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Review

Real Estate

LANDLORDS REJOICE AS HIGH COURT OVERTURNS "UNFAIR" CVA

The past two years have seen a marked increase in the use of the Company Voluntary Arrangement ("CVA") by retailers to reduce their lease liabilities and win the release of onerous parent company guarantees. Several well-known high street names have gone through the process, such as JJB Sports, Blacks Outdoor Leisure and Focus DIY. CVAs have received cautious support from landlords but real concern continues to be voiced regarding the practice of "guarantee stripping".

In ***Mourant & Co Trustees Limited & another v Sixty UK Ltd (in liquidation) & others [2010] EWHC 1890 (CH)*** the High Court has set the boundaries on acceptable practice in this area and has provided some comfort to landlords that they will not be bulldozed into accepting unpalatable proposals, simply because they are a minority voice in the proceedings. The case provides welcome clarification regarding the meaning of "unfair prejudice" to a creditor in a CVA and highlights the requirements for a fair CVA.

FACTS

Sixty UK Ltd (the "Company") traded under the brands of "Miss Sixty" and "Energie". The Company was loss-making and, in April 2008, it appointed insolvency practitioners to advise on a potential restructuring and the closure of loss-making stores. Amongst the proposals was the closure of two retail units at the Met Shopping Centre in Liverpool. The Company operated from these premises under two ten-year leases entered into in November 2006. Each lease was guaranteed by the Company's ultimate parent company, Sixty SpA. The insolvency practitioners obtained valuation advice aimed at quantifying the loss which would be suffered by the landlords as a result of a surrender of the units.

In September 2008, the Company entered administration with a view to then proposing a CVA to the Company's creditors from behind the protection of the statutory moratorium. The insolvency practitioners were appointed the administrators (and, in due course, they would become the supervisors under the CVA). In March 2009, the administrators presented their CVA proposal to the creditors and this was approved in April 2009.

The CVA proposal provided for all of the Company's trading creditors to be paid in full on an ongoing basis, save for the landlords of four premises that were to be closed, including the two retail units at the Met Centre. The CVA sought to take advantage of the decision in *Prudential Assurance Company Ltd v PRG Powerhouse Limited [2007]* by using the CVA to release Sixty SpA from its parent company guarantees.

Under the proposal, the landlords of the Met Centre stores would receive a compensatory payment of £300,000 (which Sixty SpA would pay) in return for which the Company would be released from its liabilities under the leases and Sixty SpA would be released from all liability under the guarantees. The proposal stated that the figure of £300,000 represented 100% of the Company's estimated liability to the landlords on a surrender of the leases, calculated on the basis of the valuation advice received and certain specified assumptions. The landlords disagreed with this assessment and challenged the CVA.

DECISION

The court considered carefully the basis of the calculation of the proposed compensation payment and the assumptions upon which that payment was based. It concluded that the assumptions were unrealistic and that the level of compensation proposed was too low. During the course of the proceedings, it became apparent that the proposed level of compensation was not a reflection of the true value of the landlords' losses but rather it represented the maximum amount that Sixty SpA was prepared to pay into the pot to obtain a release of its obligations under the guarantees.

The court found that the assumptions set out in the CVA proposal did not match the assumptions upon which the supervisors' valuer had based his preliminary calculations in April 2008. It was clear that the supervisors had chosen selectively which of the valuer's assumptions to adopt, in order to bring the calculation of the landlords' losses down. A later report from the valuer, provided at the trial, indicated that the likely value of the landlords' claim was approximately £1.2 million.

NO UNIVERSAL TEST OF "UNFAIRNESS"

The judge, Henderson J, went on to examine the *Powerhouse* decision in assessing whether the proposal amounted to unfair prejudice of a creditor's position. He followed, with approval, the approach adopted by the court in that case and stated that there is no single universal test that can be applied to determine whether or not a proposal is unfair. There are, however, a number of techniques that can be used to assess the impact of a proposal on a creditor's position, he said.

