting.

Section 7 IA 1986 – Implementation of proposal

28. In the context of implementation of CVA, any creditor or other person dissatisfied by any act, omission or decision of the supervisor may apply, under s 7(3) IA, to the court which has power to:
    (1) confirm, reverse or modify any act or decision of the supervisor (s 7(3(a));
    (2) give the supervisor directions (s7(3)(b)); or
    (3) make such other order as it thinks fit (s 7(3)(c)).

29. In contrast to a challenge under s 6, there is no time limit for applications under s 7(3) though no doubt undue delay would be something relevant to the exercise of the court's discretion.

30. Section 7(3) was successfully invoked by a creditor landlord in *The Cotswold Company Ltd* (supra) to challenge the CVA supervisor's decision (based on a mistaken interpretation by him of the effect of a deed of surrender of the lease) to reject as recoverable the landlord's claim for future rent and breach of other covenants.

31. The limits of s 7(3) and its relationship with s 6 were explored by the Chancellor (Sir Andrew Morritt) in a continuation of the SISU litigation. In *Tucker v Gold Fields Mining LLC* [2008] EWHC 1697 (Ch) s 7(3) was used to challenge the rejection by CVA supervisors of a creditor's claim for present, future and contingent liabilities under a deed of indemnity for being outside a 28 day time limit set out in the CVA . The issue before the Chancellor was whether on the true construction of the CVA, the claim was excluded if not made within 28 days of the creditor becoming aware of a creditors' meeting approving the CVA (as the supervisors contended) or whether time was extendable thereafter if the supervisors were satisfied that the default was not due to wilful default or lack of reasonable diligence on the part of the creditor (as the creditor claimed).

32. A subsequent appeal by the supervisors on the construction issue was dismissed ([2009] EWCA Civ 173; [2009] 1 BCLC 567), Mummery LJ observing (at para 37) that the text of the disputed provisions must be analysed carefully but not so closely or narrowly as to neglect the overall commercial context or the practical consequences. Lord Justice Rimer recognised the semantic basis on which the supervisors sought to make good their case but was ultimately persuaded that the most that could be said for their argument was that there was perhaps an element of ambiguity about the relevant paragraph and that ought to be resolved in favour of the creditor.

33. Following determination of the construction issue in favour of the creditor, the Chancellor went on ([2008] EWHC 1696 (Ch)) to determine whether or not the creditor's failure to lodge its claim earlier did not result from a wilful default or lack of reasonable diligence. That too was resolved in favour of the creditor but the Chancellor went on to consider whether, had the court determined that the creditor was guilty of wilful default, s 7(3) IA conferred on the court a discretion which should be exercised so as to allow the creditor to share in any future distribution as would be the case in a liquidation (where there are no time limits for submission of claims). The Chancellor said that had the issue arisen he would have been disposed to reject the creditor's argument on the ground that s 7(3) did not allow the relief sought. The jurisdiction under s 7(3) exists in relation to dissatisfaction with 'any act, omission or decision' of the supervisors. Its exercise here would have been sought in circumstances where it had been "indisputably determined that the late lodgement of the claim was the result of wilful default or a lack of reasonable diligence on the part of the creditor so that the time bar in the CVA applied". But in that event the dissatisfaction would have been with the terms of the CVA not any act etc of the supervisors. A challenge to the relevant provision of the CVA under s 6 IA on the basis it was unfairly prejudicial was well out of time.

34. The latest instalment of the litigation ([2010] EWHC 788 (Ch)) saw Sir John Lindsey give directions (guidance) to the supervisors as to the basis upon which they might now reject the creditor's claim.

D. The JJB model CVA

35. JJB Sports Plc ("**JJB**") and its subsidiary Blane Leisure Ltd ("**Blane**") are the UK's largest sports retailers, operating from some 250 retail stores, however with the downturn in the retail sector it ran into financial difficulty and a shortage of working capital in the second quarter of 2008. A standstill agreement with its lenders enabled a restructuring plan to be agreed under new management whereby JJB[6] disposed of its fitness club business and it proposed a CVA, the main aim of which was to compromise and curtail continuing rent roll costs of c. £17.3M p.a. that JJB was incurring to landlords in respect of 140 non-performing stores that JJB had closed ("the **Closed Premises**") but still remained liable for rent, service charges and dilapidations.

