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English Court Upholds New Look's Company Voluntary Arrangement, Following Major Challenge from Landlords

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At a Glance

The English court yesterday handed down a judgment comprehensively rejecting landlords' challenge to the company voluntary arrangement ("CVA") of New Look. This seminal judgment, which followed an extensive trial, has been eagerly awaited in the restructuring market.

The restructuring market is also keenly awaiting the court's judgment on the challenges to Regis' CVA and Virgin Active's restructuring plan — both high-profile cases focussed on the potential limits on distressed tenants' ability to compromise landlords' claims.

Kirkland & Ellis will host two webinars with market experts, discussing the legal implications of these cases on Tuesday, May 18 and the market implications of these cases on Tuesday, June 1. Further information and registration details will follow.

Core takeaways from Zacaroli J.'s judgment in *Lazari Properties 2 Ltd & others v New Look Retailers Ltd & others* (the "New Look Judgment") include:

- Market rent: There is no general principle that a CVA cannot reduce rent below market rates, or must amend terms no more than is necessary to achieve the purposes of the CVA.
- Importance of break rights: The fact that landlords were granted the right to terminate the leases provided *the* key answer to their complaints of unfair prejudice (provided that the terms offered to landlords upon exercise of that termination right were at least as beneficial as what the landlords would receive in the alternative to the CVA). "The inability to pay full rent is the consequence of New Look's insolvency and the reduction in rent and other modifications only apply if the relevant [landlord] does not opt to terminate its lease." It was not for the court to evaluate the fairness of the absence of a rolling termination right for landlords; instead, that was a factor that each landlord could assess.
- Voting discount: The application of a discount to landlords' claims for voting purposes — here, a 25% discount to landlords' contractual right to future rent for the remainder of the lease — was not a material irregularity.
- Treatment of SSN Holders: The approval threshold for the CVA was only reached by virtue of votes of the holders of New Look's senior secured notes (the "SSN Holders"), who were unimpaired by the CVA. However, this did not constitute unfair prejudice, as:
  - it was necessary to see the CVA as an integral part of a wider restructuring, including a scheme of arrangement in which the SSN Holders' rights *were* impaired (exchanging secured debt for a minority equity interest in New Look);
  - the different treatment was justified by the fact that SSN Holders were secured; and
  - the fact that SSN Holders voted in respect of the unsecured portion of their claim did not unfairly prejudice the landlords, taking account of all the circumstances.

Key terms of the CVA

Company	New Look Retailers Ltd
Proposal Date	August 2020
Approval	c. 82% (by value, of all unsecured creditors voting)
Terms	• CVA formed part of a wider restructuring, including "debt for equity swap" via scheme of arrangement • Divided creditors into various categories, including certain landlord classes (certain of which were substantively unimpaired,

	certain of which switched to turnover rents, and certain of which switched to zero rents under the CVA) and holders of senior secured notes • Critically, the CVA included 'break rights' for landlords to take back and re-let their properties

Challenges and court's rulings

The Jurisdiction Challenge

The applicant landlords unsuccessfully argued that the CVA proposal did not constitute a composition or arrangement as required by section 1(1) of the Insolvency Act 1986.

Challenge	Judgment
The CVA did not constitute a composition in satisfaction of the company's debts or a scheme of arrangement of its affairs, because on a true analysis it involved separate arrangements (on fundamentally different terms) with different groups of creditors.	A CVA that provides for different treatment of different sub-groups of creditors is not, for that reason, outside the jurisdictional scope of section 1(1).
There was insufficient "give and take" as between New Look and various creditor groups.	The court rejected the applicant landlords' contention that there was no sufficient "give" by New Look; since the CVA offered compromised landlords a better return than they would achieve in the relevant alternative, it followed that there was sufficient to satisfy the relatively low jurisdictional hurdle of "give and take".
The new termination right granted to	The release of New Look under the CVA

New Look in respect of leases with Category B and Category C landlords improperly sought to interfere with property rights of those landlords.	did not in substance operate as a surrender, as it is not an essential requirement of a lease that the tenant is obliged to pay rent. Although the CVA offered relevant landlords the *opportunity* to agree to a surrender of the lease, it did not *require* them to do so. Accordingly, the CVA did not constitute an interference with the landlords' proprietary rights.

The Material Irregularity Challenge

The applicant landlords unsuccessfully argued that there were material irregularities under the CVA.

