3PB BARRISTERS

Commercial leases and COVID-19

The payment of rent: Insolvency and Government-backed initiatives

Robert Weatherley

www.3pb.co.uk

1

What's new?

- Corporate Insolvency and Governance Act 2020
- Code of Practice
- Recent cases on CVAs:
  - Lazari Properties 2 Ltd v New Look Retailers Ltd [2021] EWHC 1209
    Judgment: 10th May 2021, Mr Justice Zacaroli
  - Carraway Guildford (Nominee A) Ltd v Regis UK Ltd [2021] EWHC 1294
    Judgment: 17th May 2021, Mr Justice Zacaroli

3PB

www.3pb.co.uk

2

Where are we now?

Table 1: There were fewer underlying company insolvencies in 2020 than 2019, following a decrease in all types of insolvency (except receiverships)[1]

England and Wales 2016-2020[p]

	Company insolvencies	Compulsory Liquidations	CVLs	Administrations	CVAs	Receiverships
2016	16,420	2,930	11,794	1,346	345	5
2017	17,315	2,806	12,884	1,316	307	2
2018	17,454	3,140	12,495	1,463	355	1
2019	17,225	3,001	12,058	1,814	351	1
2020[p]	12,557	1,351	9,418	1,526	259	3
Percentage change, last year (2020) compared with:						
2019	-27%	-55%	-22%	-16%	-26%	-

Sources: Insolvency Service (compulsory liquidations only); Companies House (all other insolvency procedures)

3PB

Taken from: The Insolvency Service, "Quarterly Company Insolvency Statistics: Q4 October to December 2020".

www.3pb.co.uk

3

But what can we expect?

- The number of companies in significant financial distress has risen at the fastest rate in more than seven years
- 723,000 businesses now in 'significant financial distress', a 15% increase from Q4 2020 to Q1 2021 (almost 100,000 increase).
- That represents a 42% year-on-year increase of business which are in 'significant financial distress' (213,000 businesses) since Q1 2020

4

And by sector

Companies in financial distress 2020-2021:

- The number of firms in the transportation and logistics sector that were in financial distress increased by 56% (12,191 – Q1 2020, 19,055 – Q1 2021).
- Of those firms in the real estate and property services sector there was an increase of 51% (56,482 – Q1 2020, 85,165 – Q1 2021).
- And, in the financial services sector an increase of 50% (12,975 – Q1 2020, 19,466 – Q1 2021)

Begbies Traynor, 2021, https://www.begbies-traynorgroup.com/news/business-health-statistics/

3PB

www.3pb.co.uk

5

Corporate Insolvency and Governance Act 2020

Temporary changes include:

- No statutory demand served between 1 March 2020 and 30 June 2021 can provide the basis of a winding-up petition presented against either a registered or unregistered company on or after 27 April 2020 (Schedule 10, paragraph 10, as amended by the 2021 regulations)
- If a winding-up petition is presented on alternative grounds , the Court must be satisfied that (broadly):

the creditor has reasonable grounds for believing that—
(a) coronavirus has not had a financial effect on the company, or
(b) the facts by reference to which the relevant ground applies would have arisen even if coronavirus had not had a financial effect on the company.

Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2021

3PB

www.3pb.co.uk

6

What is the future likely to hold?

- Informal discussion, re rent liability –
  - Code of Practice
- Moratoriums (which complements the Code of Practice) NEW – ss.A1-A55
- Attempts to re-structure debt:
  - Schemes of Arrangement
  - CVAs
  - The Restructuring Plan NEW – Part 26A of the Companies Act 2006

3PB

www.3pb.co.uk

7

Code of Conduct for Commercial Property Relationships

- Code of practice published in response to the COVID-19 Pandemic
- Published on the 19th June 2020 and updated on 6th April 2021
- Applies to all sectors, but the government anticipates that it will be used particularly by smaller businesses without access to legal support
- Voluntary code, that does not abrogate or alter the underlying legal relationship between landlord and tenant.
- A number of organisations support the Code and were consulted, including British Chamber of Commerce, RICS etc.
- Purpose appears to be to complement the pre-existing moratoriums.

3PB

www.3pb.co.uk

8

Code of Conduct for Commercial Property Relationships

"landlords and tenants must work together collaboratively and many will want to find temporary, and where possible sustainable, arrangements outside of the existing letter of their leases in order to create a shared recovery plan. The aim of this code is to facilitate those discussions by communicating best practice and presenting a unified approach….

….Tenants who are in a position to pay in full should do so. Tenants who are unable to pay in full should seek agreement with their landlord to pay what they can taking into account the principles of this code. This will allow landlords to support those tenants who are in greatest need and to maintain development activity which will contribute to economic recovery. It also means landlords should provide support to a tenant where reasonably possible, whilst having regard to their own financial commitments and fiduciary duties….

Each relationship will need to respond to these circumstances differently. Therefore, this code is voluntary and presents options for how to agree new payment arrangements" [Code of Conduct, paras 2-7].