[6] In fact there were 2 interlocking and inter-dependent CVAs by JJB and Blane. For ease of reference JJB alone is referred to in these notes.

36. The main objectives and core terms of the JJB CVA proposal dated 6 April. 2009[7] were that:

36.1. the claims of landlords of the Closed Premises would be compromised;
36.2. JJB would thereby cease to have any further obligation to pay any amount to the Closed Premises landlords, otherwise than by way of compromise payment under the CVA: clause 12.1 and 12.2;
36.3. the landlords of the Closed Premises would be entitled instead to make a claim against and share pari passu in a set aside fund of £10M[8], payments out of that fund to be made in 2 tranches in September and December 2009;
36.4. the allowable claim of Closed Premises landlords was to be determined by applying a prescribed formula based on certain assumptions[9], advised upon by King Sturge, which included:
36.4.1. standardised amounts for dilapidation claims,
36.4.2. standard assumptions as regards the prospects of landlords re-letting (2 years to re-let),
36.4.3. mitigation following re-letting (incentive of 2 year rent-free period, followed by assumption that 75% of current rental achieved);
36.5. where a Closed Premises landlord of Blane had the benefit of a parent guarantee from JJB, then that fortunate Closed Premises landlord was entitled to make a claim against both the Blane fund and JJB fund[10].
36.6. save as aforesaid the compromise of the Closed Premises landlords' claims would not affect the rights and liabilities of third parties[11], e.g. any claims that a Closed Premises landlord might have against an original tenant, intermediate assignee or guarantor;
36.7. the CVA did, however, release JJB from liability to those creditors with contingent claims against JJB ("Contingent Property Creditors", i.e. guarantors of the Closed Premises, former tenants, guarantors of former tenants and sub-tenants), upon payment of £1[12].
36.8. JJB would, however, remain liable and would pay for rates in respect of the Closed Premises until such time as the relevant lease was forfeited, surrendered or assigned;
36.9. the landlords of premises which remained open and trading by JJB (some 250 stores) agreed to vary temporarily for 1 year the terms of the leases for the open stores, such that they agreed to accept rent paid on a monthly rather than quarterly basis;
36.10. save as aforesaid, there was no compromise of the claims of any other class of creditor.[13]

37. The JJB CVA was approved by creditors on 27 April 2009 with overwhelming support from the landlord creditors[14], thereby saving 7,000 jobs. It was achieved without the protection of an administration moratorium, the standstill agreement with the secured creditors allowing sufficient time for the nominees to put together the re-structuring. Considerable emphasis and work was done by the nominees prior to the proposals being sent out communicating with and canvassing support from the landlords. The negotiation of the CVA and contact with the landlords won considerable praise from the landlords and their trade body, the British Property Federation, e.g. -

> "The recent JJB Sports CVA is an excellent example of the landlord, tenant and IP working together, with the IP steering an acceptable outcome for all of the parties concerned. … This resulted in a positive outcome that was assisted by the open and honest way in which the negotiations took place. We were very impressed with the lengths the IP had gone to in order

---

[7] A copy of the CVA proposal for JJB and Blane issued on 6 April 2009 is available on the JJB Corporate website at http://www.jjbcorporate.co.uk/pdf/CVA%20Proposals%20-%206%20April%202009.pdf

[8] There were in fact 2 separate funds for each company, the relevant closed store landlord being paid out of the appropriate fund - c. £7.3M for JJB and £2.6M for Blane

[9] See clause 12.14 to 12.16 as to the calculation of allowable claims by Closed Store landlords, Annex 7 for the assumptions applied and clause 2 for worked examples of methodology for valuing such claims and applying the assumptions.

[10] Clause 14

[11] Clause 12.3

[12] Clause 17

[13] By way of contrast the proposed CVA by Deloitte of Stylo (Barratts and Priceless shoe chains) which were voted down were criticised for (i) changing significantly the terms of open store leases to turnover based rents, (ii) leading to uncertainty over whether further stores would be closed.

