Neutral Citation Number: [2019] EWHC 2441 (Ch)

Case No: CR-2019-002843

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND & WALES
INSOLVENCY AND COMPANIES LIST (ChD)

Royal Courts of Justice
Rolls Building, Fetter Lane,
London, EC4A 1NL

Date: 19/09/2019

Before:

MR JUSTICE NORRIS

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Between:

(1) DISCOVERY (NORTHAMPTON) LIMITED
(2) DISCOVERY (NUNEATON) LIMITED
(3) SOUTHAMPTON ESTATES LIMITED
(4) DISCOVERY (TORQUAY) LIMITED
(5) DISCOVERY (FOLKESTONE) LIMITED
(6) DISCOVERY (HARROGATE) LIMITED

Applicants

-and-

(1) DEBENHAMS RETAIL LIMITED
(2) JAMES ROBERT TUCKER
(3) EDWARD BOYLE
(4) GLAS TRUST CORPORATION LIMITED

Respondents

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Daniel Bayfield QC and **Ryan Perkins** (instructed by **Shoosmiths LLP**) for the **Applicants**

Tom Smith QC, Richard Fisher and **Madeleine Jones** (instructed by **Freshfields Bruckhaus Deringer LLP**) for the **First Respondent**
Jeremy Goldring QC and **Andrew Shaw** (instructed by **Travers Smith LLP**) for the **Second and Third Respondents**

Martin Pascoe QC and **Matthew Abraham** (instructed by **Baker & McKenzie**) for the **Fourth Respondent**

Judicial Assistant: Alex Cooper

Hearing dates: 2 - 6 September 2019

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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Mr Justice Norris:

Introduction

1. This case requires (on an expedited basis) a consideration of the currently evolving standard model "retail CVA". I am grateful to Counsel for clear written and oral submissions completed within a tight timetable.

2. The Applicants are landlords who seek to challenge under section 6(1) of the Insolvency Act 1986 (the "Act") (the "Application") the company voluntary arrangement ("CVA") entered into by the First Respondent, Debenhams Retail Limited (the "Company").

3. The Company is one of the largest retailers in the UK and is a well-known name on the High Street. The Second and Third Respondents were the joint nominees of the CVA and are now the joint supervisors of the CVA (the "Supervisors"). The Fourth Respondent is a security trustee acting on behalf of certain financial creditors of the Company (the "Financial Creditors"), who have also been the beneficial owners of the Company since 9 April 2019.

4. The Applicants participated in a "sale-and-leaseback" transaction in 2010 as part of which they granted shop leases to the Company in a familiar "institutional" form. These leases all have thirty-year terms with automatically escalating rents for the first ten years of the term and thereafter the rent being reviewed on an "upwards-only" basis at five-yearly intervals.

5. Until 22 July 2019 Sportsdirect.com Retail Limited and Sports Direct International Plc ("Sports Direct"), companies under the control of Mr Ashley, were co-applicants. By a consent order dated 22 July 2019 Sports Direct were removed as co-applicants because they had been paid in full under the CVA, and thus did not have a sufficient interest to challenge the CVA. Despite being removed from the proceedings and being

unaffected by the CVA, Sports Direct have agreed with the Applicants that Sports Direct will pay the Applicants' costs of maintaining the challenge and will indemnify the Applicants for any adverse costs order in these proceedings. According to the evidence of the Applicants' witness Mr Rose, Sports Direct indicated at the time of granting this indemnity that if the CVA is revoked in consequence of the Applicants' challenge and Company then enters into administration, and if Sports Direct purchases its assets or some of them out of administration, then Sports Direct would pay rent to the Applicants at a higher rate than the Applicants stand to receive under the CVA.

6. Mr Smith QC suggests that Sports Direct is not giving away its shareholders' money to the Applicants under these arrangements out of pure benevolence, but is doing so as part of a strategic plan to acquire Debenhams, perhaps with a view to eliminating it as a competitor to House of Fraser (a group already within the Sports Direct portfolio as a result of a purchase out of administration) or perhaps with a view to undertaking its own restructuring of Debenhams (as the terms of the "gentlemen's agreement" with the Applicant suggest). I am alive to the commercial context: but the legal challenges which Sports Direct is funding the Applicants to raise must be addressed as such. (I might also note in passing that the Financial Creditors include purchasers of distressed debt who pursue a "loan-to-own" strategy: and they too form part of the commercial context).

