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Retail CVAs – landlords are feeling the pain

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As we are all only too aware, many UK retailers are struggling and landlords increasingly feel they are bearing more than their fair share of the financial fall-out. Administrations and company voluntary arrangements (CVAs) are being announced with alarming frequency, bringing with them plans for store closures and requests for rent cuts. Maplin, Toys R Us and Carpetright plan to close more than 5 million square feet of retail space between them, with at least another 5 million square feet set to close in the casual dining sector[i], and the latest announcements by House of Fraser, Mothercare and Carluccio's underline how fast the list is growing. A recent court decision in relation to the BHS CVA offers landlords some comfort but it is a small victory in the face of the huge impact of the current spate of CVAs on retail landlords and its impact may be limited.

What is a CVA?

Put simply, a CVA is a way for a struggling company to reduce its debt burden by paying only a proportion of its liabilities to its unsecured creditors. Rent is a huge part of a retailer's cost base and a successful CVA can reduce liability not just for arrears but for rent that will fall due in the future. This can enable retailers to reduce the burden of long leases of stores that are now too large and which are over-rented in comparison to today's market. The company's creditors do not have to agree to the proposals but often take the pragmatic view that they may recover more if a CVA leads to a successful recovery than if the company goes straight into insolvency. A CVA must be approved by 75% (by value) of the company's unsecured creditors and, once approved, it binds all creditors who would have been entitled to vote – even those who disagreed or who, through administrative oversight, did not have notice of the proposal.

What is the impact on landlords?

Each CVA is put together based on the company's particular position but retail CVAs invariably involve a proposal to close some stores, usually accompanied by a request to reduce the rent on those that will remain open. Stores are often ranked in categories, according to the company's assessment of their viability. Typically, some are ear-marked for immediate closure, while different levels of rent reduction will be proposed for different sets of properties. It is always open to landlords and tenants to reach agreement on surrenders or changes to rent on specific properties but a CVA enables tenants to present landlords with much wider proposals covering the tenant's entire portfolio. While a CVA is in place, landlords have no right to take enforcement action in relation to the balance of rent that would otherwise have been due.

A CVA is not permanent and can be brought to an end, for example if the company fails to meet even its reduced rental obligations. Creditors will want the CVA to set out what rights they have if it is terminated and will, ideally, want to regain their right to recover debts due to them, as if the CVA had never happened. This is a key safeguard, without which creditors may be less willing to agree to CVA proposals. There was wording of this sort in the BHS CVA, which became a key issue in the recent litigation (*Anthony John Wright and Geoffrey Paul Rowley as joint liquidators of SHB Realisations Limited (formerly BHS Limited) (in liquidation) v The Prudential Assurance Company Limited* [2018]).

The BHS case

BHS went into liquidation in November 2016 but in March 2016, a CVA had been proposed and approved, which included rent reductions on a sliding scale from 100% to 25%. Prudential were to receive 75% of the rent payable in relation to their two properties. In April 2016, BHS entered into administration. The CVA remained in place and the administrators paid rent to the landlords at the rates set out in the CVA, until such time as the stores were no longer used for the purposes of the administration.

The CVA gave any landlord creditor the right to terminate the CVA if the company failed to pay the concessionary rents. A landlord (not Prudential) served the relevant notice and the CVA was terminated. Clause 25.9 of the CVA provided that on termination, the CVA was deemed never to have happened, so that all compromised CVA creditors would have claims against the company as if the CVA had never been approved, less any payments made while the CVA was in place.

Having received only 75% of the contractual rents during the CVA, Prudential claimed for the 25% that would, but for the CVA, have been payable, as an expense of the administration. The liquidators resisted, arguing that:

- reverting to full rent after the CVA had ended created a new obligation, which was an unenforceable penalty on the company;
- Prudential was seeking an advantage over other creditors; and
- during the administration, the administrators had been liable only for rent at the rates agreed in the CVA and Prudential could not claim additional rent for that period now.

In a victory for common sense, the judge dismissed the liquidators' arguments. The judgment sets out a number of useful comments on the relationship between CVA terms and the underlying contractual obligations. The agreement that the terms of the leases would remain unchanged if the CVA failed was a key aspect of the commercial deal put to the landlords and this could not be construed as a penalty. There had been no actual variation of the leases – the landlords' right to recover full rent had been compromised against BHS, but only while the CVA was in place. In seeking to recover the full rent, Prudential was not seeking any advantage over other unsecured creditors. In relation to rent as an expense of the administration, the administrators were liable to pay what was actually due for that period. The fact that the full liability became clear only after the CVA had ended did not affect the administrators' obligation to pay.

Where do we go from here?

Landlords will be reassured that the judge in the BHS case did not let the liquidators go back on terms which were initially introduced for the benefit of all the parties (including the company itself) but subsequent CVAs may have been drafted differently. There are also wider concerns over the whole CVA regime and landlords are increasingly calling for a review of the rules. Proposals that have been aired include giving those unsecured creditors who will take the biggest hit from a CVA proposal a greater say in the outcome and tightening rules on consultation with creditors before formal CVA proposals are issued. With no quick fix on the horizon for struggling retailers, landlords will be facing CVAs for some time to come and it is arguably in the best interests of the whole property market to make the process as open and fair as possible.

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[i] Radius Data Exchange data, cited in https://www.egi.co.uk/news/news-round-up-are-we-heading-for-the-retail-apocalypse/