Challenge	Judgment
Material irregularity based on calculation of the landlords' claims for voting purposes — specifically, the 25% discount applied to landlords' claims for voting purposes	The starting point for claims of an unascertained amount is to be valued at £1 unless the chair decides to put upon it an estimated *minimum* value for voting purposes. The chair had agreed with the formula for calculating landlords' claims for voting purposes; notably, no landlord put forward evidence in support of a different conclusion. The application of the discount was not objectionable and (as the discount was applied equally to all landlords) the application of the discount had no impact on the outcome of the meeting — therefore no material irregularity.
Material irregularity based on omissions and inaccuracies in the CVA proposal	On the facts, the alleged non-disclosures did not constitute a material irregularity — although Zacaroli J. accepted that (1) the likely value of

	equity interests to be received by the SSN Holders as part of the overall restructuring and (2) the terms of a management incentive plan, ought to have been disclosed to CVA creditors.

The Unfair Prejudice Challenge

The applicant landlords unsuccessfully contended that they were unfairly prejudiced under the CVA. Whether unfair prejudice exists depends on all the circumstances. Four points were particularly relevant on the facts of this case:

1. whether there is a fair allocation of the assets available within the CVA between the compromised creditors and other sub-groups of creditors (which, the court held, necessarily requires the court to consider whether a different allocation would have been possible);
2. the nature and extent of the different treatment, the justification for that treatment and its impact on the outcome of the meeting;
3. the extent to which others in the same position as the objecting creditors approved the CVA; and
4. a finding of unfair prejudice ought not to be precluded merely because the same result might have been achieved in a restructuring plan (under Part 26A of the Companies Act 2006).

Challenge	**Judgment**
Unfair prejudice as the requisite majorities at the creditors' meeting were secured with the votes of creditors whose claims against New Look were unimpaired by the CVA	The CVA was an integral part of the wider restructuring, under which the SSN Holders *were* impaired (exchanging secured debt for a minority equity interest). The fact that a statutory majority for a CVA is achieved by the votes of unimpaired or differently-treated creditors will be an important consideration in determining whether unfair prejudice exists, but will not necessarily mean the CVA is unfairly prejudicial.

Unfair prejudice as creditors whose claims were compromised received differential treatment from those that were not	The different treatment of the SSN Holders was justified by the fact that the SSN Holders were secured. On the facts, the different treatment did not constitute unfair prejudice.
Unfair prejudice as various of the modifications to the terms of leases were unfair; the landlords' main objection was to the change to turnover rent, said to be unfair in principle because "it involves the fundamental reallocation of commercial risk and deprives landlords of their bargain"	The answer was provided in the landlords' right to terminate, provided that the terms offered to landlords upon exercise of that termination right were at least as beneficial as in the relevant 'vertical comparator' (i.e., what landlords would receive in the alternative to the CVA, e.g. a pre-pack administration or liquidation).

The future of CVAs?

The New Look Judgment is resoundingly in favour of the company. Zacaroli J.'s extensive judgment includes commentary which will help shape market practice on future CVAs. For example:

1. The judgment indicates that it is not necessarily sufficient, to avoid a finding of unfair prejudice, that the differential treatment of certain creditors was objectively justified (e.g., because they were critical creditors) and that the compromised creditors are treated more favourably than they would be in the alternative to the CVA. Rather, whether unfair prejudice exists depends on all the circumstances;
2. The judgment raises the question of whether there is a fair allocation of the assets available within the CVA between the compromised creditors and other sub-groups of creditors. This raises the prospect of greater scrutiny by the court of whether an alternative arrangement would have been fairer. This question has consistently been avoided in the context of schemes of arrangement, but is now a key point in the challenge to Virgin Active's restructuring plan; and
3. The court found that details of (i) the likely value of equity interests to be received by the SSN Holders and (ii) the management incentive plan, ought to

have been disclosed to CVA creditors (although ultimately this did not amount to a material irregularity).

The British Property Federation has published a list of "top 10 'red flag' clauses. The New Look Judgment clarifies the permissibility of certain of these (naturally, depending on the circumstances), such as continued rent reductions beyond the expiry of the rent concession period, the possibility of rental discounts to less than market rent, new rights for the company to terminate leases and the compromise of dilapidations claims to a fixed sum.

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Suggested Reading

- 10 May 2021 Award Benchmark Litigation Asia-Pacific 2021
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