What do the New Look and Virgin Active Decisions Mean for Landlords?

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This week has been a big week in the restructuring world, and it has particular importance for landlords.

On Monday (10 May 2021), the court handed down its judgment in the New Look CVA, which was a CVA challenged by landlords. New Look is a fashion retailer with over 400 stores across the UK.

On Wednesday (12 May 2021), the Court sanctioned the Virgin Active restructuring plan. Virgin Active operates a chain of gyms globally, with 39 sites in the UK. The Virgin Active restructuring plan was heavily contested by landlords.

In both cases, the tenant companies had suffered significant losses as a result of the pandemic and the site closures that followed. In both cases, the court found in favour of the tenant companies and allowed rent arrears and future rent to be compromised.

The New Look CVA

It has been common practice for some time for tenant companies looking to restructure their property portfolio to do so by means of a CVA. They do this by placing landlords into different categories. Usually, “Category A” landlords are landlords of profitable sites. There is a separate category for landlords of unprofitable sites and other categories for landlords of sites in between.

Importantly, creditors do not have to be split into classes for voting purposes and 75% in value of unsecured creditors is required to approve a CVA proposal. Landlords have increasingly become frustrated because the vote is often carried by creditors whose rights either are not being affected by the CVA or are being only minimally affected by the CVA.

This was the case in the New Look CVA. Despite significant numbers of landlords voting against the CVA proposal, the vote was carried due to the vote of various noteholders whose rights were not being affected by the CVA. Certain landlords challenged the CVA on multiple grounds, but perhaps the most interesting being:

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1. That a CVA should not be used to effect different deals with different types of creditor. A CVA should be used to reach a compromise with all creditors equally.

2. If it is possible for a CVA to be used to effect different deals with different types of creditor, it is unfairly prejudicial to compromise the claims of certain creditors when their vote is swamped by other creditors who are either unimpaired by the CVA or who receive substantially different treatment.

Unfortunately for landlords, the Court rejected the first argument. As for the question of unfair prejudice caused by the swamping of votes, it held that this is not necessarily unfairly prejudicial in itself but is relevant and should be taken into account in assessing the overall fairness of the CVA. As mentioned above, in New Look's case, the vote on the CVA was carried by the noteholders whose rights were not being affected by the CVA. However, the note holders' rights were being compromised as part of a wider restructuring (under a separate scheme of arrangement) and they needed the CVA to be approved for the wider restructuring to succeed. The Court took a holistic approach and therefore rejected the landlords' claims that the CVA unfairly prejudiced them.

The Virgin Active Restructuring Plan

The Virgin Active restructuring plan is the first of its kind that resembles a CVA in its treatment of landlords. The purpose of Virgin Active's restructuring plan was to compromise secured as well as unsecured debt (which is not possible in a CVA). In tackling lease liabilities, Virgin Active grouped the landlords into different classes depending on the profitability of the underlying gyms.

A restructuring plan is a procedure under the Companies Act 2006 which allows a company to make an arrangement or compromise with its members or creditors, or any class of them. The company must be encountering (or be likely to encounter) financial difficulties that affect its ability to carry on business as a going concern and the purpose of the restructuring plan must be to address these financial difficulties.

When proposing a restructuring plan, the company must group those affected by the restructuring plan into classes. To be approved, at least 75% in value of each class must vote in favour of the restructuring plan. However, a restructuring plan can be approved if only one class of members or creditors votes in favour of the plan (even if all of the other classes vote against it). This is called "cross class cram down". For a restructuring plan to be approved in these circumstances, it must be shown that:

- the class(es) who voted against the restructuring plan would not be worse off under the restructuring plan when compared to the most likely alternative (for example an insolvency process); and

- the class(es) who voted in favour of the restructuring plan would have received a payment or otherwise have a genuine economic interest in the company under the most likely alternative. So this would, for example, prevent shareholders from pushing through a restructuring where the most likely alternative

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would be an insolvency process under which they would be completely out of the money.

In Virgin Active, the secured creditors were placed into one class and voted in favour. Similarly, “Category A” landlords whose rights were only minimally affected by the restructuring plan voted in favour. The other classes largely voted against. Nonetheless, the court held that the dissenting classes could be crammed down and the restructuring plan was sanctioned. The Court was prepared to sanction the restructuring plan on the basis that the landlords who voted against would be better off under the plan than under the most likely alternative scenario, which here was considered to be an administration followed by a sale of the business and assets.

What do these cases mean for landlords?

It looks likely that the practice of CVAs being used to compromise lease liabilities will continue.

In addition, we are likely to see an uptick in restructuring plans being used to the same end. Note that restructuring plans are a more expensive process than a CVA and so are only likely to be used where a CVA cannot be used, for example, if the tenant company also needs to restructure its secured debt.

Contact details

If you have any questions in relation to the content of this article or wish to discuss a matter relevant to you, please get in touch with Rebecca Walker or any other member of our expert Restructuring & Insolvency team at online.enquiries@la-law.com or by calling 0344 967 0793

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