3PB

www.3pb.co.uk

9

Corporate Insolvency and Governance Act 2020: moratoriums

CIGA 2020 – inserted sections A1-A55 into the Insolvency Act 1986

- A new freestanding procedure, which may or may not lead to a CVA, or some other form of debt restructuring
- Intended to be a streamlined process with limited expense
- Applies to most companies in England and Wales, provided they are not excluded, BUT:
  - The Company Directors have to certify when they apply that the company is, or is likely to become, unable to pay its debts; and
  - a statement from a proposed independent monitor is required. The Monitor must state that in their view, it is likely that a moratorium for the company would result in the rescue of the company as a going concern

3PB

www.3pb.co.uk

10

Corporate Insolvency and Governance Act 2020: moratoriums

Initial period of 20 days, BUT, it is extendable in a number of circumstances:
- By the directors without the permission of creditors (s.A10);
- By the directors with the support of creditors (s.A11-12);
- Extension whilst CVA proposal is pending (s.A14);
- Extension by Court (on application or in other pending proceedings – s.A13 and s.A15)

Restrictions during the moratorium:
- A landlord may not forfeit by peaceable re-entry;
- No legal proceedings may be instituted OR continued
- No insolvency proceedings may be commenced, other than on an application by the directors or on public interest grounds

But, the tenant must pay the rental liability during the period of the moratorium

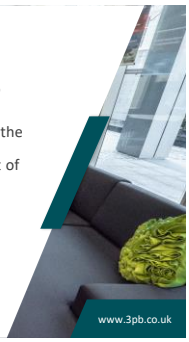
3PB

www.3pb.co.uk

11

Company voluntary arrangements

- Company Voluntary Agreements - a way for a company [or an individual, in the case of an IVA] to restructure debt
- Directors of the Company may make a proposal "to the company and to its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs" (s.(1) of the Insolvency Act 1986)
- Proposal may also be made by a liquidator or an administrator (S.1(3) of the Insolvency Act 1986
- Once approved the CVA becomes binding on all creditors to the company who received, or were entitled to receive, a notice of the meeting.



3PB

www.3pb.co.uk

12

Company voluntary arrangements

To what extent can a future liability to pay rent be compromised? To what extent may the provisions of a lease be altered?

How might a landlord challenge a decision?
- On the grounds that the voluntary arrangement "unfairly prejudices the interests of a creditor, member or contributory of the company"
- On the grounds that there has been some material irregularity at or in relation to the meeting of the company

Recent cases are:
Discovery (Northampton) Limited and others v Debenhams Retail Limited [2019] EWHC 2441
Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

3PB

www.3pb.co.uk

13

"Debenhams" litigation

Ground 1 – that the CVA went beyond the jurisdiction of s.1 of the Act - Landlords do not have a claim for rent to be paid in future at the time the CVA becomes effective. They were therefore not "creditors" within the meaning of s.1 of the Act.

Ground 2 – that in reducing the rent payable under the Leases the CVA is automatically "unfairly prejudicial" to the Applicants, or alternatively there is no jurisdiction to alter a future liability

Ground 3 – that in removing the rights of the landlord to forfeiture which would arise as a result of any CVA related event, the CVA abrogates the landlord's property rights.

Ground 4- the applicants are treated less favourably than other unsecured creditors

3PB

www.3pb.co.uk

14

"Debenhams" litigation (continued)

s.1(2)(e) of the Law of Property Act 1925 says

(2) The only interests or charges in or over land which are capable of subsisting or of being conveyed or created at law are—
(e) **Rights of entry exercisable over or in respect of a legal term of years absolute**, or annexed, for any purpose, to a legal rentcharge.

"the right of re-entry is property belonging to the landlord (not a security right created by the tenant over his property). It arises out of the relationship of landlord and tenant because (i) it defines the estate which the landlord has granted in creating the term of years and (ii) neither its existence nor its exercise is dependent upon any state of indebtedness as between landlord and tenants. A tenant who had paid all his rent to date but faces insolvency may still have his lease forfeit. It can alter the covenant but must leave the reservation untouched". *Discovery*, per Norris J, at [99]

3PB

www.3pb.co.uk

15

"Debenhams" litigation (continued)

But what is unfair prejudice?

The "vertical" comparator – the "irreducible minimum" below which the return in the CVA cannot go. A comparison between the creditors' position in the event that the CVA in the event of winding up or bankruptcy. (Mourant & Co Trustees Ltd v Sixty UK Ltd [2010] EWHC 1890, per Henderson J).

