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Welcome to Landmark Chambers' 'A New Look at Leasehold Restructuring – are landlords out of the money?' webinar

The recording may be accessed here.

Your speakers today are…

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Zia Bhaloo QC (Chair)

Camilla Lamont

Topic:
"Virgin Territory" Restructuring Plans under Part 26A of the Companies Act 2006

David Nicholls

Topic:
A New Look at Leasehold Restructuring

Evie Barden

Topic:
Carraway Guildford (Nominee A) Limited v Regis UK Limited [2021] EWHC 1294 (Ch)

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A New Look at Leasehold Restructuring

David Nicholls

Lazari Properties 2 v New Look Retailers 2021

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A Bruising Outcome!

A pragmatic response!

Deepens tensions

Tips the balance

Inevitable

Circumstances

- Decline of High Street
- Pandemic
- Coronavirus restrictions

New Look

- 400+ stores
- 10,000 people
- Sales down 32%
- No revenue

CVA

Cat B – viable:

- Arrears released in full
- Rent replaced by turnover rent
- Right to terminate

Cat C – not viable:

- No arrears
- Two months rent only
- Right to terminate

A root and branch attack

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- Jurisdiction
  - Not a true CVA
- Unfair prejudice
  - Turnover rent
  - Unimpaired creditors voted in favour
- Material irregularities
  - Insufficient information
  - Discounting of votes

Judgment

Jurisdiction:

- It was a CVA
- Differential treatment of creditors not unfairly prejudicial
- Sufficient give and take
- Termination rights counterbalanced the reduced rent

Material irregularities:

- None

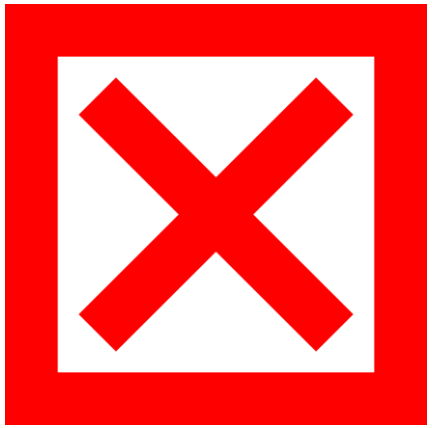
Judgment (2)

How to assess unfair prejudice

- Take into account all circumstances
- Horizontal comparator
- Vertical comparator

Unfair prejudice?

- Different treatment
- Reducing rent
- Modifying leases



The future?

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Group of creditors swamped by votes of unimpaired creditors

Factors:

- Fair allocation of assets?
- Nature and extent of differential treatment?
- Position of other objecting creditors
- Same result achieved otherwise

Conclusion

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Carraway Guildford (Nominee A) Limited v Regis UK Limited [2021] EWHC 1294 (Ch)

Evie Barden

Terms of the proposal

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- Usual provision preventing creditors taking or continuing processes for payment of liabilities outside of the CVA.
- “Critical Creditors” to the trading of the company were unaffected by the CVA and would be paid in accordance with existing terms.
- “Compromised Creditors’ Payment Fund” established for payment of “Allowed CVA Claims” and payment of costs, expenses and disbursements. The Company to pay £300,000 into the fund.
- “Profit Share Fund” established also: the Company to pay 20% of amount by which aggregate of net profit for the period of 2 years after effective date exceeded £250,000 up to maximum of £200,000.

Who drew the short straw?

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- Categories 2 to 5 landlords:
  - All arrears subject to a % reduction as well as future rent.
  - Right to terminate their leases, ranging between the right to do so on not less than 60 days' notice at any time within 90 days following the effective date and 90 days prior to 3rd anniversary for Category 2 landlords to the right to terminate at any time on 30 days' notice for the Company and the landlord for Category 5 landlords.

