

Equal Treatment for All

The Message:

A victory for landlords against the use of CVAs to guarantee strip.

The Case:

The "Powerhouse" case established the possible use of company voluntary arrangements ("CVAs") for tenant companies to deprive landlords of the benefit of third party guarantees of the tenant's liabilities. The latest challenge to this practice came in *Mourant & Co Trustees Limited v. Sixty UK Ltd* (in administration) [23 July 2010] and the landlords emerged victorious.

Sixty UK Ltd ("Sixty") sell wholesale and retail fashion garments. Among its shops were two at a shopping centre in Liverpool, which it leased from Mourant & Co Trustees Ltd and another as trustees of a property unit trust ("the landlords"). The leases were guaranteed by Sixty SpA, the ultimate holding company of the Sixty group.

Sixty went into administration and its administrators proposed a CVA for the company, which was approved at a creditors' meeting. The administrators were also the supervisors under the CVA. The CVA would impact on Sixty's leases at the landlords' centre, releasing Sixty SpA from liability under its guarantees on payment of £300,000 to the landlords. However, almost all of Sixty's other creditors would continue to be paid in full. The only creditors present at the meeting who voted against the CVA proposal were the landlords.

The landlords challenged the CVA on the statutory basis that it unfairly prejudiced their interests as a creditor. This was founded on the alleged inadequacy of the compensation offered and being compulsorily deprived of the guarantees. The landlords argued that they were unfairly treated in comparison with the rest of the creditors and there was no justification for requiring the landlords to give up the valuable benefit of the guarantees.

The High Court decided in the landlords' favour, holding that the CVA was fatally flawed and must be set aside. In judging whether a CVA unfairly prejudices particular creditors, certain techniques can be applied. One compares a creditor's position in a liquidation with its position under a CVA, which identifies the "irreducible minimum" below which the return in the CVA cannot go. Another compares the creditor's position with that of other creditors and ascertains whether any difference in treatment was justified.

The Court stated that a liquidation would not deprive the landlords of the guarantees for the remainder of the leases, which the CVA would do. The guarantees were of obvious commercial value to the landlords (particularly in times of financial turmoil) and the very reason the guarantees were taken in the first place was to use them if the tenant, for example, went into liquidation.

The Court considered it unreasonable and unfair to require the landlords to give up their guarantees in return for a sum of money, about which it was difficult to determine whether it fairly compensated the landlords. The £300,000 was not a genuine estimate of the value of the landlords' claim and the evidence showed £1 million was more appropriate. The Court also held

that the difference in treatment between the landlords and the other creditors could not be justified.

The Court was stinging in its criticism of the administrators. It is the administrators' duty to remain independent, act in good faith and only propose a CVA if satisfied it will not unfairly prejudice any creditor's interests. This is particularly so where the CVA is structured so that it is bound to be passed by the votes of creditors whose position is unaffected or improved, and a much smaller class of creditors is to be deprived of valuable contractual rights. The Court stated that the administrators lost a proper sense of objectivity and allowed themselves to side with the Sixty group against the landlords' interests.