The "Horizontal" comparator – the position between creditors:

"(1) the unfairness must be caused by the terms of the arrangement; (2) unequal or differential treatment of creditors of the same class will not of itself constitute unfairness, but may give case for inquiry and require an explanation; (3) it is necessary to consider all the circumstances, including, as alternatives to the arrangement proposed, not only liquidation by the possibility of a fairer scheme; (4) differential treatment might, in some circumstances, be required to ensure fairness". IRC v Wimbledon Football Club Limited [2004] EWHC 1020

Thomas v Ken Thomas Limited [2007] Bus LR 429

"…it appears to me that the rent falling due after the CVA should by no means necessarily be expected to be caught by the terms of the CVA, even if it is capable of being so caught (as was held first instance in *Re Cancol Ltd (1996) 1 All ER 37*). It strikes me that, at least normally, it would seem wrong in principle that a tenant should be able to trade under a CVA for the benefit of its past creditors, at the present and future expense of its landlord. If the tenant is to continue occupying the landlord's property for the purposes of trading under the CVA (and hopefully trading out of the CVA) he should normally, as it currently appears to me, expect to pay the full rent to which the landlord is contractually entitled" (per Neuberger LJ, as he was then).

"Debenhams", Judgment at paras 71-76

"Here common justice and "basic fairness" require that the landlord should receive at least the market value of the property he is providing. He should not subsidise other creditors but nor should they be compelled to overcompensate him. To that basic principle should be engrafted the principle that a contractual rent should be interfered with to the minimum extent necessary in the circumstances, the modification being limited to what is necessary to achieve the purpose of the CVA.

(…)

I hold that a CVA that reduces rent under existing lease is not automatically "unfair" as breaching some fundamental principle of common sense and ordinary justice. The ability of a landlord to bring to an end the varied relationship renders it fair in the instant case"

Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

Decision date: 10th May 2021.

- New Look Retailed Limited – the operating company of the "New Look" group that operate clothing retailers
- Huge drop revenue as the COVID-19 pandemic hit. Decline in like-for-like of 32% in March 2020 by comparison to the last year
- The Directors believed that the only way to survive the pandemic was for the Company to re-structure its debt

Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

CVA proposal:

(1) An extension the term of a credit facility;
(2) A scheme of arrangement with noteholders who would then take an equity stake in New Look's parent company and participate in a new loan; and
(3) A CVA principally used to amend the terms of the leases.

CVA approved by a majority of 81.6%, but not all creditors would be impacted equally.

- Category A landlords - a critical distribution centre - unimpaired by the CVA, save timing of payment pf rent as changed
- Category C landlords – underperforming stores - current rent arrears compromised in full, new termination clause allowing New Look to determine on 60 days' notice

Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

What were the changes proposed to the leases?

- Alteration in the rent covenants to a turnover-based rent
- Continued reduction in rent for "Category B" landlords after the initial "rent concession period"
- A move to payment of rent in arrears
- The release of covenants imposed on the tenant to "keep open" the premises (which would have an impact on the extent which turnover rent would be paid);
- The release of New Look's obligation to enter into an authorized guarantee agreement on assignment.

Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

Ground 1 – the proposal, or aspects of it, did not constitute a "composition or arrangement" within the meaning of s.1(1) of the Insolvency Act 1986, because:
- On a true analysis it was a separate agreement with different groups of creditor
- The new termination rights granted to New Look in respect of leases with Category B and Category C landlords improperly sought to interfere with the property rights of those landlords

Ground 2 – there were material irregularities in the CVA

Ground 3 – The Applicants were unfairly prejudiced, because:
- The CVA was largely approved by creditors whose rights were unimpacted
- Various modifications of the lease were unfair.

Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

Reading Norris J's judgment [In the Debenham's case].....I do not understand him to have laid down a rigid test that the CVA could only escape a finding of unfair prejudice if at least market rent was paid and the interference was necessary to achieve the purposes of the CVA. If he did, then I respectfully disagree that there is such a rigid test.....

I can see considerable force in the contention that a permanent long-term reduction in rent imposed on landlords without option to terminate would be inherently unfairly prejudicial, certainly if achieved by the votes of other creditors who did not suffer the same treatment, but that is not the case here...

In relation to the broader argument that long term modifications were unfair, I consider (in agreement with the concession in *Debenhams)* that the answer is provided in the landlords' right to terminate, provided that the terms offered to landlords upon exercise of that termination right are at least as beneficial as in the relevant vertical comparator"

Lazari Properties 2 Limited and others v New Look Retailers Limited [2021] EWHC 1209

"Provided, there....the vertical comparator test is satisfied in relation to the returns offered to those landlords who opt to terminate their lease, I consider that it is not unfairly prejudicial to offer landlords that choice. The fact that the landlords are offered that choice, and the nature and extent of the proposed lease modifications are matters to take into account when considering the differential between the landlord and other creditors. As a practical matter, any company proposing such a CVA will need to ensure that the reduction in rent and other modifications to the leases are as far to landlords as possible, because it will need a sufficient number of the landlords to opt to continue the leases if it is to have premises from which to trade. This, however, is a purely commercial question, the answer to which is provided by the number of landlords that continue their leases. The "fairness" of the modifications, per se, is not something which falls to be evaluated by the Court" at [222] per Mr Justice Zacaroli.


3PB
BARRISTERS
It's time for Questions & Answers
Questions Welcome
www.3pb.co.uk

25