Briefing Note

Landlord fights back against “Guarantee - Stripping” in CVA A Restructuring perspective

Mourant & Co Trustees Ltd v Sixty UK Ltd [2010]

The High Court has recently set aside a company voluntary arrangement in relation to Sixty (UK) Limited, a fashion retail company trading as "Miss Sixty" and "Energie". The debtor company (Sixty) was ultimately owned by an Italian company, Sixty Spa. Mr Justice Henderson made the order on the application of the debtor company's landlord (Mourant) on the ground that it was unfairly prejudiced by the terms of the CVA, in particular by the removal of its rights under a guarantee from the debtor company's parent. The parental guarantee was in respect of all the tenant's obligations under the leases of two retail outlets in Liverpool's Met Quarter shopping centre.

The CVA was approved by the majority of creditors at their statutory meeting. The provisions in relation to Mourant were that it should receive a sum of about £300,000, on payment of which Sixty’s Italian parent company would be released from all liability to Mourant under its guarantee of the liabilities of Sixty under the two leases. Other creditor landlords of Sixty, without the benefit of third party guarantees, were to receive sums calculated by a different methodology and, crucially, all other creditors were to receive payment in full.

Mourant challenged the CVA, claiming to be unfairly prejudiced by the inadequate compensation of £300,000 and the compulsory deprivation of the benefit of the parental guarantee. Mourant submitted expert evidence that a figure of about £1.16 million was the correct amount of compensation for loss of the parental guarantee. Although the Administrators did not contest the hearing, the Judge said he had no hesitation in accepting the evidence of the landlord’s expert valuer.

The evidence indicated that the Administrators had obtained a professional valuation as to Mourant's loss by the closing of the two stores in question but had been unable to persuade the Italian parent group to make a compensating payment to be available as a fund for Mourant that was anywhere close enough to the valuation. The evidence also indicated that the CVA proposal stated that amount of compensation to be paid to Mourant was in accordance with the professional valuation, when in fact it was not.

In his judgment given on 23 July 2010, the Judge severely criticised the Administrators (who were also the supervisors of the CVA). He said that the Administrators had allowed

themselves to side with Sixty group against the interest of Mourant. They had also permitted Sixty Spa to dictate the crucial terms of the CVA and misrepresented the true position to the creditors. The Judge also said that insolvency practitioners acting as administrators and supervisors had a duty to maintain an independent stance. He added that they should only propose a CVA if they were satisfied that it would not unfairly prejudice the interests of any creditor of the company.

Unusually, the Judge directed that copies of his judgment should be sent to the administrators' regulatory bodies. He went so far as to say that the CVA "*should never have seen the light of day*" as he considered that the Administrators had not taken the necessary steps to ensure that the CVA would not unfairly prejudice any creditor of the company.

Comment

It seems that the Administrators did not take all they could have done from the *Powerhouse*[1] case decided in the High Court in 2007. *Powerhouse* also involved a CVA which was revoked by the court for removing the rights of some of the debtor company's landlords to claim unpaid rent under parental guarantees. Although that case establishes that, in theory, it is legally possible to structure the removal of parental guarantees by a CVA, there has been no subsequent reported case as to the ways in which this might be done without amounting to unfair prejudice against the landlords whose guarantee rights are taken away.

Since the Powerhouse case, a number of CVAs of large retail companies including JJB Sports, Focus DIY, and Blacks have been approved by sizeable majorities of creditors including landlords. The CVAs that have been successful were carefully structured to ensure that no creditors were unfairly prejudiced. This can be achieved by the debtor company setting aside a fund for the benefit of the landlord creditor group in respect of closed stores, to provide pro rata compensation to the landlords for the loss of rent for a sufficient period (calculated in accordance with principles as to the landlords' rights in the liquidation of its tenant as established by case law) as well as for the cost of business rates (which in some cases are greater than the passing rent). The effect is that the landlord creditors as a group will be significantly better off than they would have been in the event of the liquidation of their tenant.

The evidence in the *Sixty* case also suggests that the Administrators underestimated the persistence of Mourant in pursuing its application to set aside the CVA under the unfair prejudice provisions of section 6 of the Insolvency Act 1986.

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[1] Powerhouse (Prudential Assurance Co Ltd v PRG Powerhouse Ltd [2007] EWHC 1002 (Ch)

The fundamental flaw with the CVA was that it did not constitute an arrangement at all, because the only creditors who were not paid in full under the proposals were the landlords. The landlords lost their right to claim under the parental guarantee by virtue of the terms of the CVA, as voted through by all the other creditors - each of whom were to be paid in full. For that reason, the CVA was clearly unfairly prejudicial to Mourant who ended up in a far worse position than it would have been in had Sixty gone into liquidation. If Sixty had gone into liquidation Mourant would have been entitled to pursue Sixty Spa for its losses under the guarantee.

The key message for landlords and other creditors is that CVAs can be set aside even where an overwhelming majority of creditors has voted in favour of them. For that reason, it is worth analysing the terms of a CVA proposal to see if any creditor or class of creditors has been treated significantly worse than others (the horizontal comparison) and if their position is also worse than it would have been in a liquidation of the debtor (the vertical comparison). If both comparisons fail this test, it is likely that the CVA is unfairly prejudicial to one creditor or group of creditors and capable of being set aside by the court.

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This note does not constitute legal advice but is intended as general guidance only. It is based on the law in force on 31 July 2010.

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