CVAs: a brief background

7. CVAs were introduced in the Act on the recommendations of Sir Kenneth Corks' Report of the Review Committee on Insolvency Law and Practice (1982) (Cmnd 8558) (the "Cork Report"). The Cork Report reviewed the statutory provisions governing schemes of arrangement which were then in existence under sections 206, 287 and 306 of the Companies Act 1948, and are now covered by Part 26 of the Companies Act 2006; and it concluded that these provisions were too cumbersome and complex to protect creditors of insolvent companies effectively. The Cork Report recommended that a new procedure should be created to give companies a more convenient way of restructuring their debts without the expense and complexity of a scheme of arrangement.

8. One of the defining features of the new CVA process is flexibility. In Inland Revenue Commissioners v The Wimbledon Football Club Limited [2004] EWCA Civ 655. Neuberger LJ said at [52]:

> "52. ….Paragraph 364(2) of the Cork Report said this about the proposed voluntary arrangement system:
>
> "*The proposed system has far more flexibility than is available in a creditors' voluntary winding up with regard to the type of proposal capable of being submitted to and accepted by the creditors or some of them. Unless such flexibility exists, the advantages accruing to the creditors from the provisions of third party monies or from any after-acquired property of the debtor will be lost.*"

> 53. Two important points emerge from that brief passage, and, indeed, from the provisions of Part I of the 1986 Act, when read in the context of that Act as a whole. First, the CVA regime is intended to be an additional, and particularly flexible, option in the case of corporate insolvency, in addition to liquidation, administration and administrative receivership. Secondly, a particular feature of a CVA is that any proposal can include, or be based on, monies or other assets belonging to persons other than the company concerned — reflected in Rules 1.3(2)(b) and 1.12(3)."

9. CVAs provide a contractual mechanism through which a company can restructure its debts and liabilities, allowing it to continue trading for the benefit of the creditors as a whole. They facilitate compromises or variations of contractual rights or other obligations, whereas other insolvency regimes (in a broad sense) suspend enforcement of existing rights and obligations and substitute for them rights to participate in the collective insolvency process.

10. CVAs take effect under section 1 of the Act. Section 1(1) of the Act provides that:

> "The directors of a company (other than one which is in administration or being wound up) may make a proposal under this Part to the company and to its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affair (from here on referred to, in either case, as a "voluntary arrangement")."

Once made, the proposal must be approved by at least 75% of the company's creditors at a meeting of the company and its creditors (sections 3, 4 and 4A of the Act, rule 15.34 of the Insolvency Rules 2016). Once approved, the CVA is binding upon all creditors of the company who received, or were entitled to receive, notice of that meeting (section 5 of the Act). A single meeting of creditors is a key element.

11. Section 6 of the Act provides for applications to be made to the Court to challenge a CVA. Section 6(1) of the Act provides as follows:

> "Subject to this section, an application to the court may be made, by any of the persons specified below, on one or both of the following grounds, namely—"
>
> (a) that a voluntary arrangement which has effect under section 4A unfairly prejudices the interests of a creditor, member or contributory of the company;
>
> (b) that there has been some material irregularity at or in relation to the meeting of the company, or in relation to the relevant qualifying decision procedure."

12. The authorities identify two useful heuristics for assessing whether a CVA is "unfairly prejudicial" under section 6(1)(a). The first is commonly called "the vertical

comparator". It compares the projected outcome of the CVA with the projected outcome of a realistically available alternative process, and sets a "lower bound" below which a CVA cannot go: see Re T&N Ltd [2005] 2 BCLC 488 at [82] per David Richards J and Prudential Assurance Co v PRG Powerhouse Ltd [2007] BCC 500 at [75]-[81] per Etherton J. The second is commonly called "the horizontal comparator". It compares the treatment of creditors under the CVA *inter se*. Whilst there is no prohibition on differential treatment, any differential treatment must be justified; see Powerhouse at [88]-[90].

