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## The British Property Federation

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £100bn to the economy in 2018 and supported more than 2 million jobs.
2. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.
3. This briefing outlines our primary concerns with the way in which Company Voluntary Arrangements (CVAs) are being used. We also propose some recommendations for Government, with a view to improving CVAs so that they provide more transparency, oversight, effectiveness and clarity for creditors. We would be delighted to provide further information on any aspect of this paper. Please contact Laurence Raeburn-Smith (Policy Officer) at: [laeburn-smith@bpf.org.uk](mailto:laeburn-smith@bpf.org.uk), or on 020 7802 0121, if you would like to discuss any of the points raised.

## The BPF's overarching position on CVAs

4. CVAs can be a useful tool for restructuring when used correctly, however, they are currently being abused as a means of business rescue and we consider that the existing legislation has not kept pace with their innovation. This is especially the case for "Landlord CVAs", where landlords are the only compromised class of creditors but the CVA is approved by other, unaffected creditors.
5. We have heard numerous testimonies from our members that inward investors, who have traditionally regarded the UK market as a safe haven, are unsettled by these CVAs. Companies now use CVAs to substantially re-write contracts in an opaque manner and, as they seemingly are even being used by businesses that are not in distress, the potential pool of uncertain income CVAs threaten extends far further than just those retailers that are financially challenged. Even where a business really is in distress and in need of restructuring, time and again BPF members find that CVAs are being used opportunistically to rewrite contracts in a way that goes far beyond what is necessary to achieve the rescue of the business. This makes assessing the likelihood of potential income compromises extremely difficult and is driving away investment in retail property at the very moment in time when it is needed most.
6. This is not just to the detriment of the property sector and the jobs we provide, but the pensions that underpin property investment as well. Commercial property represents around £183bn of insurance company and pension fund assets. If businesses can abuse the CVA process to compromise property owners unduly, they can unfairly compromise pensioners too.
7. By extension, problems with CVAs are also undermining the property sector's ability to help reimagine our struggling town centres. Ensuring a sustainable future for the retail sector is critical to the property sector's future. We understand that retailers are facing often quite fundamental and acute challenges, as shoppers change their habits and competition intensifies, and property owners want to support them where possible to restructure and restore their

businesses to long-term health. Empty shops blight our town and city centres, and everyone is poorer when a high street becomes void of life and loses its role as the beating heart of a community.

8. High Street adaptation is however predicated on mature and long-term partnerships between property owners and retailers. CVAs are undermining these partnerships by allowing some retailers to opportunistically shed underperforming assets and force their losses unjustifiably onto their creditors. This is discouraging voluntary compromises between property owners and retailers too, as fears mount that voluntary concessions will be compromised again by an unfair CVA further down the line.
9. The "quick fix" incentive that a CVA provides for a retailer is also to the detriment of efforts to turn that sector's fortunes around. Many of the present difficulties in the retail sector stem from a chronic lack of investment over a number of years. In bygone years the owner of a business would have invested in it to turn around its fortunes and avoid insolvency. Now, CVAs provide a much easier means of reducing overheads without increasing investment. As a result, the problems with the business remain as they are. This is one of the key reasons why so many CVAs fail.
10. The numerous issues prevalent in CVAs, the persistent use of them to target landlords and the lack of clarity in the legislation also means challenges in the courts are now becoming commonplace, and this is equally bad for the companies undertaking CVAs for whom certainty is key. The property sector does not want to threaten recoveries through challenges but in many cases must do so in order to gain clarity and push back against abuse of process.
11. Our specific concerns with CVAs are outlined in more detail below and primarily encompass:
  - 11.1. [Lack of transparency](#)
  - 11.2. [Manipulation of the vote](#)
  - 11.3. [Lack of effective restructure](#)
  - 11.4. [Lack of oversight](#)
  - 11.5. [Lack of legislative clarity](#)
12. Our [recommendations to Government](#) are noted throughout but are also outlined in condensed form at the end of this briefing.