[14] The JJB CVA was approved by 99% of creditors and the Blane CVA by 98% of creditors.

Guildhall CHAMBERS

to keep various audiences informed, and tailored the communications specifically to those audiences. We would hope that this agreement sets a precedent in the industry, with similar standards upheld in any future negotiations."[15]

"A CVA can be an important mechanism to rescue a business but it has to be used fairly. If a firm wants to renegotiate terms of a lease to reflect, for example, their revenue, they have to be prepared to be fully transparent and present all their figures. This has not always happened. Thankfully though, JJB has acted commendably throughout this process and we hope that the level of practice employed here can set the standards for any other such negotiations."[16]

Application of the JJB model to other companies and morphing

38. The "JJB model CVA" has subsequently been successfully mirrored across in similar terms by KPMG to Focus DIY (CVA approved 23 August 2009 dealing with 180 trading stores and 38 closed stores) and Blacks Leisure (CVA approved 23 November 2009 dealing with 291 trading stores and 89 closed stores – the open store landlords agreeing to monthly rental receipts for 18m).

39. It has also been morphed to suit the Speciality Retail Group (Suits You, Racing Green) which was approved on 23 February 2010 by 98.1% of creditors. Following dialogue with the landlords the JJB model was variedsuch that:

    39.1. the landlords of 29 profitable stores (including designer outlets) would compromise their claims by agreeing to accept monthly, rather than quarterly, rent payments for 18 months;
    39.2. there would be no immediate closure of the 42 underperforming high street stores;
    39.3. the underperforming stores would continue to trade from those premises for a fixed term of 18 months and then close;
    39.4. during that 18m period landlords would compromise their claim at 60% of rent, insurance and service charge;
    39.5. rates would continue to be paid for 18m and if needs be beyond that;
    39.6. the landlords would have the option of taking on new tenants in the 18m period on giving 45 days notice.

Hardening of attitude / press coverage

40. Notwithstanding the successful approval of CVAs for JJB, Focus DIY, Blacks and SRG, there appears to have been a hardening of attitude by the large commercial landlords to such CVAs in the future, not least caused by concerns that (i) the landlords are the only class of creditor being singled out to suffer, (ii) the rapid turnaround of some of the insolvency patients and re-expansion into previously abandoned stores and (iii) threats by solvent and healthy businesses to use insolvency procedures to shed liabilities:

    40.1. "The property industry was recently angered by news that Blacks Leisure planned to expand back into stores it has previously exited through the use of its own CVA. That was passed last November, but today the British Property Federation (BPF) said that the industry would stand firm against future CVA proposals that it considered to be a mis-use of the system. …

    Liz Pearce, chief executive of the BPF, said:

    "Landlords are caught between a rock and a hard place. If they support a CVA, they're accused of creating a two-tiered market, disadvantaging successful, well managed businesses by offering cheaper rents to their competitors. If they oppose it, they're accused of sending the retailers under, even though they have absolutely no say in how the firms are run. Landlords do not force retailers into agreeing leases or

[15] Liz Pearce, chief executive of British Property Federation, Recovery Autumn 2009, p. 30.
[16] John Richards, chief executive of Hammerson Plc, major UK landlord, BPF press release 27 April 2009.

into expanding beyond their capacity. Clearly there is resentment over abuses of the system, and we now need a public debate on how the system is taken forward.

… there are now plans afoot to look at what clauses could be included in future proposals, to ensure that landlords would have a way of benefiting from the kind of miraculous recovery enjoyed by Blacks. Shortly after its CVA last winter, it then quickly announced plans to expand back into locations it had vacated."[17]

40.2. "The BPF has responded to reports from its members that Regus has demanded rent concession threatening insolvency for its underperforming assets even though it has a strong case position.

The BPF has condemned Regus for its cynical use of insolvency tools which were not intended to allow companies to pick and chose which parts of their contractual commitments they would like to walk away from in order to improve the profitability of their businesses."[18]

41. That changing tide of attitude may see future CVAs failing to get approval, alternatively dissatisfied landlords or contingent property creditors (prior tenants, guarantors) breaking ranks and seeking to challenge approved CVAs, arguing e.g.