Landlords' votes

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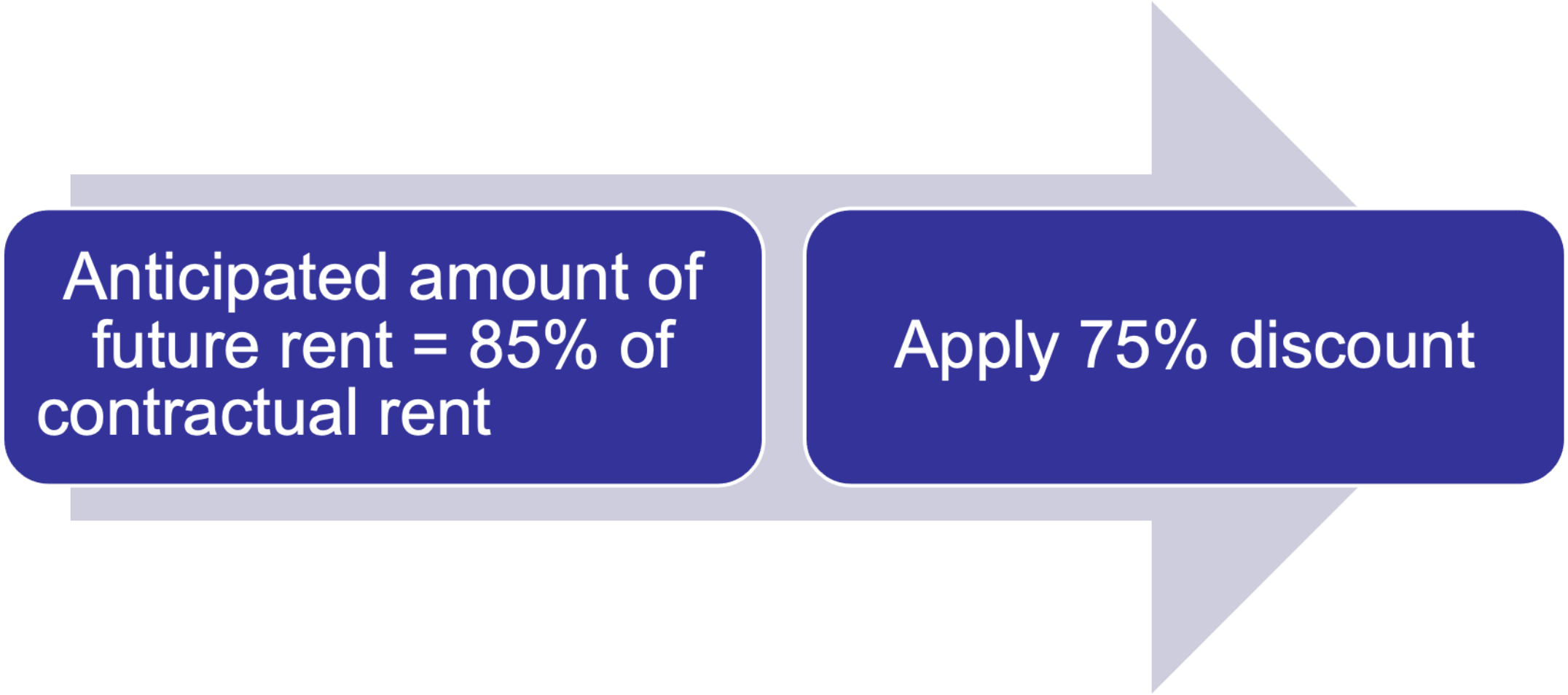

Who were the winners?

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Regis Corporation (Regis Corp)

- Former ultimate parent until October 2017.
- Parent sold shareholding to IBL in October 2017.
- In the process, the Company transferred a number of assets to group companies which were the then subject to franchise agreements or licences to IBL.
- Debt of £1,097,136.

International Beauty Limited (IBL)

- Sole shareholder.
- After purchase of shareholding, a dispute arose with Regis Corp.
- Dispute settled in August 2018 by IBL issuing a promissory note to Regis Corp, backed by a debenture from the Company.
- Debt of £594,035.

What were the issues?