## **Lack of transparency:**

### **Lack of rights to information**

13. Unsecured creditors have little rights to information. A CVA proposal document typically runs in excess of 200 pages, yet, there is almost always a lack of quality financial information regarding the company's financial status, the basis for future funding to support a successful restructuring and the assessment of profitability applied to the properties in its property portfolio. All of this information is available to the company, and often made available to secured creditors, but is not given to the unsecured landlord creditors being asked to vote and support turnaround.
14. Proper disclosure to creditors from whom the company is seeking support for a CVA is required to ensure the CVA in question really is the most appropriate course of action, it has been structured in a fair and appropriate manner and the firm truly is nearing insolvency.
15. As a bare minimum, store level EBITDA should be provided to landlords for the leases that are compromised. Without that, landlords are simply unable to assess whether they are being treated fairly. In light of the ruling in the challenge to the Debenhams CVA that firms must ensure property owners receive market rent under CVAs, companies should also be required to disclose any market rental valuations that they have obtained and are relying on for the purposes of calculating discounted rent under the CVA.
16. Recent experience justifies property owners' suspicion of CVAs and their need for information. On multiple occasions our members have encountered situations where the company has compromised future rent through a CVA, given the landlord creditor a break right, and on exercise of that break right offered to pay the landlord a higher rent than that which was originally payable under the lease pre-CVA. This seriously undermines the confidence that landlords have in the system as it calls into question the representations made by the firm in the CVA proposal as to the profitability and market value of the property.
17. In addition, the simple fact that so many CVAs fail, despite Insolvency Practitioners (IPs) testifying in each case that they think they have a real chance of success when proposed, suggests that either IPs and firms frequently make poor judgements on CVAs or perverse incentives are at play. In order to overcome these issues, unsecured creditors must be given sight of all relevant information to see whether a CVA is appropriate for themselves.

### **Lack of time to consider proposals**

18. Unsecured creditors, especially smaller ones who may be unfamiliar with CVAs, are not given adequate time to consider proposals.
19. The IP is required to prepare a prospectus on the CVA and host a creditors meeting. However, the meeting is usually at the end of the process and by that time it is too late for creditors to affect change. This problem is exaggerated further by the fact that CVAs are nowadays being used to restructure very large, complex companies, such as Debenhams or the Arcadia Group, and proposal documents mirror this in their scope and detail.
20. The 14-days after launch creditors get to consider proposals, decide how they will vote and propose amendments is simply not enough. CVAs affecting property owners should always be discussed with them at a CVA's inception like they are with a firm's secured creditors and the time period between launch and the creditors meeting should be extended to 28-days.

21. An effective turnaround will almost always need landlords to work in partnership with firms and CVAs are currently working against this by giving property owners the impression that they are being taken advantage of by an expediated process.

### **Lack of effective engagement**

22. In an attempt to overcome this problem, we have sought to facilitate pre-launch engagement by hosting meetings on prospective CVAs with IPs.
23. Some IPs working on CVAs for major retailers still though do not engage with us, or even individual property owners effected, or seem to believe that one can be a substitute for the other. Even those IPs we consider to be relatively good at engaging often only bring proposals to property owners a matter of days before launch, even though we know they work on these proposals for months in advance. As property owners have no rights to information, we are also often asked to engage on CVAs without being given the requisite material to assess them effectively.
24. This is a concern that our members share about CVA engagement too. We have heard countless testimonies that in individual one-to-one meetings there is usually a reluctance to provide information, such as store level trading data, to landlords even though that same information will be shared with secured creditors, such as banks. IPs and firms will also often only engage adequately with institutional landlords with which they have a prior relationship, or whom 'hold the vote' (in the rare occasions that this is the case).

### **Manipulation of the vote:**

25. The voting procedure is being manipulated in order to target property owners. This widespread practice has gone on for many years. It is not supported by case law and there is no justification for it, other than to cram down the votes of property owners.
26. To get a CVA approved it must be voted through by 75% of the unsecured creditors by value. The 75% is based on the weight of claims that the creditor has, but the rules for calculating unascertained debt, such as future rent, for voting purposes provide that these claims can be valued at £1 unless the chair decides to attribute a higher value to the claim.
27. In theory, the landlord's claim on future rent should run to the end of the lease. However, landlord claims are deflated to a few months' rent under the ever more unlikely presumption that they will be able to re-let the unit, and IPs frequently appear unwilling to consider evidence put forward by landlords that would allow them to more robustly assess their claim.
28. The estimated minimum value of landlord's future contingent claims for voting purposes are typically calculated according to the approach taken in the *Re Park Air Services* case, with the formula used often comprising standard terms across a portfolio of properties. An arbitrary 75% discount is then applied for voting purposes, without proper justification. The explanation given for this arbitrary discount is always that it reflects the uncertainty of the landlords' losses. However, this ignores the property advice the firm will have received, which is used to calculate *Re Park Air Services* discounts before the further 75% discount is then applied anyway.
29. In essence, companies should not have it both ways. If the chair has sufficient evidence to calculate the landlords' likely loss on a *Re Park Air Services* basis then he or she should do so and

no more. If he or she has no such evidence then it may be justifiable to apply an arbitrary discount to the maximum possible amount of the landlords' loss (the future rent should run to the end of the lease). He or she should not be able to do both.

