C A D W A L A D E R

A Further Blow to the Landlords? The Virgin Active Case and the New Restructuring Plan Regime

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It's not news that the COVID-19 pandemic has exacerbated losses in sectors that are reliant on footfall − namely, the retail and leisure industry. Prior to the pandemic, the general weakness in the "bricks and mortar" retail industry has given rise to a series of company voluntary arrangements, and companies struggling to meet fixed rent have used CVA as a tool to renegotiate reductions for fixed rent leases, and in some cases, completely overhauling the fixed rent to turnover-based measurements. Due to the pandemic, along with **measures** announced by the Government on a stop on forfeiture over non-payment of rent, it wouldn't be uncommon for businesses to be sitting on a debt pile of unpaid rent arrears since March 2020.

Last week, the High Court handed down a momentous judgment on a rescuing plan presented by Virgin Active which relies on wiping out the majority of the rent arrears. It was a test case on the new rules around scheme of arrangement introduced last year, which no longer requires 75% votes from all creditors to be obtained, provided certain conditions are met.

This article revisits the current rules around pre-insolvency restructuring and how this could affect landlords, as well as the implications of the Virgin Active case.

The Rise and Rise of CVA

Until last year, tenants who are not yet insolvent but are nevertheless struggling with cash flow pressures have looked at company voluntary arrangements ("CVA"), which is a procedure undertaken between a company and its creditors under Part I of the *Insolvency Act 1986* ("IA 1986"). The CVA is not a formal insolvency arrangement, but is a tool companies could use in restructuring their unsecured debts.

CVA does not compromise claims of secured creditors and only involves unsecured creditors (such as landlords) and, amongst other criteria, once passed by 75% of all unsecured creditors (measured by value of the aggregate debt) the arrangement binds all unsecured creditors. Due to the recent decline in the retail sector, which was exacerbated by the pandemic, companies in the retail industry have been increasingly using this strategy as a tool to renegotiate rent reductions and/or write-offs of rent arrears with landlords. Recent examples include the New Look CVA, where the CVA included moving rents to turnover rents and 3-year rent concession periods.

For more discussion on the use of CVA and how this could affect landlords, please see our earlier article **here**.

New Rules for Scheme of Arrangement

In addition to the above, *The Corporate Insolvency and Governance Act 2020* ("CIGA"), which came into place on 26 June 2020, provided an additional restructuring tool which is seen to be favourable for companies with respect to Restructuring Plans. Prior to CIGA, the scheme of arrangement under Part 26A of the Companies Act 2006 provides under s901F that the Restructuring Plan may be approved if a number representing 75% in value of the creditors or class of creditors or members or class of members have voted for the Restructuring Plan. With the introduction of CIGA, however, a new restructuring process is introduced under s901G Companies Act 2006, which provides that, if the Restructuring Plan has not been approved by 75% of the creditors, provided that the following two conditions are met, then the court may sanction the Restructuring Plan *notwithstanding* such Restructuring Plan was not endorsed by 75% of the creditors. These two conditions are:

Condition (A) − the court is satisfied that, if the Restructuring Plan was to be sanctioned, none of the dissenting class would be ***worse off*** than they would be compared to the ***relevant alternative***; and

Condition (B) − the Restructuring Plan was agreed to by over 75% of ***one class of creditors*** who are in the class of creditors ***who would receive a payment or have a genuine economic interest*** in the company if the company was to be subject to the ***relevant alternative***.

There are two key factors here (highlighted in bold above):

- the conditions require a satisfaction of a "no worse off" test by the dissenting creditors, when compared to the likely outcome in the "relevant alternative." The relevant alternative is the situation the court considers as most likely to occur if the Restructuring Plan were not to be sanctioned; and
- the Restructuring Plan can be sanctioned so long as over 75% of one class of creditors who, if the relevant alternative were to occur, would be "in the money" (and therefore have a genuine economic interest) and would receive a payment, have endorsed the Restructuring Plan.

If these two conditions are met, the court may, in its absolute discretion, decide whether or not to invoke s901G to sanction the Restructuring Plan.

The Virgin Active Case – A Test Case for s901G

This provision has been tested twice since its introduction: in *DeepOcean 1 UK Limited* ***[2021] EWHC 138 (Ch)***, and *Virgin Active Holdings Ltd & Ors, Re [2021] EWHC 1246 (Ch)* ("Virgin Active"), the latter which is of most relevance to landlords.

In Virgin Active, Virgin Active Holdings Limited and Virgin Active Health Clubs Limited (together, Virgin Active) sought court sanction of a Restructuring Plan pursuant to 901F of the Companies Act 2006.

The Restructuring Plan in short consisted of, amongst other things, certain recapitalisation and injection of new money by the shareholders, and also a substantial reduction of certain classes of rental arrears. The leases were split into different classes according to the importance of the premises to the revival of the business and revenue, with Class A leases classified as most important. The Restructuring Plan was approved by over 75% of secured creditors and also over 75% of landlords of Class A leases. It was largely opposed by the rest of the landlords and other unsecured creditors.

It was submitted and accepted by the court that, if the Restructuring Plan was not approved, the relevant alternative in this instance was administration for around 6 weeks with an objective to sell certain arms of the business (Scenario 1) or liquidation of the companies (Scenario 2). It was further submitted and accepted by the court that Scenario 1 will achieve a return for the secured creditors in the region of 84.6 p/£ for Scenario 1, and only 21.8 p/£ for Scenario 2.

The court found that the liquidity crisis facing the companies is so acute that administration (Scenario 1) is the relevant alternative in this instance if the Restructuring Plan was not sanctioned (therefore satisfying Condition A). It follows that if the administrators pursue on an accelerated sale, it is highly likely that the claims by the landlords which were in dissent of the Restructuring Plan are unlikely to recover any payment. This is because, in an administration, the commercial negotiation of any assignment of any lease as part of a sale of a business is likely to require the landlord to agree to a rent that is less than the contractual amount and a write-off of any arrears. Therefore, it was the view of the court that Condition B is also satisfied.

Finally, the court is within its discretion to decide whether to apply s901G to sanction the Restructuring Plan, and the court was satisfied that the legislation was sufficiently wide to allow it to exercise such discretion and would exercise such discretion in this instance.

The Implication for Landlords and Their Lenders

The implication for landlords from the introduction of s901G Companies Act 2006 and the judgment in Virgin Active provides that the size of the claim of the landlord (which would be relevant for voting rights in CVA) is less relevant and the question is whether such claim is likely going to result in a payment in the relevant alternative, which often in practice is administration or liquidation. This new regime and the court cases have effectively diminished the voting powers of unsecured creditors in situations where the company is closer to formal insolvency processes.

For the lenders, the movement towards a more favourable restructuring regime for companies (tenants) means that increasing focus should now be placed on the financial capability and financial performance of the underlying tenants, and in particular, those considered as “key tenants” who make up a material proportion of the rental income. This could include additional covenants on information reporting on certain tenants, and additional warning triggers relating to the tenants and adjustment of financial covenant thresholds to include additional buffers against adverse events.