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- Disclosure: was the disclosure to creditors adequate?
- Regis Corp and IBL: should Regis Corp and IBL have been admitted to vote and/or was their treatment as Critical Creditors unfairly prejudicial?
- Claims' discounting: was the calculation of landlords' claims for voting a material irregularity or unfairly prejudicial?
- Modifications to leases: were they unfairly prejudicial or were they mitigated by the new termination rights or profit-share fund?
- Nominees' conduct: were they in breach of duty and, if so, what were the consequences?

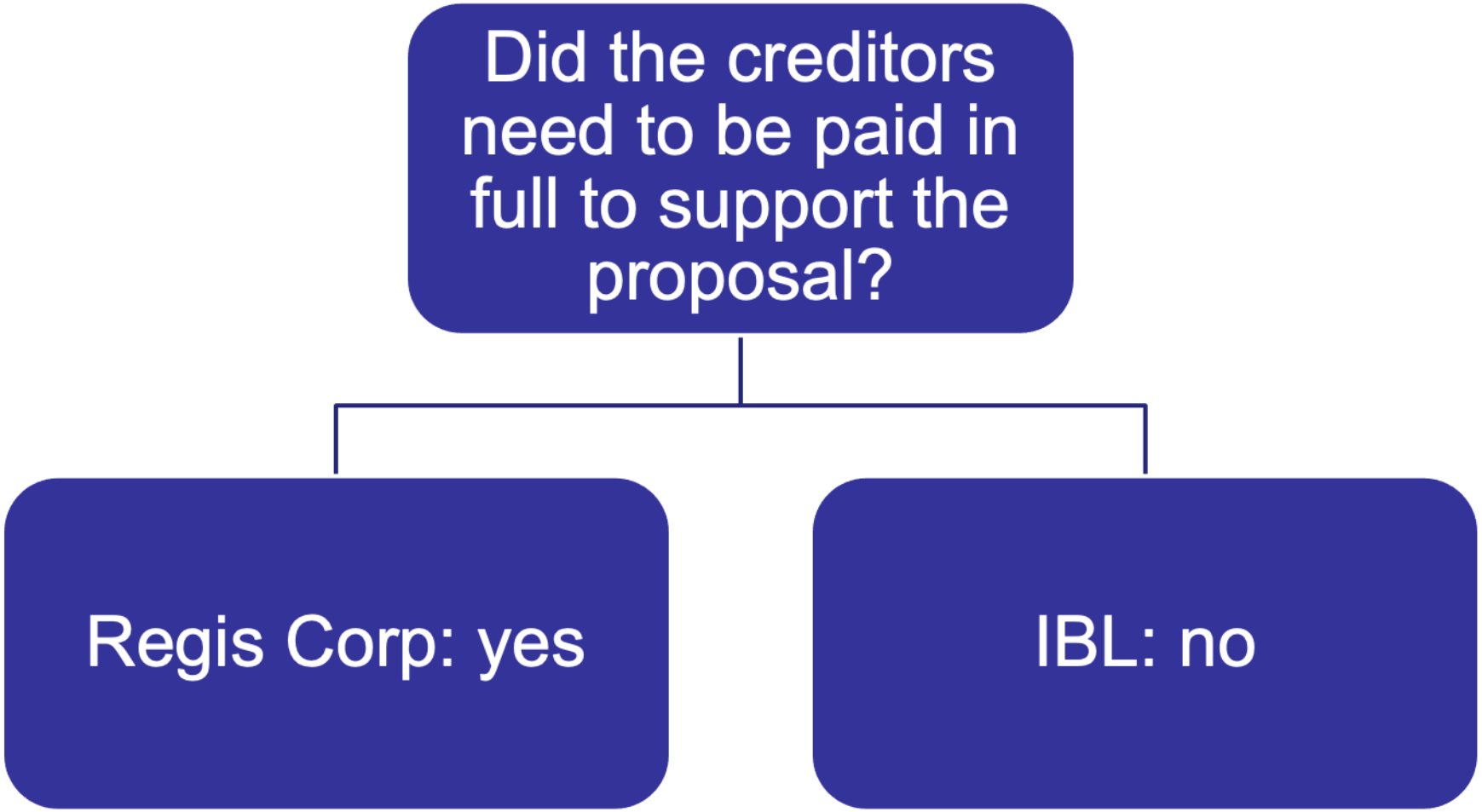
Disclosure

- Non-disclosure only a material irregularity if there is a substantial chance that the non-disclosed material would have made a difference to the way creditors would have voted.