30. The current rules thereby enable companies to unfairly engineer the weight attached to affected creditors' voting rights, often resulting in unaffected creditors approving CVAs with affected creditors being powerless (it should be noted that this engineering is company driven and built into the CVA proposal itself, despite the fact that the calculation of votes is meant to be in the chair's discretion). We believe this is fundamentally unfair and requires Government intervention to be solved.
31. This also means the argument that landlords vote CVAs through, so there is no problem, does not stand. The manipulation of the vote often means that even if all affected landlords voted against the proposal, they would in most cases still not be able to block the CVA. They would though still have to endure being castigated in the media for attempting to vote down proposals.
32. It is wrong to target particular creditors in this way and this is a clear abuse of the CVA process. This should be a key aspect of a Government review into CVAs. A way to ensure fairness would be to implement a statutory requirement that creditors who are unaffected by a CVA (or only nominally affected) do not have their votes counted on the basis of their inherent conflict of interest with those creditors who are, in effect, funding the turnaround of the business. Alternatively, the chairman should be required properly to assess the value of future/contingent claims for voting purposes via a more appropriate formula that creates proportionality between vote weighting and those the CVA compromises. Government should explicitly rule out the use of the arbitrary 75% discount through legislation.

### **Lack of effective restructure**

33. CVAs do not require firms, or indeed their IPs, to adequately assess why they are failing. This is a key reason why so many companies entering CVAs eventually end up in administration.
34. Successful CVAs have tended to be a proper restructuring exercise of the business in distress, whereby refinancing is sought and an effective turnaround plan is proposed and implemented alongside the CVA. In these cases, the firm in question will look at all the aspects of the business: Is the consumer offer up to scratch? Does it have the right marketing channels? Does it have the right management? Is the debt being restructured? Is new equity being invested, particularly by existing shareholder? Is it most effectively restructuring the property estate and leases?
35. However, many firms undertaking CVAs focus only on compromising creditors and cutting costs. As a result, these CVAs tend to simply keep the business in distress afloat for a short period, without making the necessary changes to turn its fortunes around. Most CVA packs we see actually point to issues such as over expansion, poor product, poor marketing, ill-thought through logistics plans, IT failures and over leverage, while at the same time outlining no means through which to address these failings. If CVAs are to work effectively, they should be proper restructuring exercises that look at all aspects of the business, including whether the firm has the most appropriate management. Firms should be required by legislation to outline their turnaround plan in CVA proposals in full.

36. This is also a significant frustration for other well-run businesses that see their competitors simply benefiting from the restructuring of costs achieved through a CVA. It is a complaint that our members hear frequently from corporate retailer occupiers. It should be noted too that as CVAs provide for cost reductions in specific locations, they impact upon competition on a local level in a way in which other forms of insolvency usually do not, often therefore allowing for local monopoly advantage. CVAs must move on from simply being cost cutting exercises if this is to be in any way justified.

## **Lack of oversight**

37. A CVA has too many important implications to be left exclusively to the IP in question. CVAs affect thousands of employees, retailers themselves, the future of our town centres, local authorities' business rates revenue, wider trade creditors, pension funds, property owners and the real estate investment market which is fundamental to the economy.
38. In many cases, IPs even abdicate this responsibility and claim that CVAs are a company led process and it is not for them to assess fairness or scrutinise the terms of the proposal, or indeed, the financial information upon which CVAs are based. This is deeply concerning. As an out of court process, creditors rely on the IP to be the "honest broker" and provide independent oversight of the CVA in the interests of creditors, as is the case in other insolvency situations. That is not happening.
39. Despite this, there is also no means of recourse for creditors other than to challenge CVAs through the courts. This is extremely expensive and to some extent means threatening the business rescue itself. A challenge (whatever the outcome and whether or not it goes to court) will threaten the refinancing that the company has secured and will frequently involve considerable time burdens and costs that the company cannot afford. Challenging CVAs often means the challenging landlord's reputation is dragged through the mud in the media as well. There needs to be a means through which unsecured creditors can gain confidence from an independent body that the CVA was fair (especially considering the aforementioned issues regarding transparency) without having to use the judicial system and threatening business recovery.
40. As any legislative changes are likely to take time, we suggest that as a more immediate measure there should be an independent second opinion on large CVAs, to ensure they are being conducted fairly and are partnered with a proper restructuring. This could be a task for an existing body called the Pre-Pack Pool. It would not cost Government money, as the services for the Pre-Pack Pool are paid for as part of the insolvency process and it is not a Government body (but a group of mainly retired accountants and IPs, who are experts in picking through these deals).