41.1. as regards open store landlords that the CVA was prejudicial insofar as it sought to alter for the future the contractually agreed terms upon which the premises were supplied (e.g. changing to monthly rental payments) and insofar as it sought to restrict the exercise by that landlord of its proprietary right to forfeit for non-payment of the contractually reserved rent;

41.2. as regards closed store landlords, the differential treatment of closed store landlords from (i) open store landlords and (ii) the general unsecured creditors of the company. If the closed store landlord could produce evidence that on an administration or liquidation he would receive a greater return than under the CVA, then such differential treatment/prejudice may be **unfair** prejudice[19];

41.3. as regards contingent property creditors, if they were able to show a greater return on administration or liquidation than provided for under the CVA (e.g. in JJB they received only £1) that again may be unfair prejudice[20].

Richard Ascroft & Jeremy Bamford
Guildhall Chambers
April 2010

Appendix I

[17] BPF press release 23 February 2010
[18] BPF press release 11 March 2010.
[19] See Jeremy Goldring, Recovery Autumn 2009, p.34; Kevin Pullen, Recovery Winter 2009, p.34 and Jeremy Goldring, Recovery Spring 2010, p.33 for a series of articles questioning whether the JJB CVA would have withstood a challenge.
[20] See generally paras. 18-20 above.

Case Study – terms of CVA

Basis of the proposal

1. The main features of the proposals are that Parent will defer due repayment of £14M due from the Company. This will be to the benefit of general creditors (who should all be paid in full) and for the landlords of four loss making stores that will have to close for the Company to continue as a going concern. The key points are:
    a. The four loss-making stores will close with trading continuing from the Company's other stores;
    b. The landlords of the Closed Stores will receive 21% of the amount which it is estimated the Company would be liable to pay on the surrender of the leases;
    c. The landlords of the Closed Stores who have a guarantee from Parent will in addition receive a compensation payment from the Company financed by Parent of an additional 79% of the amount which it is estimated the Company would be liable to pay on the surrender of the leases, in return for releasing Parent from the guarantees; and
    d. All other creditors will continue to be paid in full under normal terms and conditions.

Terms of proposal

2. Four of the Company's stores, namely (i) Liverpool 1, (ii) Liverpool 2, (iii) Manchester and (iv) N. Ireland are loss making and it is proposed that they be closed ("Closed Stores")

3. The Company's obligations under the leases of Liverpool 1 and 2 are guaranteed by Parent ("the Guaranteed Leases").

4. The Company believes it can operate solvently if it disposes of the Closed Stores and if Parent is released from its guarantees of the Company's obligations under the Guaranteed Leases.

5. The Company is advised that in a liquidation, the rule of thumb will be that the landlords on the surrender of the leases of the Closed Stores will be entitled to a year's rent before they can reasonably be expected to find new tenants. On an individual basis, the extent of the Company's liability is as follows:

    a. Liverpool 1 and 2 (£300,000);
    b. Manchester (£675,000);
    c. N Ireland (£42,500)

    The assumptions and qualifications on which these estimates are based are set out in the Appendix.

6. It is proposed that the Landlords of the Closed Stores without guarantee, that is to say Manchester and N Ireland will receive a settlement payment representing 21% on the surrender of the lease of these premises, that is to say £142,747 and £8,988 respectively.

7. It is proposed that the Landlords under the Guaranteed Leases will receive (a) a settlement payment representing 21% of the Company's estimated liability under the leases, that is to say £63,443 and (b) a compensation payment from Parent representing a further 79% of the Company's estimated liability under the leases, that is to say £236,557.

8. The receipt of this compensation payment by the landlords under the Guaranteed Leases will immediately and automatically operate to release all liability of Parent under the guarantees of the leases of the Closed Stores and the landlords under the Guaranteed Leases shall not take any steps to enforce the guarantees provided to them.

9. All remaining creditors will continue to be paid in full.

10. The landlords of the Guaranteed Leases (severally and collectively) shall on approval of these proposals and as far as permitted by law release the company from any obligation (except to enforce the payments referred to above) and agree with the company not to claim against Parent under its guarantees or otherwise. The purpose of this latter restriction is to avoid the risk to the Company of Parent bringing any claim for indemnity or contribution against the Company further to any guarantee claims on Parent.

