ARTICLE

Landlord's Day in Court? Lessons Learned from the New Look CVA and Virgin Atlantic Restructuring Plan Judgments

Nick Cooper, David Bor, Edward Lewis, Associates, **Oskar Forsblom**, Trainee Solicitor, **Lindsay Hingston**, Partner, and **Katharina Crinson**, Counsel, Freshfields Bruckhaus Deringer LLP, London, UK

Synopsis

In quick succession, the High Court dismissed a series of challenges and objections by landlord creditors to the proposed company voluntary arrangements ('CVA') in *New Look*[1] and Part 26A restructuring plan ('RP') in *Virgin Active*[2] respectively. The judgments contain many points of interest for practitioners (and much has and will be written about each of the judgments), but this article takes a more detailed look at what the judgments, read together, mean for the use of CVAs and RPs going forward. While the *Regis*[3] judgment was also handed down recently, it largely follows *New Look*, so we focus on the latter for the purpose of this article.

Introduction

As has been a common theme in the last twelve months, the New Look CVA and Virgin Active RP were each proposed against the backdrop of significant financial difficulties brought on by the COVID-19 pandemic. As a UK high-street fashion business and international health club operator respectively, COVID-19 restrictions significantly impacted the performance, viability and liquidity of both businesses.

In August 2020, New Look began a restructuring comprised of three central and inter-conditional elements: (i) a consensual amendment and extension of its first lien secured loan and revolving credit debt; (ii) a scheme of arrangement to equitise a significant portion of its second lien senior secured note debt; and (iii) a CVA primarily targeting liabilities under its large portfolio of long-term property leases.

By contrast, Virgin Active sought to address its liquidity issues by launching (in March 2021) three inter-conditional restructuring plans for three group companies to deliver: (i) an amendment and extension of its secured loan facility of over £200 million; and (ii) compromises of its lease liabilities owed to landlords (and certain other property-related liabilities owed to so-called 'general property creditors').

In keeping with past practice for CVAs, in both the New Look CVA and Virgin Active RP, landlords were grouped into categories broadly based on the profitability of their leases. Except for those landlords whose leases were considered most profitable ('class A' landlords, who were left largely untouched save for changes to payment terms), landlords were asked to make significant compromises in the form of rent reductions, deferrals and/or releases and termination. The Virgin Active RP represented the first 'landlord' RP, where the debtor company sought to compromise liabilities to landlords in a manner the market would generally associate with CVAs.

More broadly, both cases involved a comprehensive restructuring, compromising secured financial creditors and landlords. Another point of significance was that, in both cases, the company's position (as was accepted by the court) was that the relevant alternative was entry into administration in which the value broke in the secured debt and landlords would receive a share of the prescribed part only.

A reminder of the legal processes

While CVAs and RPs have certain similarities, they are certainly not identical processes, and have different requirements, particularly as to voting and class composition, as set out in Table 1.

Notes

1 *Lazari Properties 2 Ltd v New Look Retailers Ltd* [2021] EWHC 1209 (Ch).
2 *Re Virgin Actives Holdings Ltd, Re Virgin Active Ltd, Re Virgin Active Health Clubs Ltd* [2021 EWHC 1246 (Ch).
3 *Carraway Guilford (Nominee A) Ltd v Regis UK Ltd* [2021] EWHC 1294 (Ch).

Table 1.

