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Spotlight on CVAs – The British Property Federation Gives Its Views on the Recent Spate of "Landlord" CVAs

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Cathryn Williams and Paul Muscutt, partners in the Restructuring & Insolvency team in London, interview **Ian Fletcher, Director of Policy (Real Estate)** of the BPF (the trade association for UK residential and commercial real estate companies) to get the BPF's views on the recent spate of CVAs seeking to reduce/compromise lease liabilities.

Do you think the current use of CVAs is fair on landlords?

CVAs have been a part of the insolvency landscape for the past decade. They have been used to rescue retailers and hospitality sector businesses in significant distress and landlords have generally been supportive. What seems to have changed is that they are now being deployed in circumstances where immediate distress is less clear cut. CVAs are meant to put businesses in trouble back on their feet and there has also been a concern that recent CVAs are not 'whole' restructuring exercises, but simply focused on shedding lease liabilities. Landlords are concerned that such an approach weakens the chances of the CVA working and their investments are being prejudiced to the benefit of some retailers' investments and other creditors.

Should a clause be introduced into leases which can be triggered by a tenant to commence negotiations for rent reductions/alterations to lease terms in the event of tenant financial distress, so that a formal insolvency process can be avoided?

It is difficult to see how a system that relied on tenants self-declaring their own distress would work. If anything, landlords are looking for additional assurance that a business needs support and tending towards second-opinions, rather than none. If a CVA is done well, it should also take account of all the requirements that will help put a business back on its feet, for example equity and debt raising, management changes and changes to other supply contracts, marketing channels, etc. None of that would come within scope, if negotiations were limited to just leases. The BPF has this week called on Government to conduct an urgent review of CVAs (https://www.bpf.org.uk/media-listing/press-releases/british-property-federation-calls-government-urgent-review-cvas), but that won't happen overnight. We have therefore also suggested some short-term measures that will help restore landlords' confidence in the CVA process:

- To ensure that the CVA is a good restructuring of the business, we have suggested that larger CVAs should be the subject of a 'second-opinion', perhaps a task that could be fulfilled by the existing Pre-Pack Pool (if the Pool can be given a wider remit to scrutinise such processes).
- To ensure that the creditors' vote is fair, we have suggested that the rules on this should be codified and perhaps issued as a Statement of Insolvency Practice (SIP).
- To improve transparency and fairness, we have issued a best practice document on engagement between Insolvency Practitioners and landlords. This contains a questionnaire for a landlord to use when facing a CVA proposal. Asking such questions may also help property owners if they wish to mount a legal challenge to the terms of a CVA.

Should it be mandatory for directors and shareholders of a company proposing a CVA to make an investment, provide security or take on some personal liability to landlords for a minimum dividend where a store closure is proposed?

Most CVAs contain claw back arrangements, which are triggered if a business that has undergone a CVA is restored to health. If CVAs are being used in situations where insolvency is more contingent, then claw back arrangements should become even more necessary, because the chances of revival are stronger. Most claw back arrangements at present, however, are derisory and it is certainly a point of push-back when the BPF's Insolvency Committee is approached on a CVA, to ensure that those who have their leases compromised get some recompense if the business recovers. However, the whole basis of business and entrepreneurship in the UK is based on the limited liability company and to start making individual directors or shareholders personally liable could act as a disincentive to business formation. If, however, there is misconduct on the part of the directors then that is a different situation.

Do you think that there should be "opt out" clauses in CVAs enabling landlords to give notice to terminate their leases where a reduction in rent is proposed?

This already happens to large extent. Most CVAs will contain a landlord break on compromised stores. The BPF's Insolvency Committee will often engage with an insolvency practitioner on a CVA prior to it going public. The terms of landlords' and the tenant's break are typical points that will be scrutinised, along with claw back arrangements, dilapidations and other terms. Typically, landlords will get a break which can be exercised on anything from 30-180 days' notice. This will apply to both stores that will be vacated and often those that are categorised as seeking rent reductions. Stores that remain on full lease terms will get no such break, however.

Is there a better alternative to a CVA where a tenant has an unprofitable lease portfolio?