- No material irregularity in the way IBL and Regis Corp transactions were presented.

- Reasonable to present the alternative to the CVA as a shut-down administration in the circumstances.

Regis Corp and IBL



Claims' discounting

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Blanket formula

- Not appropriate because large variations in prospects of premises being re-let.

- Likely to be an overestimate of landlord's loss for better premises (Category 2) and underestimate for the worse ones (Category 5).

Amount of discount

- Difficult to identify what % discount would be appropriate BUT some justification must be offered.

- The bigger the discount, the harder to justify and none offered here.

- Irrelevant that this discount had been used in other CVAs.

Modifications

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- Like *New Look*, critical that landlords had the option to terminate the leases.
- In the absence of the CVA, no real prospect that the landlords would have recovered rent from the Company at a rate higher than that offered by the CVA.
- BUT, would have been unfairly prejudicial for a landlord of multiple properties to be able to only exercise a termination for one lease if it exercised it for all leases, had this not been varied.
- Profit share fund illusory and shareholder stood to gain from profit, which might have been unfair.

Nominees' conduct

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- Duty: to take reasonable steps to satisfy themselves that debtor's position is materially what is in the proposal.
- More to be expected where company is large and the CVA is complex.
- Mr Williams' conduct fell below standard because there was no evidence he made any attempt to question the propriety of IBL being paid in full.

Results?

- A pyrrhic victory?
- CVA revoked, but it had already terminated.
- Held that the Court could order the nominees' costs to be repaid, but nominees should not ordinarily be deprived of their fees. Only where conduct is egregious e.g. bad faith or fraud. Not such a case.

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“Virgin Territory”
Restructuring Plans under Part 26A of the Companies Act 2006

Camilla Lamont

What is a Restructuring Plan?

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- New restructuring procedure introduced by CIGA 2020 as a new Part 26A of the Companies Act 2006. Also see the relevant new Practice Statement issued by the former Chancellor on 26.6.2020.

- Similar to schemes of arrangement under CA 2006 but Part 26A only applies to companies in financial distress and also includes a power of cross class cram down

- Part 26A facilitates broader restructuring than CVAs involving not only unsecured creditors (including landlords) but also secured creditors and shareholders

- As with CVAs, Part 26A does not permit interference with landlord's property rights

The Threshold Conditions – s.901A

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That the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern ("Threshold Condition A")

That a compromise or arrangement is proposed between the company and its creditors or members (or any class of them), the purpose of which is to eliminate, reduce, prevent or mitigate the effect of, any of the financial difficulties so mentioned ("Threshold Condition B")