13. These comparators are not to be treated as a statutory test; it is necessary to consider the particular facts of each case when deciding whether a given CVA is unfair: see Powerhouse at [74]-[75].

The Debenham's CVA

14. The Company's directors proposed the CVA in order to address what they had identified as unsustainable property costs associated with certain stores, by compromising future liabilities for rent and business rates. CVAs of this type have become common in recent years as a way for retail and casual dining companies to deal with burdensome leases. Since April 2009, there have been approximately 40 CVAs of this type, which have been well-documented in the press. It appears that in most cases the relevant companies cite the costs associated with large lease portfolios as contributing to their financial troubles, in particular the difficulties caused by upwards-only reviews in leases with long terms and without "break" clauses leading to significant "over-renting". In such cases the majority of the unsecured creditors, trade creditors and financial creditors are unaffected by the CVA.

15. The Debenhams CVA principally affects the landlords of the Company and local authorities. The CVA groups leases into six categories, numbered from 1 to 6, according to the extent to which the Company seeks to alter its obligations under the relevant leases. I am told that such categorisation of leases (and the differential treatment of them according to category) is commonplace.

16. The categories are constituted by reference to the financial performance and sustainability of the rent for the Company's individual properties. Category 1 leases are those which the Company is satisfied the branches are performing relatively strongly from a financial perspective with rents considered to be at a market rate (or if above market rate, then at a sustainable premium). Category 5 leases are those where the Company considers the branch not to be financially viable. The categories are determined by the profitability and overall financial viability of the stores, not merely any disparity between a market rent and the contractual rent under the lease. Category 6 contains a single ancillary lease which is not materially affected by the CVA.

17. The table below summarises the effects of the CVA on the different categories of lease:

Lease category	**Rent Payment**	**Rent payment terms**	**Landlord break clause**	**Mutual break clause**	**Dilapidations**	**Business Rates**
Category 1	100% of contractual rent.	Monthly in advance	None.	None.	No change.	No change.

		for five years.				
Category 2	75% of contractual rent during the first five years following the approval of the CVA (the “Rent Concession Period”).	Monthly in advance for five years.	To be exercised within 90 days of the first date on which rent becomes payable following the CVA becoming effective (the “Next Payment Date”), subject to 60 days’ prior written notice, or, at the option of the Company, an additional 30 days (for 90 days’ total notice) with full contractual rent to be paid during such 30 day extended notice period.	Available to both parties on any of the second, third, or fifth anniversary of the Next Payment Date, subject to 90 days’ prior written notice.	No payments in respect of dilapidations after exercise of break right by either party or where a lease expires during the term of the CVA.	No change.
Category 3	65% of contractual rent for the Rent Concession Period.	Monthly in advance for five years.	As above for Category 2 leases.	As above for Category 2 leases.	As above for Category 2 leases.	No change.
Category 4	50% of contractual rent for the Rent Concession Period.	Monthly in advance for five years.	As above for Category 2 leases.	As above for Category 2 leases.	As above for Category 2 leases.	50% of business rates until the end of the current business rates year (or such earlier date as the relevant lease expires if applicable).
Category 5	100% of contractual rent	Monthly in advance until 24 January 2020 (when these leases will terminate under the CVA).	As above for Category 2 leases.	As above for Category 2 leases.	As above for Category 2 leases.	50% of business rates until 24 January 2020 (or such earlier date as the relevant lease expires if applicable).

Category 6	100% of contractual rent	Monthly in advance for five years.	None.	Available to both parties on 24 August 2020, subject to 90 days' prior written notice.	No change.	No change.

18. The First and Second Applicants are landlords of Category 3 leases; the Third, Fourth and Sixth Applicants are landlords of Category 4 leases; and the Fifth Applicant is a landlord of a Category 5 lease (together, the "Leases").

