

Challenging CVAs - the Debenhams decision

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Judgment has been handed down regarding the challenge to the Debenhams CVA providing some long-awaited judicial guidance to certain aspects of retail CVAs.

In common with the recent trend, the Debenhams CVA sought to address what it identified as unsustainable property costs. It categorised landlords by reference to the financial performance and sustainability of the rent for each property. Essentially, the lower the performance, the lower the category of the property and the greater the impact of the CVA on that landlord.

A group of landlords (whose properties fell into the lower categories) brought the challenge on five grounds which, in brief, were as follows:

1. The CVA went beyond the jurisdiction of the Insolvency Act 1986 (“Act”) in binding landlords as they were not creditors for future rent.
2. The rent reductions were unfairly prejudicial - if a company wishes to make use of premises let to it then it must pay the full contractual rent.
3. The removal of the landlords’ right to forfeit abrogated a proprietary right and went beyond the jurisdiction of the Act because it was a property right as opposed to a right between debtor and creditor.
4. It was unjustifiable to treat the landlords less favourably than other unsecured creditors.
5. Claims that might be available to Debenhams in administration were not disclosed in the CVA - that non-disclosure being a material irregularity.

CVAs were designed to provide a flexible mechanism by which a company could restructure its debts and liabilities. It is apparent that landlords have become increasingly concerned that the flexibility was being abused to their detriment.

The challenge to the Debenhams CVA was heard on an urgent basis by Mr Justice Norris. The landlords failed on all but one ground and the CVA stands. The decision of Mr Justice Norris on the five grounds was as follows:

1. The term “creditor” must be given a wide meaning and the term “debt” extends well beyond a debt strictly so called. While future rent might not be a provable debt (a point which he did not need to determine), it is a pecuniary liability to which a company might become subject by reason of an existing obligation and was therefore a debt within the extended meaning of the term and could be captured by a CVA. The challenge on ground 1 therefore failed.
2. The flexibility of CVAs means that rents can be reduced without this being automatically unfair and the ability, in this case, of the landlords to end their relationship with the company rendered the rent reduction fair. The court had to consider fairness in the round and the CVA was varying existing arrangements (rather than creating new contractual arrangements) which enabled the landlord to terminate the arrangement if they thought fit. Overall, the rent reduction was deemed not to be unfair. The challenge on ground 2 therefore failed.
3. Each of the applicant landlords’ leases contained a provision entitling them to re-enter in the event that Debenhams entered into a composition with its creditors. However, the CVA purported to prevent any landlord from exercising such a right. The Judge agreed that the landlords’ right was a property right not capable of being affected by a CVA. The challenge on ground 3 therefore succeeded.
4. Evidence given on behalf of the Supervisors of the CVA was that advice had been received to the effect that all leases were over-rented when compared to current market rents. That evidence was unchallenged. Evidence was also given on why it was necessary to draw a distinction between suppliers of goods and services and long-term liabilities to landlords. The Judge was satisfied on the evidence that the differential treatment of landlords was justified but remarked that there would have been unfairness if landlords were expected to take reductions in rent below the market value of the premises concerned. No evidence had been given by the applicant landlords to suggest that was the case. The challenge on ground 4 therefore failed.
5. The Judge found that there was no material on which to conclude that the prospect of a modest recovery from the claims identified would have resulted in a different result on voting for the CVA. The challenge on ground 5 therefore failed.

Overall, the judgment is likely to be welcomed by many insolvency professionals but viewed as disappointing for landlords. Although the application succeeded on one ground, the discretion afforded to the court meant that the offending provision could be removed with the modified CVA declared valid and enforceable such that it remains in force and binds all creditors. It is not yet known whether the landlords will appeal.

Even if there is no appeal then there remains scope for further challenges to retail CVAs in the future. Based on this judgment:

- Any attempt to reduce rents below market value may be unfair.
- Landlords are likely to pay close attention to whether any CVA proposal properly justifies differential treatment of unsecured creditors.
- Any attempt to alter a landlord's property right is likely to be challenged.

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