

There is not a “one size fits all” approach when assessing the fairness of a CVA, and the terms of a company’s proposal need to be considered on an individual basis. This alert highlights key points for landlords to take into account when considering a CVA proposal that seeks to reduce rent and/or modify lease terms.

It looks at some of the common ways that a CVA can deal with leases and landlord claims, which often, on the face of it, can appear unfair. It also explains how perceived unfairness might be addressed.

Over recent years, there have been a number of high profile CVAs that have sought to restructure lease portfolios, some of which have ended up being challenged. Most notably, CVAs proposed by *Debenhams*, *New Look* and *Regis* were challenged by landlords on the grounds of material irregularity and unfair prejudice. We have taken into account the findings in those cases when preparing this alert.

Ultimately, whether the terms of a CVA proposal are unfair to a particular landlord will depend on the specific terms of the proposal, and specific legal advice should be sought.

## Rent Reductions

Simply put, a CVA can compromise both rent arrears and future rent. There is no minimum requirement to pay market rent and it is not automatically unfair if landlords are paid nil rent or rent is switched to a turnover rent.

The reason a company is looking to modify the terms and reduce rental liabilities by proposing a CVA is not (ordinarily) to treat landlords unfairly, but because it is insolvent and does not have the cash to pay.

Although a CVA can reduce rent below contractual rent, or even market rent, and may even reduce rents to nil, a landlord should expect to receive at least what they would receive in the relevant alternative (*see below for an explanation as to what this means*). Further they should also expect to be given a right to terminate the lease, and we consider this below.



## What Does “No Worse off Than in the Relevant Alternative” Mean?

Each CVA will explain what is likely to happen to the company if the CVA is not approved. In most cases, it is likely to enter into liquidation or administration. Administration could be a trading administration, a pre-pack sale or shut down.

When considering whether the terms proposed are fair, a landlord will need to know what they would receive in the alternative insolvency process. The relevant alternative essentially sets the lowest amount which a landlord should expect to receive in the CVA. It is also used as a test (referred to as the “vertical comparator” test) that helps assess the fairness of a CVA.

If the landlord is no worse off under the CVA than in the relevant alternative, it is likely that a CVA term will meet the vertical comparator test, but that does not mean that the offer to landlords is fair. Other factors, such as the treatment of other creditors will need to be considered – this is referred to as the horizontal comparator test. [See our other alert.](#)

## Can a CVA Reduce Rent to Below Market Rent?

Yes, because it is not automatically unfair for a CVA to reduce rent to an amount lower than market rent provided that the landlord will be paid at least the same as they would in the relevant alternative. There was some debate about this following the court decision in *Debenhams*, but this point was clarified in the case of *New Look*. The court confirmed that there is no “rigid test” that a landlord must be paid at least market rent. Therefore, from a landlord’s perspective, if a CVA imposes a lower-than-market rent, it does not mean the CVA is automatically unfair to that landlord; other factors will need to be taken into account.

## If a CVA Proposed to Terminate a Lease, How Much Rent Should a Landlord Be Paid During a Notice Termination Period?

There is not a minimum threshold, which means that a CVA could propose a rent payment that is lower than contractual rent or even lower than market rent during a notice termination period, provided, again, that the landlord will be paid at least the same as they would be if the company entered a different insolvency process.



Although most CVAs provide for a landlord to receive contractual rent during a termination notice period, in *New Look* the Judge said that “even in relation to rent reductions during a termination notice period”, the case of *Debenhams* did not set a test that rent should be at least market rent.

### **Can a CVA Impose a Term That Requires a Landlord To Be Paid Nothing?**

Although, a CVA cannot interfere with a landlord’s proprietary rights such as forfeiture or surrender, it can include a provision that releases the company from all of its obligations, including the requirement to pay rent, provided the landlord is given a right to terminate.

CVA proposals sometimes include a provision that enables the company (perhaps if the store does not meet certain performance criteria) to bring its obligations under the lease to an end, including the obligation to pay rent. In return, the landlord is usually given the option of agreeing a surrender, or leaving the lease in place. In the latter case, although the landlord receives no rent, business rates liability does not revert to them.

