Client: Mayer Brown
Source: Estates Gazette (Main)
Date: 26 March 2011
Page: 107
Reach: 21947
Size: 432cm2
Value: 2626.56

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Rescue bids

CVAs JJB's second proposal has been received less warmly than its first. Simon Hartley and Andrew Hepner consider the merits of these arrangements

Less than two years ago, JJB Sports announced that it was seeking approval for a company voluntary arrangement (CVA), restructuring its lease liabilities. This was welcomed by landlords and approved by 99% of the company's voting creditors. Other retailer CVAs were subsequently approved, including those of Focus DIY and Blacks Leisure. The procedure was hailed by some as an effective rescue tool and an attractive alternative to administration, particularly of the pre-packaged variety. Many landlords had vilified the latter because they were seen as allowing defaulting tenants simply to walk away from unattractive leases and continue trading.

However, the past two years have been eventful and JJB's proposal for a second CVA has not been greeted with as much enthusiasm as its earlier plan.

CVA proposal

This CVA proposal was a test case for the continuing use of the procedure by struggling retailers. In asking its creditors to approve a second CVA, initially closing 43 stores with the option of closing a further 46, JJB admitted the previous reduction in its lease liability had not secured its financial position. The proposal also followed the overturning of the creditor-approved CVA of Miss Sixty by a landlord on the ground of unfair prejudice: see *Mourant & Co Trustees Ltd* v *Sixty UK Ltd (in administration)* [2010] EWHC 1890 (Ch); [2010] 2 EGLR 125.

The challenge to Miss Sixty's CVA was worthwhile only because the alternative (administration) provided a better return for the landlord, which regained the benefit of a guarantee. JJB seemed conscious of the need to balance its reduced liabilities against making the procedure attractive to creditors. Its proposal of 3 March therefore included various innovations to achieve this.

As with all CVAs, JJB required the approval of its creditors and shareholders; separate meetings were duly held on 22 March. It needed the support of a majority exceeding three-quarters in value of those creditors present and more than 50% of creditors unconnected with JJB. Approved CVAs are binding on all unsecured creditors.

JJB indicated that adversely affected "compromised landlords" would have the opportunity to share in any upturn in its fortunes. (This may have been prompted by criticism of Blacks' CVA, which saw profits rise with no corresponding benefit to the landlords of its closed premises.) This sharing of the benefit took the form of a clawback provision, namely a payment to the compromised landlords of a sum linked to performance over the next two years of between £2.5m and £7.5m, depending on factors including the level of rent and the remaining term, payable on 24 April 2013 or on a prior takeover. Although the provision was generally welcomed, the two-year timetable was not.

It is likely that the landlords would have preferred the clawback in cash, but JJB may replace cash with ordinary shares. This may have been dictated by necessity, but JJB's landlords may not have found the prospect of shares in a retailer with recurring financial problems and the same

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management particularly attractive. The reported collapse of talks between JJB and JD Sports and the announcement of a share-placing to raise £65m, following a placing three months earlier, would only have made this proposal less attractive.

As further sweeteners, JJB proposed to pay rates (until surrender, forfeiture, assignment or the earliest contractual lease break date), full service charges, insurance premiums and contracted turnover rents in respect of the stores to be closed.

Under existing authorities, it is possible, although controversial, to use CVAs to rewrite a company's contracts, including its leases. The limits of this power have yet to be fully tested. JJB's CVA takes a further step in that direction. The movement of the remaining 147 leases onto monthly rent cycles was unsurprising given the number of retailers seeking such a concession and the inclusion of this for one year in the previous CVA.

The option to close additional stores after two years if they are unprofitable is similar to a tenant's break option. The rent under the compromised leases is also to be reduced to 50% of the (contractual pro rata) monthly rent prior to closure. The CVA also addresses dilapidations, by providing for a contribution equal to 5% of the contractual pro rata monthly rent.

Reduced rents, the uncertainty of a tenant break option and no effective incentive for the tenant to keep its premises in repair are a toxic mix for a landlord. On their own the rewritten provisions could affect a landlord's capital values and create a risk of adverse comparable evidence for other tenants on a landlord's estate, depressing the rental market. However, compromised landlords that dislike the new terms can walk away, with a right to remove JJB on 45 days' notice. The CVA allows these landlords to market premises while funds continue to come in from JJB until a new tenant is found, at which point notice can be served, mitigating the adverse effect on value.

The inherent risk of the CVA is that it could set a precedent for leases to be rewritten without the landlord's express agreement. The ensuing uncertainty could potentially reduce property values, as was feared by some when Powerhouse sought to remove parent company guarantees using a CVA: see *Prudential Assurance Co Ltd* v *PRG Powerhouse Ltd* [2007] EWHC 1002 (Ch); [2007] 3 EGLR 131.

Prudential was also an example of unfair prejudice. Despite the approval of JJB's CVA, one or more creditors may seek to overturn the arrangement on this ground. An application to do so may be made within 28 days of the creditors' meeting or of an unnotified creditor becoming aware of the proposal. Such a challenge may have a reasonable prospect of success: the compromised landlords have been treated differently and less favourably than other landlords and unsecured creditors. Whether an application is made will depend on how attractive the alternative (administration) is perceived to be. It would raise the potential for a deal with JD Sports, and something similar to a partial pre-pack sale of selected stores to it may release value.

A valuable tool

The use of CVAs still appears valuable and JJB has opened the door to more creative lease redrafting. It remains to be seen how many retailers will take advantage of this and whether landlords will, at some point (in a better market perhaps), take a stand against it.

Simon Hartley is a solicitor and Andrew Hepner are solicitors at Mayer Brown International LLP

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