	CVA	Restructuring plan
Origin	Insolvency Act 1986	Companies Act 2006
Type of liabilities compromised	Unsecured liabilities (unless consent given by secured creditors)	Secured and unsecured liabilities
Court involvement	The process is supervised by an insolvency practitioner who is an officer of the court (the 'nominee' or 'supervisor') No court hearing unless challenged	The process is subject to direct court supervision Two court hearings – convening and sanction
Voting threshold	75% by value of all unsecured creditors who vote, but if 50% of unconnected creditors vote against it fails All unsecured creditors get a vote, whether the CVA compromises them or not	Creditors are separated into classes depending on their economic interests A class approves the plan if 75% in value of those voting in the class vote in favour
Effect	If approved, CVA is binding on all unsecured creditors but is capable of being revoked if successfully challenged	If sanctioned, restructuring plan binds all creditors within the approving classes, and additionally binds the dissenting classes if the Court is satisfied that (a) no creditors in any dissenting class would be worse under the plan than in the most likely alternative scenario; (b) at least one of the approving classes would receive a payment or has a genuine economic interest in the company in the relevant alternative ((a) and (b) together being the ***Cram-Down Conditions***) and (c) in the circumstances, the Court should exercise its discretion to allow cross-class cram-down and sanction the restructuring plan
Fairness test	Fairness in a challenge scenario assessed with reference to the horizontal comparator (relative treatment of creditors as between each other) and vertical comparator (treatment of creditors as against the likely alternative)	Vertical comparator test manifests in Cram-Down Condition (a). Fairness generally considered as part of court's discretion to exercise cram-down.

Comparative analysis – could the restructuring have been implemented using the RP (for New Look) or the CVA (for Virgin Active) instead?

Given the similarities between the two entities' situations and classes of liabilities being compromised in each case, it is interesting and informative to consider whether New Look could have proposed a restructuring plan – and what the likely outcome would have been, and, to the contrary, whether Virgin Active could have utilised a CVA.

New Look

If New Look had proposed a restructuring plan rather than a CVA, it would have been able to combine all three elements of its restructuring (the consensual deal with financial creditors, scheme of arrangement and CVA) into a single court process. It would have been possible to convene meetings of at least the RCF creditors, the trade facility creditors, the senior secured noteholders, the landlords (divided as in Virgin Active according to lease performance) and the unsecured creditors according to how they are affected by the plan. Based on the voting breakdown from the CVA as cited in the court judgment, it can be assumed that the requisite 75% majority by value would not have been reached in a number of the landlord classes and perhaps the unsecured classes as well. New Look would have needed to use cross-class cram down in order for the plan to be sanctioned.

In order for the court to exercise its discretion to sanction the (hypothetical) RP, notwithstanding the dissenting classes, New Look would need to satisfy the Cram-Down Conditions. To deal with condition (b) first, it is clear that at least one class would have voted in favour with the requisite 75% threshold (as the senior secured notes did in the scheme that did in fact complete) and indeed it is reasonable to assume that all of the classes of secured lenders, the senior secured noteholders and the class A landlords would have approved the plan.

For condition (a), the court would have first considered what the most likely 'relevant alternative' would have been should the plan not be sanctioned. For New Look, it was common ground between the parties that should the CVA not been approved then an administration was the most likely outcome. Should that have happened, then the only assets available for unsecured creditors would have been the prescribed part under s.176A IA 1986 (£600,000). As per the CVA, this would have only amounted to a return to creditors of £0.1p/£. Applying the reasoning from Virgin Active, it is likely that the court would be content that condition (a) was satisfied as the dissenting landlord classes (and indeed any dissenting general unsecured classes) would receive more under the plan than they would from any dividend paid out in an administration. Furthermore, as the dissenting landlords were out of the money in any event, Snowden J commented that 'little or no weight should be placed on their votes, and certainly not so much weight that it should cause me to decline me to sanction the Plans'.

So what does this analysis tell us about the restructuring plan process and how we may see it used in future? It seems likely that a company in New Look's position could have used a restructuring plan to achieve its restructuring rather than combining a CVA, a scheme of arrangement and a consensual process. This scenario appears to highlight one of the obvious strengths of the RP, namely the ability to combine what previously would have required numerous different processes run in parallel into one common process.

Virgin Active

As CVAs are not capable of compromising secured liabilities (except with the secured creditors' consent), a Virgin Active CVA would have been more problematic. It would likely have been necessary to use a parallel scheme of arrangement (as New Look did) or consensually restructure the secured debt outside a court process. It is difficult to establish whether the unsecured aspect of the Virgin Active restructuring plan would have succeeded as a CVA based on the publicly available information. However, on the assumption that the B-E landlord classes and the General Property creditors form the majority of the unsecured debt it appears unlikely that it would have been possible for the Class A Landlords to carry the vote through on their own.

