Legal viewpoint on CVAs

Mathew Ditchburn discusses why CVAs fail more often than not, and what it means for landlords.

In March 2016, BHS entered a company voluntary arrangement (CVA) with its creditors, designed to transform the company's fortunes and avoid full-blown insolvency. Just a few weeks later, the retailer collapsed into administration. This was not a one-off. According to the Insolvency Service, 388 of the 563 CVAs in 2014 failed. R3 (the Association of Business Recovery Professionals) has begun a new research project to investigate what is going on.

A CVA is an agreement between a company and its creditors that compromises debts and liabilities so it can continue trading. If approved by 75% of creditors by value, it binds all creditors irrespective of how they voted. CVAs are a popular tool for restructuring leasehold liabilities and, in recent months, the model has evolved to comprise trade debts as well.

When coffee shop Love Coffee proposed to close 11 out of 30 outlets and halve the rent for another six under its CVA, the British Property Federation objected to the perceived lack of prior engagement with landlords. Matters were not helped by the CVA's stated aim of attracting funding for the company's new store concept – it seemed that landlords were paying to supplement shareholders' profits rather than save an insolvent tenant. Fortunately, further dialogue and changes to the CVA led to its eventual approval.

Some CVAs fail to achieve their aims. BHS successfully agreed to close 40 of its 164 stores and reduce the rent for a further 47, but the company still needed £100 million to continue trading. One month later, when it failed to raise the funds, the business went under. There was no provision within the CVA that such an agreement would cause it to terminate. The administrators tendered rent at CVA discounted rates but claimed not to be bound by break rights given to landlords in return.

Landlords will be wary of other CVAs that could lead to such a result. This includes The Food Retailer Operations' proposal to close a number of former Somerfield and Budgens stores, which was voted down by creditors in February this year. Landlords were also concerned about the low return on rent arrears and lack of any investigation into antecedent transactions prior to the company's failure.

Even if a CVA runs its course, that is not the end of the story. Some businesses still go on to fail. Unlike a firm in administration, a company proposing a CVA remains in the hands of its current management, who might be overly optimistic about its future. There is no requirement to change the fundamentals of the business or address its structural problems. The trick for landlords is to separate those CVAs that genuinely show how things will be done differently from those that are just a tool to cut bills.

This article was co-written with John Cook, revenue manager at Capital & Regional. John and Mathew are chair and vice-chair respectively of the BPF's insolvency committee. A previous version of this article appeared in Property Week on 17 February 2017.

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