



3 HARE COURT

CVAs and commercial property

In the third of a series of articles on Company Voluntary Arrangements Ben Channer gives an overview of the implications for landlords of commercial tenants entering into CVAs.

Barely a week seems to go by without news of another financially struggling high street retailer considering a CVA. The loss of revenue caused by the ongoing coronavirus restrictions and boom in online shopping has been particularly felt by many such businesses who have significant rental obligations associated with occupying large multilocal premises.

Inevitably, this causes concern for commercial tenants and landlords alike. In these circumstances a retailer may look to reduce or alter the basis of its rental payments failing which a CVA can be viewed as a route towards a compromise with its landlord and other creditors.

In an effort to reverse its fortunes Debenhams proposed a CVA to its creditors on 9 May 2019. As well as reducing the amount of rent payable the CVA had the effect of shortening lease terms, preventing dilapidation claims¹ being made and removed a landlord's right to forfeiture because of the CVA.

The subsequent legal challenge to the arrangement by a group of Debenhams' landlords, led by Sport Direct's Mike Ashley, resulted in a High Court decision which clarified some of the effects that a tenant's CVA will, or can, have on their landlords.²

Future rent

The court held that whilst not an immediately provable debt rent is, however, a contingent debt that the company may become liable for due to an existing legal obligation namely its lease. As such landlords who will be due rent can properly be regarded as creditors and future rent can be included within the provisions of a CVA.

However, any proposed reduction in rent can be challenged on the basis that it unfairly prejudices the interests of a creditor. This may appear to be the case in circumstances where rent is compromised but other trade creditors are paid in full (as provided for by the Debenhams CVA).

¹ In the absence of specific quantum evidence dilapidations will often and in any event be regarded as unliquidated claims with a value of £1 (r. 15.31(2) IR 2016)

² *Discovery (Northampton) Ltd v Debenhams Retail Ltd* [2019] EWHC 2441 (Ch)

In relation to Debenhams the reduced rent to be paid under the CVA was not lower than the current market rate which the judge found to be an important feature. He indicated that contractual rent ought to be interfered with as little as possible to implement the purposes of a CVA. Further, although there would be unfairness where landlords were in effect being asked to subsidise other creditors it would not be unfair where landlords received at least the market value of the property they were providing.

Although this gives some clarity many retailers have been keen for landlords to accept turnover rents or have already agreed this in advance of entering into a CVA. Given that any rental obligations can be compromised under a voluntary agreement this would inevitably include those based on the tenant's turnover. How this would then relate to market rent as a measure of fairness against other creditors remains unclear.

The question of fairness is to be answered having regard to the overall picture and may well vary from case to case and be decided with reference to other features of the CVA. For instance, it is common for retail CVAs to provide landlords with an initial entitlement to terminate the lease. This was the position with Debenhams' CVA and it was found not to be unfair to the landlords. Some CVAs also set out future dates at which point either party can terminate on notice. The perceived benefit to the landlord of these provisions may, when viewed in the round by the court, be sufficient to fairly justify a below market rent.

Forfeiture

What of a landlord's ability to forfeit the lease because of an insolvency event - can a CVA prevent this? In short, the answer is no. Most commercial leases allow a landlord to forfeit a lease if an insolvency event occurs which is highly likely to include a tenant's entry into a CVA. A CVA can only affect the rights of creditors and a creditor is someone to whom money is owed (or as mentioned above someone who may be owed money in the future).

The Court of Appeal has ruled that the right of re-entry is property belonging to the landlord not a security right created by the tenant over his own property. Whilst a CVA may, therefore, modify the pecuniary obligation which gives rise to the right of the landlord to forfeit (such as reducing the amount of rent) it cannot modify the right of forfeiture itself.³ In practical terms, this means that a landlord cannot exercise the right to forfeit on the basis of the unpaid rent due under the lease if that amount has been reduced by the CVA and paid in accordance with it. For non-rent payment breaches the landlord's right to forfeiture will remain dependant on the terms of the lease provided the right has not been waived.

Commercial reality

Faced with a tenant contemplating or having entered into a CVA the decision their landlord has to make is largely a commercial one. Given the current difficulties with re-letting a landlord may understandably, albeit reluctantly, favour a lower CVA rent rather than an empty premises and no rental income. Perhaps the group of Debenhams' landlords who challenged the CVA back in 2019 had these practicalities in mind as none of them in fact sought forfeiture.

³ *Re Lehman Brothers International (Europe)* [2010] B.C.C. 272

Even if a landlord does forfeit the lease of an insolvent tenant the court may well grant relief based on the commercial reality of the situation. Allowing the tenant a period of time to try to assign the lease has been viewed as being to the benefit not only of the tenant but also its lenders, creditors and neighbouring retail businesses.⁴

Whilst ultimately a landlord may, in relative terms, have little to lose or be able to offer minimal resistance to a tenant's CVA recent examples show acceptance very much being a last resort. Unsurprisingly Caffé Nero's landlords are currently opposing a CVA in favour of supporting a takeover bid that would see them receiving full payment of rent whilst Moss Bros and Ann Summers both launched CVAs after discussions with landlords to reduce rent levels failed.

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⁴ *SHB Realisations Ltd and another v Cribbs Mall Nominee (1) Ltd and another* [2019] EW Misc 11 (CC)