19. The effect of the CVA on the Leases is:

    a) To reduce the rent payable under the Leases for the Rent Concession Period. For Category 3 leases, the contractual rent will be reduced by 35%; for Category 4 and Category 5 leases, the contractual rent will be reduced by 50%. Following the end of the Rent Concession Period, the rent payable will be adjusted to the greater of the reduced rate of the rent under the CVA or the market rent at that time (so that it may or may not be restored to the reserved rent);

    b) To prevent the landlord from exercising any forfeiture rights triggered by the CVA;

    c) To release the Company from any liability under dilapidations claims;

    d) To grant the landlord an initial, one-off right to terminate the lease. This right must be exercised within 90 days of the Next Payment Date, subject to 60 days' prior written notice, or, at the option of the Company, an additional 30 days (for 90 days' total notice) with full contractual rent to be paid during such 30 day extended notice period (the "Landlord Break Right");

    e) (in the case of Category 3 and Category 4 leases) to grant the landlord and the Company a mutual right to terminate on the second, third, fourth or fifth anniversary of the Next Payment Date, subject to 90 days' prior written notice (the "Mutual Break Right"); and

    f) (in the case of Category 5 leases) to foreshorten the term of the lease until 24 January 2020.

20. The CVA was approved at a creditors' meeting on 9 May 2019 by 94.71% of the Company's creditors. Of the landlords who voted on the CVA, 82.1% by value voted in favour of it. The landlords voting in favour of the CVA comprised (by value) 100% of Category 1 and Category 2 landlords, 87% of Category 3 landlords, 65% of Category 4 landlords, and 29% of Category 5 landlords.

21. The Applicants did not vote in favour of the CVA, and subsequently issued the Application to set aside the CVA under section 6(1) of the Act on 10 June 2019, just within the 28-day time limit under section 6(3) of the Act. They then applied for an

expedited hearing of the Application. As a condition of obtaining that relief they were obliged to serve a "position statement" setting out the challenges that they made and the basis for them.

22. The position statement identified five grounds (in addition to a further two which were not pursued at trail), which (in summary) are:

a) Ground 1: that the CVA goes beyond the jurisdiction conferred by section 1 of the Act in binding the landlords, since landlords do not have a claim for rent to be paid in future at the time the CVA becomes effective, and therefore, are not "*creditors*" within the meaning of section 1 of the Act.

b) Ground 2: that in reducing the rent payable under the Leases, the CVA is unfairly prejudicial to the Applicants under section 6(1)(a) of the Act (which the Applicants refer to as the "Basic Fairness Argument"); or, alternatively, the attempt to do so takes the CVA beyond the jurisdiction conferred by section 1 of the Act because it has the effect of changing the terms of the Leases (which the Applicants refer to as the "New Obligations Argument").

c) Ground 3: that in removing any right of the landlords to forfeiture which would arise as a result of the CVA or any CVA related event, the CVA abrogates the landlords' proprietary rights, which is beyond the jurisdiction conferred on the CVA by section 1 of the Act.

d) Ground 4: that the Applicants are treated less favourably than other unsecured creditors without any proper justification.

e) Ground 5: that the CVA fails to comply with the contents requirements set out in rule 2.3(1) of the Insolvency Rules 2016 ("IR"). Specifically, the Applicants contend that there are potential claims which may arise under sections 239 and/or 245 of the Act if the Company were to enter into administration which claims were not disclosed in the CVA, in contravention of IR2.3(1)(f). The Applicants argue that this a "material irregularity" under section 6(1)(b) of the Act.

Ground 1: the Applicants are not "creditors" for future rent within the scope of section 1 of the 1986 Act.

23. The fundamental proposition on which this argument of the Applicants rests is that claims capable of compromise in a CVA cannot include a claim for future rent because "future rent" is not a "debt" but an "unearned future payment".

24. It is common ground that the argument turns upon the true construction of section 1(1) of the Act. As I have noted, this enables the directors of the company to

> "… make a proposal… to the company and to its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs….."

There are two points to draw out immediately.

25. First, the proposal must be made to "creditors" of the company. The term "creditor" is not defined for the purposes of Part 1 of the Act. But s.5(2) of the Act explains that the CVA will bind every person who was entitled to vote in the procedure by which the CVA was approved. Entitlement to vote at a CVA is determined by IR15.28(5). This provides that every "creditor" who has notice is entitled to vote "in respect of that creditor's debt". The concepts of "creditor" and "debt" are therefore intertwined.