## **Lack of legislative clarity**

41. Ultimately many of the issues mentioned already stem from a lack of legislative clarity on CVAs.
42. Property owners are frequently left uncertain of their rights and the duties owed to them. Consequently, companies have repeatedly pushed the extent to which they seek to re-write contracts. By way of example, some CVAs now vary the terms of the lease beyond the CVA

period; even, in some cases through extending rental discounts beyond termination of the CVA or by restricting landlord's ability to utilise their regular break clauses. We also see cases where CVAs removal the company's obligation to give an authorised guarantee agreement (AGA) on assignment; give firms a new right to terminate leases or trigger rent reviews at the end of the CVA (after the landlords have paid through the CVA for the turnaround); or, implement a moratorium against enforcement of tenant's covenants and/or full and final release of tenant's liabilities (other than CVA rent). The extent to which this should be allowed is not clarified in the legislation but needs to be in order to avoid further abuse.

43. In addition, we believe that CVAs are no longer being used to fulfil their initial intention and are instead increasingly being used by large firms, such as the Arcadia Group or Debenhams. The legislation makes no exceptions for these cases. It does not provide the necessary time needed to consider these larger proposals; does not restrict the unfair and often intricate ways in which these large CVAs are structured to give a competitive advantage outside of the CVA period; and, gives property owners no means of gaining confidence that CVAs have been designed in a fair or transparent manner. Furthermore, CVAs should have regard to the fundamental principle in insolvency of equality amongst creditors. The current legislation does not ensure this principle is adopted by companies proposing CVAs.
44. Property owners are having to spend a substantial amount time and money challenging CVAs through the courts just to uncover what their rights and obligations truly are. This is also undermining the ability of CVAs to provide a stable, effective restructuring. The Government should act to clarify these points either through changes to the Insolvency Rules or a new Insolvency Act. We do not believe the necessary changes are possible through SIP 3.2 or cross-industry collaboration.

### **Recommendations to Government**

45. The Government should conduct an independent, urgent review of CVAs to ensure they are being used for restructuring purposes and not as opportunistic cost-cutting exercises. This review should assess whether the current provisions in the Insolvency Act 1986 and the Insolvency (England & Wales) Rules 2016 need to be reformed to provide greater clarity.
46. Large CVAs should be referred to an independent third-party for review. The Pre-Pack Pool could perform such a function. The remit of that independent third party would be to check that (a) one class of creditors was not being treated less favourably than others unless that was absolutely necessary for the rescue of the business, (b) if they were so treated then there was a proper mechanism to compensate them out of the future profits of the business (e.g. no dividend should be paid to shareholders until their claims were met in full), and (c) the CVA proposal went no further than was reasonably necessary to avoid formal insolvency.
47. Government should ensure the voting procedure is fairer to those that the CVA compromises. A way to ensure this would be to not count the votes of creditors who are unaffected (or indeed their position is improved) by the proposal. Alternatively, Government could implement a statutory requirement that the chairman assess the value of future/contingent claims for voting purposes via a more appropriate formula. The arbitrary 75% discount should be explicitly ruled out.



48. The 14-day notice period of the creditors' meeting should be extended to 28-days to give creditors enough time to consider proposals, however with a provision that allows businesses to apply for a 14-day notice period, if they can prove they cannot avoid insolvency for 28-days. This would require a change to The Insolvency Rules 2016.
49. If legislative change is not possible immediately, Government, the insolvency profession and the BPF should work together to codify what is good practice in terms of the nominees' duties towards creditors (including the duty to scrutinise the proposal, investigate and give full disclosure) and voting rights for CVAs.
50. Government must encourage insolvency professionals to follow BPF best practice guidance on engagement with property owners, including ensuring that engagement takes place as early as possible in the CVA process.