Practically, the company would have needed to build sufficient consensus amongst its (out-of-the-money) unsecured creditors including (i) landlords (ii) trade creditors (iii) intercompany creditors and (iv) under-secured portion of secured creditors. This highlights another strength of the RP over the CVA as, where secured creditors have approved the RP and the value breaks in their debt, separate consensus amongst unsecured creditors is not required and the court is unlikely to attribute much weight to their views.

What this shows us is that while the CVA is still likely to have its place in the restructuring market (for reasons we explore further below), there are clearly scenarios where the ability to cram down dissenting classes of creditors will be a powerful and uniquely suited tool for a restructuring situation.

Is there convergence in the fairness principles underpinning CVAs and RPs?

Fairness is one of the key legal principles underpinning RPs and CVAs (and traditional schemes of arrangement), but does it mean the same thing in each case? Looking at the judgments, there is clearly a lot of read across in how fairness will be approached and interpreted in the context of the different processes. Zacaroli J in both New Look and Regis makes close comparison with the RP (and schemes), and Snowden J in Virgin Active picks up these references.

When assessing unfair prejudice in a CVA the court in New Look referred to scheme case law and by analogy RPs: 'Whether unfair prejudice exists depends on all the circumstances, including those that would be taken into account in exercising the discretion to sanction a Scheme, per Hildyard in Lehman (...), and in exercising the discretion to cram-down a class in a part 26A plan.' (at paragraph [191]). Indeed, the court went on to state that 'it is also relevant to have regard to the extent to which others in the same position as the objecting creditors approved the CVA: c.f. Lehman (above), at [129] to [130]), in the case of a scheme; and Deep Ocean, (above) at [59], in the case of a Part 26A plan.' (at paragraph [198]).

Similarly, in *Re DeepOcean 1 UK Limited*,[4] Trower J commented that the identification, relevant for the exercise of cross class cram down in an RP, of the relevant alternative 'is also an exercise which the court may be called on to carry out when applying a "vertical" comparison for the purposes of an unfair prejudice challenge to a company voluntary arrangement under section 6 of IA 1986' (at paragraph [29] – [30]). Indeed, he went on to state that 'because a class' right of veto is removed by the operation of section 901G, justice may require the court to look at questions of horizontal comparability in the context of a cross-class cram down to see whether a restructuring plan provides for differences in treatment of creditors inter se, and if so whether those differences are justified.' (at paragraph [63]).

Notes

4 [2021] EWHC 138 (Ch).

The nuances

However, even though the court clearly draws on well-established concepts, this is far from meaning that the approach to fairness in the various processes is now interchangeable.

In a traditional scheme, the court is concerned only with the terms of the scheme actually proposed: it does not enquire whether a different scheme might have been better for particular groups of creditors.[5] In both *Sisu* (at [73]) and *Powerhouse* (at [82]), it was said that the same approach applies in the context of a CVA. Zacaroli J in *New Look* however highlights the tension that in considering whether an arrangement creates unfair prejudice for a creditor it is necessary to look beyond a comparison with that creditor's position in a liquidation because, among other things, the alternatives to the arrangement included the ability to press for a more satisfactory arrangement. As the court identifies, this tension also exists for an RP with cross class cram down where it is necessary to consider whether the plan involves a fair allocation of the 'restructuring surplus' between different sub-groups of creditors (as per New Look at paragraph [147]).

So are we seeing a divide between schemes on the one hand (where the court looks only at the scheme proposed) and CVAs and RPs on the other hand (where the court engages in a broader assessment of the terms including by reference to potential alternatives)? It is possible the emerging divide may be between schemes of arrangements and RPs without cross-class cram-down on the one hand and CVAs and RPs which utilise cross-class cram-down on the other? In the former case, there is only cram-down between classes and the fairness enquiry focuses on ensuring the class vote is fair and representative. In the latter case, approving creditors may have materially different rights to dissenting creditors, meaning the court will conduct a more fulsome enquiry around fairness.