11. Standard condition. The claims of unsecured creditors as at the date of the creditors' meeting at which the proposals are agreed will be deemed to be fully satisfied on the issue by the supervisor of a certificate of final completion.

Appendix II

Is it possible for a CVA to discharge a surety?

1. Chadwick LJ identified this issue in *Johnson v Davies* [1999] Ch 117, at p. 129A-F. It had been held by Jacob J in *R. A. Securities Ltd v Mercantile Credit Co Ltd* [1995] 3 All ER 581, at p. 586-587 that a term which, if contained in a consensual document, would have the effect of discharging a surety as a matter of law, will not have that effect if contained in a voluntary arrangement (whether individual or corporate) under IA 86, at least not where the creditor has not, in fact, consented to the CVA. Jacob J had distinguished actual consent from what he described as "a statutory binding" under the CVA and had followed his own decision at the first instance appeal in *Johnson v Davies*. Lightman J in *March Estates Plc v Gunmark Ltd* [1996] 2 BCLC 1 had endorsed Jacob J.'s views although, as Chadwick LJ (p.129C) commented:

   "that judge, at p.6F-G, accepted that a voluntary arrangement might expressly or by necessary implication regulate the rights of a creditor of a company and of third parties liable for the same debt. Lightman J. expressed the view that, for such to be the case, the intention to regulate such rights must be made plain on the face of the proposal: "The voluntary arrangement may statutorily absolve the company from liability without absolving or releasing from liability any other party and will ordinarily be construed as reserving all rights of creditors against other parties".

2. Chadwick LJ considered that issue as against the history of the insolvency legislation, the position under deeds of arrangement, the provisions for release on discharge from bankruptcy and the wording of the IA 86 (seep. 129 – 139) and concluded:

   2.1. At p. 137G:

      "There is an important – and, to my mind, crucial distinction between the provisions in Part VIII of the Act of 1986 and those in sections 125 and 126 of the Act of 1869. Under the Act of 1869 the discharge of the debtor took effect by virtue of statute and the rules made under it: see *Megarth v Gray*, L.R. 9 C.P. 216, 231 and *Ex parte Jacobs*, L.R. 10 Ch.App. 211, 213. Under the various Companies Acts, considered in the authorities cited, the discharge takes place by virtue of a scheme which becomes operative when it is approved by the court. Under Part VIII of the Act of 1986, the discharge of the debtor depends entirely on the terms of the arrangement. **One must look at the arrangement, and nothing else, in order to find the terms (if any) under which the debtor is discharged**. This is emphasised by the words in section 260(2) of the Act of 1986: "The approved arrangement … (b) binds every person … as if he were a party to the arrangement." Unlike the earlier legislation, section 260(2) of the Act of 1986 does not purport, directly, to impose the arrangement on a dissenting creditor whether or not he has agreed to its terms; rather he is bound by the arrangement as a result of a statutory hypothesis. The statutory hypothesis requires him to be treated as if he had consented to the arrangement. The consequence, as it seems to me, is that the legislature must be taken to have intended that <u>**both**</u> **the question whether the debtor is discharged by the arrangement and the question** <u>**whether co-debtors and sureties are discharged**</u> **by the arrangement were to be answered by treating the arrangement as consensual; that is to say, by construing its terms** as if they were the terms of a consensual agreement between the debtor and all those creditors who, under the statutory hypothesis, must be treated as being consenting parties."

2.2. Chadwick LJ noted the policy considerations at p. 138 D-F and concluded (p.138F-G) that it was up to the debtor, if the debtor wanted to effect a release of co-debtors or sureties, to include within its proposal terms to that effect:

"It is **up to the debtor to propose**, and for the creditors to accept or reject, **proposals which either do or do not have the effect of releasing co-debtors or sureties**. A creditor who is prejudiced by the decision of a majority to approve proposals which have the effect of releasing a co-debtor against whom he would otherwise have recourse can apply to the court, under section 262 of the Act of 1986, for the approval of the meeting to be revoked."