The need for CVA reform is more about process than broad principles. If a debtor can reach a voluntary arrangement with its creditors that helps rescue the business that is usually a more desirable outcome than administration or liquidation. The problem with CVAs is that some of the processes need reform. The only way to challenge a CVA is to go to court within 28 days of the creditors' meeting/decision process. That is not a particularly satisfactory way to seek a second opinion on what are huge decisions made by one individual and hence our suggestion of referral to the Pre-Pack Pool. There was a lot of controversy around pre-pack administrations in the past, but the Pre-Pack Pool was introduced to give an independent second-opinion on pre-packs. It is currently a voluntary measure. We would like to see it become compulsory. There may also be a role for it, or a similar structure, in CVAs.

The other big issue of process on CVAs is the vote, how it is structured and what vote creditors get. Much of that has grown up through precedent and we would like to see it now codified, through the insolvency profession working with creditor bodies, such as ourselves.

It is important that CVAs retain the confidence of those affected and Government should conduct an urgent independent review, but reviews take time and legislative reform is notoriously slow, hence the immediate focus should be on what processes can be improved through existing structures and best practice.

What other measures do you think landlords would like to see introduced into CVAs?

There is a frustration over transparency. Some of the big insolvency practices are very good at engaging with the BPF's Insolvency Committee, but individual landlords feed back to us that in one-to-one meetings they feel the information they are provided with is inferior to other conversations with debt and equity providers. Getting the most out of the pre-publication stage is important, but landlords also have the opportunity to scrutinise the CVA at the creditors' meeting/decision making process. That is often seen as a waste of time, but one CVA often sets the precedent for the next and pitching up at a creditors' meeting with pointed questions helps create an atmosphere that will not tolerate CVA abuse.

How do you think landlords will react to requests for clauses to be included in lease renewals where non-CVA tenants require rent to be reduced by the same proportion as that which has been approved in a CVA of another tenant in the same shopping centre/vicinity?

I think most of our members would have some sympathy with solvent rivals if a CVA is being used unfairly. It is one of the reasons why landlords accept that this has to be an insolvency process, with experts declaring that the business is in distress, which helps to justify the process to other retailers. If other retailers start to secure such clauses in leases it will work against a rescue culture and that may be detrimental. Whether such clauses become prevalent, however, will also reflect in large part the negotiating strength of the parties at lease negotiation. The concerns expressed by rival retailers, however, show that it is not just landlords that are losing confidence in the CVA process, but other retailers and also we get concerns expressed by local authorities about which stores have been chosen to close and why. There will be more CVAs because of the challenges facing the retail sector and for the sake of all concerned, we think it is vital that confidence in the process is restored.

Should CVAs require all creditors (including secured creditors, investors and shareholders) to take equal pain?

Secured creditors will always be in a preferential situation and that is part of doing business. A world where debt providers are less willing to provide debt is probably not a good place to be. Debt can, however, be restructured and certainly that should be a part of the CVA considerations. Equity providers, on the other hand, are the business owners and stand to lose everything if the business enters an insolvency process. They should also, as the business owners, be 100% behind the rescue and illustrating their confidence in it, with additional investment. There is certainly an impression amongst members that CVAs during the financial crisis shared the pain more evenly, whereas recent CVAs are more specific to just landlord creditors.

Should rents for retail spaces be linked to turnover?

There is a wider selection of ways that rent is calculated than 10 or 20 years ago and the short leases are far more prevalent, so re-basing back to market happens more often. Turnover rents can work for large sophisticated tenants, but it requires a lot of systems and trust to ensure data is flowing between tenant and landlord.

One criticism of CVAs is that they usually fall short of addressing the fundamental problems of the business which caused the distress. Do you think directors (and IPs) should be compelled to be more transparent in addressing the core issues in their CVAs?

Many past CVAs have not ultimately rescued the businesses that sought to use them. By their very nature they are a compromise, rather than the optimum route to salvation. Arguably, recent CVAs have not been 'proper' restructuring exercises and some of the big insolvency practitioner firms won't use them because of their lack of an holistic approach. The vote and need to get 75% approval also means that insolvency practitioners are to some extent being driven by the vote and which creditors fall into which categories, rather than leaving the insolvent business in the best situation to move forward. The best that can be said about most past CVAs, with the odd exception, is that they have provided a more orderly and phased break up of businesses, rather than the 'shock' and severe impacts that come with immediate administration or liquidation.

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