26. The term "debt" is not defined for the purposes of Part 1 of the Act either. But it is defined for the purposes of administration and winding-up by IR14.1(3) to mean:-

> "(a) any debt or liability to which the company is subject at the relevant date;
>
> (b) any debt or liability to which the company may become subject after the relevant date by reason of any obligation incurred before that date……"

The language of the Rule adopts that of s.382(1) of the Act which defines the meaning of "bankruptcy debt" in individual insolvency. In all these contexts "debt" extends to a "liability" (which is clearly something other than a "debt" strictly so called). In my judgment this definition is of equal application in the context of CVAs.

27. IR14.1 contains further explanation of the terms "debt or liability". IR14.1(5) and IR14.1(6) are in these terms:-

> "(5) For the purposes of references in any provision of the Act or these Rules about winding up or administration to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, whether its amount is fixed or liquidated, or capable of being ascertained by fixed rules or as a matter of opinion……;
>
> (6) In in any provision of the Act or these Rules about winding up or administration… "liability" means… liability to pay money or money's worth, including any liability under an enactment, liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution. "

The "liability" must therefore be a pecuniary one even if it cannot be characterised as a "debt", present future or contingent.

28. Taking all these indications together it appears to me that on the face of the words themselves a "creditor" includes someone towards whom the company has a present pecuniary liability which will in the future or may on a contingency become payable as a debt.

29. The second point immediately to draw out is that the proposal may be for "a composition in satisfaction of [the company's] debts" or for "a scheme of arrangement of its affairs". The latter is obviously different from the former and draws on the language used in the comparable provisions now found in Part 26 of the Companies Act 2006. In that context the word "arrangement" is given an unrestricted meaning (save that an arrangement cannot simply amount to a surrender or confiscation) and can cover extensive variations of rights. In my judgment the same approach must be adopted under Part 1 of the Act.

30. That is the legislative context. It is common ground between Mr Bayfield QC (for the Applicants) and Mr Smith QC (for the Company) that for the purposes of Part 1 of the Act the word "creditor" is to be given a wide meaning and extends to all persons having pecuniary claims against the company. But Mr Bayfield QC argues that "future rent" (i.e. rent under an existing lease that has not fallen due for payment as at the relevant date) cannot be such a pecuniary claim because it is an unearned future payment under an executory contract. So, a landlord with a claim for "future rent" is not a "creditor" for the purpose of receiving notice of the proposal, has no "debt" in respect of which he can vote, and is not bound by any approved CVA, for there is no jurisdiction to include his claim. On the other side Mr Smith QC acknowledges that "future rent" is not a *future debt* as at the date of approval of the CVA, but he argues that "future rent" is *contingent debt or liability* in respect of which a landlord was entitled to receive notice and to vote and the adjustment of which could properly form part of the proposal.

31. How to deal with leases that are vested in insolvent companies has long vexed the courts. The landlord could, of course, always prove for arrears of rent accrued due at the date of the winding-up: the position in administration, winding-up and bankruptcy is now covered by IR 14.22(1). The problem arose in relation to rent accruing due after the date of the winding-up.

32. Any well-drawn lease would give the landlord the right to forfeit if such rent was not paid. That would put an end to the lease (and with it any question of "future rent"). But having himself chosen to re-enter, retake possession and put an end to the lease, the landlord could not claim compensation for the lost "future rent".

33. Since 1929 the liquidator has had the power to disclaim an onerous lease and the landlord has had the right (now embodied in s.178(6) of the Act) to be treated as a creditor of the company to the extent of the loss or damage sustained in consequence of the disclaimer and to prove for the same in the winding up. The landlord is not then proving for "future rent". There is no question of "future rent" because the disclaimer puts an end to the lease. The landlord is suing for loss and damage sustained in consequence of the disclaimer, one element which may be lost rent for a period.

34. But suppose the landlord insisted upon keeping the lease on foot, declining to forfeit or to accept a surrender: and suppose disclaimer was not available. In respect of what (if anything) could the landlord prove or claim?