2.3. The Judge's conclusion on the point of principle is at p. 138H:

"It follows that I would reject the submission that, as a matter of principle, no term in a voluntary arrangement can have the effect of releasing a co-debtor or surety. **In my view the effect of a voluntary arrangement has to be determined by construing its terms.** In the present case, the terms of Mr. Hopkins's voluntary arrangement did not have the effect of releasing or discharging the defendants from their liability as co-debtors."

3. As to the terms of the IVA in *Johnson v Davies* Chadwick LJ's analysis of the construction of those terms is set out earlier in the judgment (p. 122-128), which can be summarised as follows:

3.1. The IVA proposal provided for the debtor to pay 75% of his net income and any windfall receipts for the period of 5 years to his supervisor for distribution to creditors (p.123E).

3.2. The release provision was contained in paragraph 4, which provided for release of the debtor once all monies had been realised and distributed to creditors (p.123F):

"When all moneys to be made available under these proposals have been realised and distributed to creditors in accordance with the terms herein I will be released from any further liability to them relating to claims in respect of which they were entitled to participate in this voluntary arrangement."

3.3. Chadwick LJ's conclusions on construction are at p. 127H – D:
"Approaching the matter on this basis, it seems to me plain that the words used in paragraphs 4 and 19 of the voluntary arrangement, construed in the light of the proposals as a whole, are inconsistent with any intention to effect an immediate or absolute release of the debts owed to creditors. … When all moneys "to be made available … have been … distributed … I will be released" means just that. The release is not to take effect (if at all) until the debtor's obligations under the proposals have been fulfilled.

I am satisfied, therefore, that this is not a case in which the bargain evidenced by the voluntary arrangement between Mr. Hopkins and his creditors has led to a release by accord and satisfaction of the joint debt owed by Mr. Hopkins and the defendants to the plaintiffs, such that that debt can no longer be enforced against the defendants."

3.4. The judge went on to consider whether it was necessary to imply any terms into the IVA (p.128E-H):

"It is plain that some term has to be implied into the arrangement if it is to work. This is because the arrangement does not, in terms, preclude any creditor from taking steps, outside the arrangement, to enforce his claim. Nor is there anything in Part VIII of the Insolvency Act 1986 which has that effect, other than the terms of the arrangement to which creditors are bound. Any interim order made under section 252 of the Act ceases to have effect once the approval of the creditors to the arrangement has been notified to the court: see section 260(4). But, plainly, the arrangement will not work as intended if creditors are under no restriction in relation to enforcement of their claims. **At the least, a term which must be implied in order to give efficacy to the arrangement is that creditors bound by the proposals will take no steps to enforce their claims *against the debtor*** while the debtor is complying, or has complied, with his obligations thereunder. It is plain that the arrangement would work better, in the interests of the debtor and of creditors who have no claim against a co-debtor, if all creditors were bound to take no steps to enforce their debts not only against the debtor but also *against any co-debtors*. **But, although that might be a convenient and tidy result, it does not seem to me it is *necessary* that that result should be achieved in order to give efficacy to the arrangement. And if it is not necessary the term should not be implied**."

4. In *Prudential Assurance v PRG Powerhouse* [2008] 1 BCLC 289 Etherton J rejected a contention that a clause which provided that payment of the dividend under the CVA to any scheme fund creditor immediately and automatically operated to release all liability of PRG as holding company guarantor under the guarantees, insofar as it purported to have a direct binding effect on the substantive rights and obligations of the guaranteed landlords and PRG under the guarantees, on the basis that

> "[51] The hypothetical agreement resulting from approval of a CVA is not, therefore, one between creditors as to rights and obligations between themselves in a capacity other than as creditors of the company. In relation to the guarantees PRG's obligations are those of debtor arising out of contract made by itself as principal on its own behalf. There is nothing in the IA or IR which makes the CVA binding and enforceable as between PRG and the guaranteed landlords in respect of such obligations."

5. However the judge went on to hold [58] – [66] that a separate clause which provided that the PRG guarantees "shall … be treated as having been released" was enforceable by Powerhouse against the guaranteed landlords as an obligation of the guaranteed landlords not to claim against PRG under the guarantees.