Part 26A Procedure

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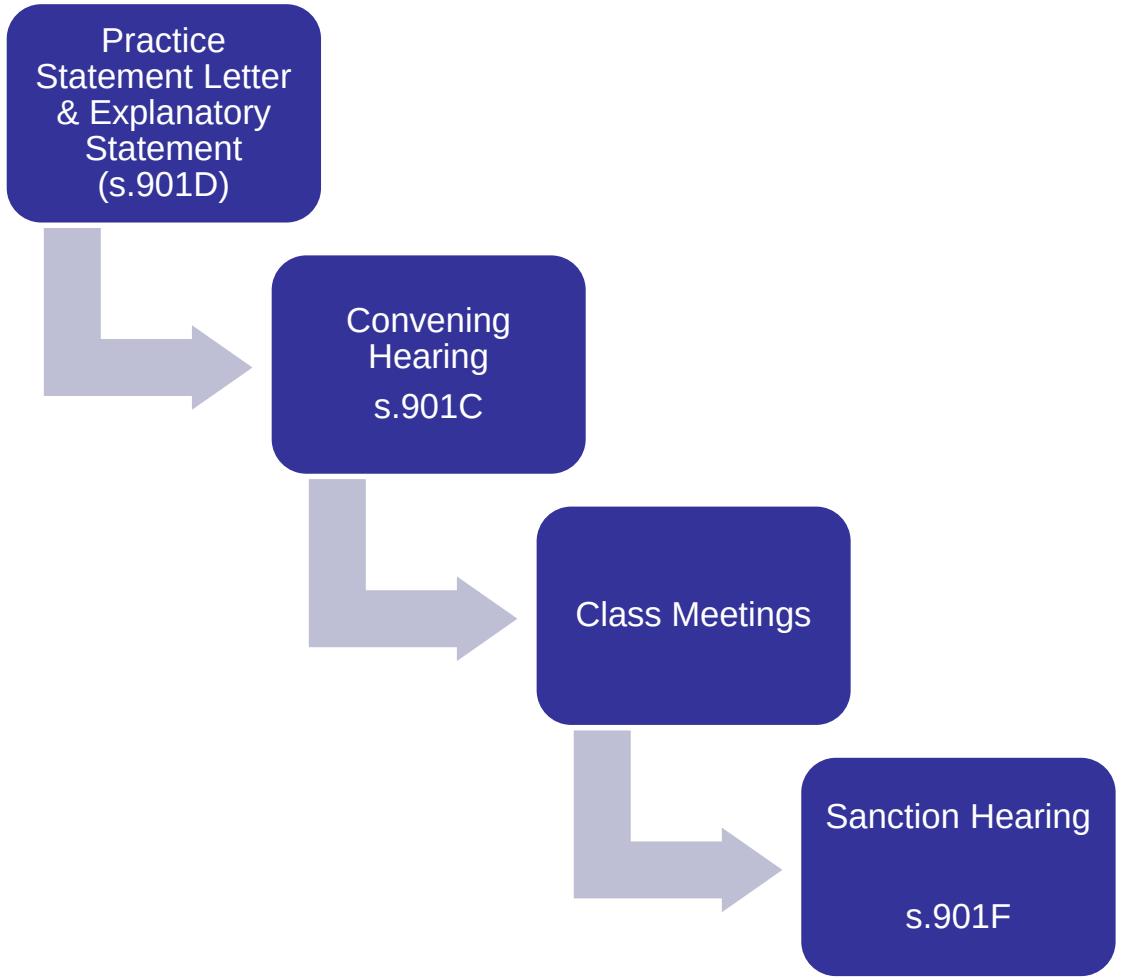

Court's power to Sanction Plan – s. 901F

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If each class votes in favour of Plan by 75% in value of creditors/ members voting

Court then decides whether to exercise its discretion to sanction Plan at the Sanction Hearing

Where Plan is sanctioned by the court, it is binding on all creditors, members and the company

Cross Class Cram Down – s.901G

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If at least one of the classes does not achieve a 75% majority

Do the Cross Class Cram Down Conditions A & B in s.901G apply?

If Yes, the court can (but is not obliged to) exercise its discretion to sanction the Plan

The Cross Class Cram Down Conditions

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Condition A is that the court is satisfied that, if the compromise or arrangement were to be sanctioned under section 901F, none of the members of the dissenting class would be any worse off than they would be in the event of "the relevant alternative" ("the No Worse Off Test")

The "relevant alternative" is whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned under section 901F

Condition B is that the compromise or arrangement has been agreed by a number representing 75% in value of a class of creditors or (as the case may be) of members, present and voting either in person or by proxy at the meeting summoned under section 901C, who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative

Virgin Active Restructuring Plans

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- On 12 May 2021 Snowden J sanctioned Plans proposed by three companies in the Virgin Active Group - [2021] EWHC 1246 (Ch)

- First case in which the High Court has considered an application to sanction a Plan under Part 26A CA 2016 compromising landlords' existing and future claims under leases

- Striking example of the cross class cram down being exercised against dissenting landlords, so as to achieve a compromise that could not have been effected by a CVA

Plan Creditors

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Included Creditors

- Secured Creditors under a Senior Facilities Agreement of over £200 million
- Landlords in Classes A – E of 45 properties with unpaid rent claims of circa £30 million
- General Property Creditors

Excluded Creditors

- 9 categories of excluded creditors, deemed essential to day to day running of the Group, including trade creditors

The Convening Hearing & Meetings

- Snowden J made a “Meetings Order” convening 21 meetings of various classes on 16.4.21 (see [2021] EWHC 814 (Ch))

- Secured Creditors and Class A Landlords voted overwhelmingly in favour.