35. In Re Haytor Granite Company (1865-66) LR 1 Ch App 77 the company was wound up at a time when it had 20 years left to run on its quarry lease (which it had assigned, though remaining liable on the original covenant). The landlord sought an order for the liquidators to set aside a sum to satisfy the rent as it might become due over the

remainder of the term. Knight Bruce and Turner LJJ ordered that a claim be entered in the winding-up for the whole amount of the "future rent" but that the amount to be received on the claim should be limited to that for which the company was liable under the original covenant i.e. the rent falling due rent-day by rent-day whilst the lease subsisted and which the assignee did not pay.

36. In Re London and Colonial Company (Horsey's Claim) (1867-68) LR 5 Eq 561 the brewery was in voluntary winding up and its landlord sought to enter a claim for the rent payable for the next 20 years of the lease as a debt payable on a contingency, or alternatively for the setting aside of a fund to cover it. The Vice Chancellor held that there was no present claim (i) because the landlord

> "…has the lease always as an absolute security - a continual remedy by distress – a remedy by re-entry if he desires it.."

and (ii) the chances of a future breach of covenant were not calculable. He said the landlord could apply if rent actually became due or if there was any proposal for a return of assets to shareholders.

37. In the Scottish case of Lord Elphinstone v Monkland Iron and Coal Co (1886) 11 App Cas 332 the House of Lords held that a landlord was entitled to a declaration that a company in voluntary liquidation was bound to fulfil all of the liabilities undertaken in lease with 3 years left to run and that the liquidators were

> "bound to set aside the surplus assets of the company, or so much thereof as may be necessary, in order to make due provision for these liabilities".

38. The House looked at this area again in Hardy v Fothergill (1883) App Cas 351. The assignee of a lease covenanted to indemnify the original grantees against liability for terminal dilapidations. The assignee then became bankrupt, but the original grantees did not know that and did not seek to prove in respect of the indemnity in the bankruptcy. The bankrupt was duly discharged. Eight years later (when the term expired) the original grantees were required to perform the repairing covenant and they sought to enforce the covenant for indemnity against the assignee. They were held unable to do so because s.31 of the Bankruptcy Act 1869 said that "all debts and liabilities, present or future, certain or contingent" to which the bankrupt was subject were capable of proof in the bankruptcy, and the original grantees had not sought to prove in respect of the indemnity (even though at the time at which they would have had to prove the value of the terminal dilapidations could not be known, nor could the prospect of the tenant performing the covenant be known). The Earl of Selborne said:-

> "A contract to indemnify against the non-performance of covenants in a lease, such as to pay rent, or to keep the demised premises in repair, or to deliver them up in a proper state is, to all intents and purposes, "an obligation or possibility of an obligation to pay money or money's worth" on the breach of any such covenant: it is "an engagement to pay, or capable of resulting in payment of, money or money's worth" if the contingency against which the indemnity is provided should occur." [The quotations are from the definition of "liability" in

> the 1869 Act, and the similarity of language with current definition of "liability" will be noted].

If an indemnity against any future breach of the covenant to pay rent created a "liability" it would be odd if the covenant itself did not do so.

39. In Midland Coal, Coke and Iron Co (Craig's Claim) [1895] 1 Ch 267 Craig was liable as original grantee for the due performance of the covenants in the mining leases which had been assigned to Assignee 1. Assignee 1 went into liquidation and proposed a scheme of arrangement under which the leases vested in Assignee 2. Craig then applied in the liquidation of Assignee 1 to have a sum provided to meet his contingent liability as original covenantor for rent and breaches of covenant. A very strong Court of Appeal held that it was "difficult if not impossible" to say that Craig was *unable* to prove in the liquidation of Assignee 1 as a contingent creditor i.e. as someone secondarily exposed to the potential claim for future rent.

