Briefing Note

Protection of Landlords' Guarantees in CVAs

Property investors, professionals and insolvency practitioners will all remember the important principles established by the 2007 case of *Prudential Assurance Co Ltd v (1) PRG Powerhouse Ltd* [2007] concerning the treatment of a landlord creditor who had the benefit of a third party guarantee in a company voluntary arrangement (CVA) of a debtor tenant company.

Hot off the press comes a judgment handed down on Friday 23 July 2010 in *Mourant & Co Trustees Ltd v Sixty UK Ltd* [2010]. The judgment shows that *Powerhouse* has not ended debtor tenant companies' efforts to deprive their creditor landlords of the benefit of third party guarantees in respect of the tenant debtor company's liabilities in the context of a CVA. It also serves as a reminder that, as in *Powerhouse*, the Court will intervene when a CVA unfairly prejudices the interests of a creditor.

Powerhouse

In *Powerhouse*, the debtor company closed a number of its stores and entered into a CVA, approved by the required majority of creditors in the face of landlords' opposition in relation to the closed stores.

The effect of the CVA was that the creditors (including the landlords of the closed stores) would receive a dividend of 28p for each £1 they were owed, from a fund provided by its parent company. The parent company was to be released from its guarantees to the landlords of the debtor company's performance of its obligations under its leases of the closed stores. The rights and obligations of all other creditors were to be unaffected.

The landlords applied to revoke the CVA on the grounds that by removing their rights to enforce the guarantees against the parent company (under which the landlords had a realistic prospect of recovering the debt in full) and by treating other creditors more favourably, the CVA unfairly prejudiced their interests.

The Court agreed in *Powerhouse* that the landlords were unfairly prejudiced by the CVA and revoked it. However, the Court also said that in principle a CVA could lawfully be structured in a manner which would deprive a creditor landlord of the benefit of a third party guarantee of the liabilities of the tenant debtor company.

Sixty

In *Sixty*, the CVA approved by the majority of creditors tried to take advantage of the decision in *Powerhouse.* It proposed that a creditor landlord of Sixty UK Ltd (the tenant debtor company) should receive a sum of £300,000 and that Sixty's Italian parent company should be released from all liability to the landlord under its guarantee of the liabilities of Sixty under Sixty's lease.

Other creditor landlords of Sixty, without the benefit of third party guarantees, were to receive sums calculated by a different methodology and other creditors were to receive payment in full. Mourant, the creditor landlord with the benefit of the third party guarantee, challenged the CVA, claiming that it would be unfairly prejudiced by the inadequate compensation of £300,000 and the compulsory deprivation of the benefit of the guarantee.

Mr Justice Henderson was unhesitating in finding that the CVA did unfairly prejudice the creditor landlord and granted revocation of the decision to approve it. In his concluding remarks, the Judge reminded insolvency practitioners of their duty, as administrators and other office holders, "*to maintain an independent stance, to act in good faith, and only to propose a CVA if they are satisfied that it will not unfairly prejudice the interests of any creditor, member, or contributory of the company*".

These remarks will undoubtedly encourage creditors who feel that they are unfairly prejudiced by the terms of an approved CVA to exercise their rights of challenge.

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