- 75% majority not achieved in relation to Class B to E Landlords and General Property Creditors

Sanction Hearing – [2021] EWHC 1246 (Ch)

- Cross class cram down conditions were held to be satisfied as:
  - Secured Creditors and Class A Landlords had voted in favour by requisite majority ("Condition B"); and
  - the court was satisfied on the evidence that the dissenting classes of creditor would be "no worse off in the relevant alternative"("Condition A")

- Judge exercised his discretion to sanction the Plans:
  - As the dissenting classes of creditors were "out of the money" in the relevant alternative, their objections to the Plan carried no weight
  - In any event it was not unfair for the shareholders to retain their equity as they had provided substantial "new money" on market terms which would rank junior to the SFA

Cross Class Cram Down - Key Points

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- Court does not need to be satisfied that relevant alternative will occur on balance of probabilities. It only needs to decide what is most likely to occur at the date of the hearing
- Plan Companies would otherwise have entered a trading administration involving an accelerated sale of the profitable parts of the UK businesses
- Plan Companies' valuation evidence showed that in administration the "value would break" with the secured creditors and unsecured creditors would be "out of the money". Dissenting classes would be paid 120% of the Estimated Administration Return under the Plans.
- No competing valuation evidence offered by the Landlords who "did not act with the urgency to be expected" in seeking additional disclosure. Procedure held not unfair to Landlords

Discretion – Key points

- Court should not have the usual reluctance (as is the case for schemes under Part 26) to differ from the vote where cram down powers are used under Part 26A

- Satisfaction of cross class cram down conditions not in itself sufficient reason to sanction and it was not appropriate to read in a principle that Plans should be approved unless court considered them not just and equitable

- Court must consider all the relevant factors and circumstances that it would ordinarily take in account in considering whether to sanction a scheme

The “out of the money” principle

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- A key principle is that it is for the company and the creditors who are “in the money” to decide, as against a dissenting class who is “out of the money” how the value and assets of the company should be divided. “Out of the money” creditors can, on application, be excluded from the vote altogether under s.901C(4)

- Court will however need to be satisfied that any restructuring surplus is fairly distributed between “in the money” creditors

- Differences in treatment between unsecured creditors will be justified if there are good commercial reasons for such differential treatment but a plan should not discriminate arbitrarily or capriciously between different classes of unsecured creditors even if they are all equally out of the money.

The importance of valuation evidence

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- The outcome of any individual case will be highly fact sensitive
- Valuation evidence will be critical both in respect of the "no worse off test" and in determining whether landlords are "in or out" of the money
- Landlords must act quickly to seek necessary disclosure and to obtain expert valuation evidence. Plan companies are expected to co-operate in the timely provision of information that may be relevant to the efficient resolution of genuine valuation disputes
- Landlords will need to consider costs implications of challenging

CVAs v Restructuring Plans

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- Plans likely to be favoured for larger and more complex restructuring involving secured creditors and reorganisation of share capital

- Plans are expensive and require court sanction but provide greater certainty

- Cross class cram down under a Plan is a potent tool where landlords' voting power would defeat a CVA – so a Plan is likely to be useful where the company wants to write off substantial arrears built up during the pandemic.

- The CVA jurisdiction is effective and well understood and, subject to the outcome of the New Look appeal, is likely to continue to be popular with companies looking to restructure over rented leasehold portfolios

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Q&A

We will now answer as many questions as possible.

Please feel free to continue sending any questions you may have via the Q&A section which can be found along the top or bottom of your screen.

Thank you for listening

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