This type of provision was challenged in *New Look* on the basis that it interfered with a landlord’s proprietary rights, but the court did not agree that it was analogous to a surrender. The reason why the challenge did not succeed came down to choice. If a landlord can choose between agreeing to take the property back or leaving the lease in place, it is up to the landlord to decide whether to continue the lease even at nil rent.

### **Can a CVA Grant the Company a New Right To Terminate That Is Not in the Lease?**

Provisions in a CVA that give the company a right to serve a Notice to Quit, or a new right to terminate in favour of the company, need to be carefully considered. The wording might suggest that the lease will be brought to an end, which, if that occurs, is likely to be an interference with the landlord’s proprietary rights, which is not permitted. However, it is most often the case that the effect of the termination right is not to terminate the lease, but to reduce rents to nil and release the company from its obligations under the lease – which, as explained above, is permitted and will not be automatically unfair if the landlord has a choice whether to take the property back.

## **Turnover Rent**

A number of CVAs have sought to modify rent provisions by switching to turnover rent for the CVA term. For the reasons set out above, and explained below under termination rights, a switch to a turnover rent is unlikely to be automatically unfair if a landlord has a choice about whether to continue the lease.

### **Is a Landlord Entitled To Ask for a Profit-share Fund?**

Just because other CVAs have proposed a profit-share fund does not mean that all CVAs must include one. However, the availability of a profit-share fund or other uplift mechanism may help balance any unfairness if creditors are treated differently.

## **Termination Rights**

When assessing the fairness of a CVA proposal, the ability of a landlord to terminate will be a key consideration when looking at whether a particular provision in a CVA is unfair.

Provided the CVA offers the landlord choice – a right to terminate and take the property back, or accept the terms and be bound – a court is unlikely to find any modifications to lease terms automatically unfair. Provided that, on exercising a right to terminate, the landlord would be no worse off than in the relevant alternative.

If a landlord can choose between opting to accept the modified lease terms or taking the property back, then it is up to the landlord (not the court) to determine whether it considers the terms fair. If the landlord does not like the terms or does not think they are fair, then they can terminate the lease.

It is, therefore, important for landlords to weigh up, at the outset, the consequences of taking the property back (such as liability for business rates and insurance) and opportunity (such as re-letting to a new tenant) against the terms proposed in the CVA. For example, re-letting on terms that require the landlord to offer a rent-free period may be preferable to the terms proposed by the CVA.

### **Rolling Termination Rights**

Although a right to terminate is key, a landlord cannot expect this to be a rolling right exercisable by the landlord at any time. Although some proposals might include such a term, the court concluded in *New Look* that the fact that a CVA does not contain a rolling right to terminate, is a matter for the landlord to consider at the outset when deciding whether to opt to continue with the lease.



## How Does a Right to Terminate Work if a Landlord Has Multiple Leases?

Following the reasoning in *New Look* and *Regis*, landlords with multiple leases should expect to be given an option to terminate those on an individual basis, rather than, as has typically been the case, being given a choice between terminating all or none of them. An “all or nothing” type of provision restricts the landlord’s choice, and choice was an important consideration when assessing the fairness of the *New Look* and *Regis* CVAs.

There may be some properties that the landlord wishes to re-let, and others where the better option is to leave the lease in place. Having the choice to decide which leases to terminate, rather than a more arbitrary choice between all or none, helps address the question of fairness.

### Summary

In terms of challenging a CVA on the basis that the rent reductions and other lease modifications are inherently unfair, unless those modifications interfere with a landlord’s proprietary rights (which it is not permitted to do) then largely it is up to a landlord to decide whether they are “fair,” not the court.

The proposed terms have to be considered in light of all of the circumstances and, most importantly, whether the landlord has a right to terminate, which, upon exercising that right, means that the landlord is no worse off than if the CVA was not approved and the company entered a different insolvency process.

Although a right to terminate is likely to ensure that longer term lease modifications are fair, a CVA must also meet the horizontal comparator test, which requires the treatment of landlords to be fair when assessed against the treatment of other creditors. If other creditors are treated differently, that differential treatment needs to be justified. It often is, on the basis of ensuring business continuity, but that is not the end of the matter. If the CVA has been approved as a consequence of the votes of unimpaired creditors (so called “vote swamping”), this could lead to a finding of unfair prejudice even if there is justification for differential treatment. [See our other alert](#) for further discussion about this.

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