The judge focused on two approaches: the "vertical" approach and the "horizontal" approach. He applied these as follows:

- **the "vertical approach" to assessing unfairness**

  It is an established principle that a CVA proposal ought to place the creditor in a better position than it would have been in, had the company simply been liquidated. In this instance, the rights of the landlords under the parent company guarantees would have been unaffected by a liquidation of the Company and the landlords would have had full recourse against the parent company for all of their losses under the leases. Any offer of compensation for a release of the parent company guarantees would therefore have needed to be significant in order to persuade the landlords that it was appropriate to give up their contractual rights against the parent. Against this background, Henderson J considered that the loss of these valuable rights in return for an unsatisfactory financial lump sum payment was unfairly prejudicial.

- **the "horizontal approach" to assessing unfairness**

  This involves comparing the position of the creditor against the position of other creditors or classes of creditors who are also able to prove within the CVA. Different treatment of creditors will need to be justifiable. In this instance, the position of the landlords was compared with the position of the landlord of another store, where the Company operated as assignee from Muji Ltd. Muji Ltd was liable as original tenant for all of the liabilities under that lease and therefore stood in a quasi-guarantor position. The CVA allowed Muji to claim in full for any losses that it may suffer as a result of the closure of that store and this in turn meant that the landlord of that store retained the benefit of the Muji "guarantee". This differed significantly from the position of the landlords involved in this case, as they were effectively being stripped of the benefit of the parent company guarantees. The judge concluded that there was no justification for treating the Met Centre landlords differently from Muji's landlord and that the CVA was also unfairly prejudicial on a horizontal basis.

CONCLUSION

The evident purpose of the CVA, said the judge, was to compel the affected landlords to give up their rights under the parent company guarantees for a fraction of their fair value. In his view, the CVA was proposed solely to improve the Company's negotiating position, in circumstances where it knew that the majority of the Company's creditors would be bound to pass the CVA proposal, as only a very few of the creditors were adversely affected by the terms of the proposal.

The judge also concluded, having considered the *Powerhouse* decision, that it is possible to propose a fair CVA of this type but the greatest care is needed to ensure fairness to the small class of affected creditors, *"both in the substance of what is proposed and in the procedure that is adopted"*.

It is incumbent on the office holders proposing the CVA to maintain an independent stance and to act in good faith when proposing such a CVA, he said.

OUTCOME FOR THE PARENT COMPANY

Subsequent to this decision, the High Court ruled that Sixty SpA is liable to pay the sum of £600,000 to the landlords under its parent company guarantees in respect of unpaid rent, interest and breach of tenant trading covenants contained in the leases. The judge refused Sixty SpA the right to appeal this judgement.

The landlords are seeking total damages in excess of £4 million and it is expected that the full claim will be heard later this year.

COMMENT

This case lays down a useful marker regarding the acceptable boundaries of any CVA proposal. It provides some cautious support for the continued use of a CVA to release parent company guarantees but makes it crystal clear to insolvency practitioners that they must act at all times in the best interests of all the creditors. They must not allow their judgement to become clouded by the commercial considerations of any parent company that may be providing the ultimate funding behind the application. The case also highlights the need to ensure that the basis of assessment of compensation proposed is properly justifiable on an objective basis.

For further information on this topic please contact any of the following:

DANIEL FRENCH
PARTNER, BIRMINGHAM
T: +44 (0)121 222 3697
E: daniel.french@ssd.com

ANDREW SPRAKE
PARTNER, LEEDS
T: +44 (0)113 284 7367
E: andrew.sprake@ssd.com

MIKE SHAW
PARTNER, LONDON
T: +44 (0)20 7655 1227
E: michael.shaw@ssd.com

LIAM BUCKLEY
PARTNER, MANCHESTER
T: +44 (0)161 830 5017
E: liam.buckley@ssd.com

NICK GREEN
PARTNER, BIRMINGHAM
T: +44 (0)121 222 3519
E: nick.green@ssd.com

JOHN ALDERTON
PARTNER, LEEDS
T: +44 (0)113 284 7026
E: john.alderton@ssd.com

CATHRYN WILLIAMS
PARTNER, LONDON
T: +44 (0)20 7655 1189
E: cathryn.williams@ssd.com

SUSAN KELLY
PARTNER, MANCHESTER
T: +44 (0)161 830 5006
E: susan.kelly@ssd.com

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