There are also indications that a different legal standard may be applied as between CVAs and RPs. We note that the court was keen to point out that the processes are very different in relation to the greater court oversight and longer notice periods inherent to an RP, with the court sounding a clear warning shot in New Look that 'a finding of unfair prejudice ought not to be precluded merely because the same result might have been achieved in a Part 26A plan.' This suggests a higher standard of fairness might apply in the context of a CVA relative to an RP.

By contrast, in Regis there was a suggestion that the standard required to establish the relevant alternative is lower in a CVA than in an RP. The court stated that the 'question (…) is not to determine what *would have* happened if the CVA had not been approved, but whether *it was reasonable* in the circumstances at the time to identify a shutdown administration as the likely alternative' (at paragraph [124], emphasis added). This compares to an RP where the court is mandated by section 901G(4) to determine what would be *most likely* to occur in the relevant alternative.[6]

What this means for each process going forward?

Going forward we expect to see an uptick in the use of the RP as uncertainty surrounding the discretion of the court to sanction cross-class cramdown subsides (with increasing precedent available) and the advantages of the process are better understood. In addition, there may be a number of scenarios in which an RP could be used where a CVA could not (such as imposing debt-for-equity swaps or, potentially, terming out senior lenders in a junior-led process).

Further, while it is easier for dissenting creditors to bring objections in the courts to an RP there may be real advantages to companies in using an RP – namely (i) the ability to bring a restructuring under a single plan which would previously have required several processes to implement, (ii) certainty once sanctioned (unlike the potential challenge overhanging a CVA) and (iii) a lower voting hurdle (at a minimum, 75% of any one class as against 75% of all unsecured creditors).

Where then, does that leave the CVA? The process has survived the 'root and branch' attack of *New Look* and it would not be surprising to see an increase in proposed CVAs following the perceived lull in advance of the New Look and Regis judgements. Assuming the New Look judgment is ultimately upheld on appeal, it seems likely it will remain part of the restructuring practitioner's toolkit with a lot of the previous uncertainty resolved.

Comments from Zacaroli J in New Look that a finding of unfair prejudice ought not be precluded merely because the same result might have been achieved in an RP may give future challenges a glimmer of hope. In making these comments Zacaroli J drew attention to the key differences between the processes, in particular

Notes

5 *Re Co-operative Bank PLC* [2017] EWHC 2269 (Ch), per Snowden J at [37].

6 The impact of the decision in *ALL Scheme Limited* [2021] EWHC 1401 (Ch) on restructuring plans and CVAs remains to be seen. In this case, Miles J declined to sanction the 'Amigo Loans' scheme of arrangement following opposition to the scheme from the FCA (despite overwhelming creditor support) on the basis that he was not convinced that administration was the appropriate comparator. Miles J did not determine what the appropriate comparator was in place of administration but found that refusal to sanction the scheme would 'probably not lead to the imminent insolvency of the Group'. This differs from how it appears a judge is required to determine the relevant alternative in a restructuring plan, and may be an interesting point of distinction going forwards.

the increased Court oversight prior to the implementation of the RP and increased prior notice periods and disclosure requirements. It remains to be seen whether these comments will discourage those considering a CVA – if satisfied that a restructuring has a strong likelihood of satisfying the 'relevant alternative' test then the RP may be preferred for increased certainty over the risk of a CVA challenge.

Although we may see an increase in the number of proposed CVAs following New Look, it is likely that the combination of a CVA with a scheme to implement a restructuring of both secured and unsecured debt will no longer be an attractive option. With the increasing establishment of the RP it will make more sense in most situations where this is an option to use an RP and bring the whole restructuring into a single process. Prior to Virgin Active's sanction, the 'safe' route would have been to use a CVA and scheme, as both processes were known and well understood, however dual-tracking processes may become increasingly redundant as the market becomes more familiar with the RP.

Where unchallenged, CVAs remain a quicker and cheaper process, with reduced exposure to scrutiny by the courts. However, as New Look demonstrates, a CVA is still subject to the risk of a challenge and the associated judicial and public scrutiny, in particular on the grounds of unfair prejudice. CVAs then, may continue as a more commoditised tool, but for more complex and bespoke restructurings, it is plausible that the RP may come to be the preferred tool.