40. But that was not what Craig wanted. He wanted a fund set aside. The Court referred to Lord Elphinstone's Case, and continued:-

> "…the House made an order in favour of the lessor of a limited company which was being wound up voluntarily, and declared that the lessee company was bound to fulfil its future obligations under its lease, and that the liquidators were bound to make due provision for fulfilling such obligations and to set aside assets of the company in their hands for that purpose. It is true that this was a Scottish case, and a case between lessor and lessee; but we see no reason to suppose that there is any difference between English and Scottish law in this respect. The effect, however, of the decision in Hardy v Fothergill on the right of a lessor to have the assets of a limited company which is being wound up impounded has not yet been judicially determined. The English decisions in favour of his right to enter a claim and have assets impounded to meet it have all proceeded upon the view that the lessor could not prove for any ascertainable sum and be paid a dividend upon it, and on some future occasion those decisions will have to be reconsidered. In the present case it is not necessary to solve this new problem, and we say no more about it. We will assume that, apart from the scheme, Mr Craig would have been entitled to enter a claim for indemnity, and to have assets in the hands of the liquidators set apart to answer this claim before the final dissolution of the company.… We will now consider the effect of the scheme of arrangement. Mr Craig was clearly entitled to be heard in opposition to that scheme. The cases to which we have referred presuppose the existence of assets not yet distributed amongst the shareholders. Until they are distributed he is entitled to be heard in opposition to any scheme for their distribution. Whether the court is bound to give effect to his opposition is a different question, and depends on the meaning of the word "creditor" in the Joint Stock Companies Arrangement Act 1870. Considering that that Act was passed in order to enlarge

> the powers conferred by section 159 of the Companies Act 1862, we agree with Mr Justice Wright in thinking that the word "creditor" is used in the Act of 1870 in the widest sense, and that it includes all persons having any pecuniary claims against the company. Any other construction would render the Act practically useless. If we are right in this interpretation of the Act of 1870, Mr Craig is bound by the scheme approved by the Court; and in our opinion he is so bound.…"

Craig was therefore a "creditor" for the purposes of the arrangement because he had a pecuniary claim against the company.

41. The decisions about the right of a lessor whose lease was vested in a company in winding-up being able to claim in the liquidation as a contingent creditor and/or to have assets impounded to meet the claim were not in fact reconsidered by the Court of Appeal. The practice at first instance became (as Vaughan Williams J in New Oriental Bank Corporation [1895] 1 Ch 753 at 757 told a lessor who declined to accept a surrender of the remaining 14 year term)

> "….you must enter a claim for the whole of the future rent, and prove for the breaches which have taken place up to the present time. "

This approach was also adopted in bankruptcy: the lessor could not prove in the bankruptcy for "future rent" but only for accrued arrears up to the date of proof (see Metropolis Estates v Wilde [1940] 2 KB 536). The consequences of adopting the approach are somewhat different in that context, because a bankrupt survives discharge in a way that a company does not survive dissolution.

42. The result of these cases was that "future rent" could not be proved for in a liquidation until it fell due payment. However, the landlord (and anyone else who could call upon the company to pay the "future rent" e.g. under an indemnity) had a pecuniary claim in respect of that future rent which was to be entered in the liquidation, had to be addressed or satisfied before dissolution or distribution to shareholders (presumably as a non-provable debt) and might be secured by the constitution of the fund in the meantime.

43. It is now necessary to see how this approach to the treatment of "future rent" has been applied in the context of CVAs. Mr Bayfield QC submits that the inevitable consequence of adopting the approach is that the landlord cannot be a "creditor" in respect of future rent, so "future rent" cannot be within the scope of a CVA.

44. The treatment of future rent in a CVA was first considered in Burford Midland Properties Ltd v Marley Extrusions Ltd [1994] BCC 604. The original grantee (M) assigned a lease with 18 years to run to a tenant (C) which entered into a CVA of which the landlord had been given due notice. The landlord sought to recover rent and service charges arising after the date of the CVA from both M and C. The judge held that the CVA was binding upon the landlord for whatever it did, and what it did depended critically on the definitions it contained, and what liabilities were caught by those definitions the case was therefore concerned with the construction of the CVA.

45. The judge embarked on what he himself called "a digression" to consider the meaning of "contingent" or "prospective" debts under the Companies Acts. The "considerable industry" of Counsel had not uncovered any of the cases on "future rent" to which I have been referred. But from first principles HHJ Roger Cooke addressed the question "What is a debt or liability?" answering it thus:-

> "Inevitably I would have thought the answer to that question must be: '*An obligation to pay that is no longer dependent on executory matters either side but where subject only either to date or some uncertain inhibiting factor it is fully crystallised.*' I cannot to my mind see how something that depends on future executory matters can properly be called a debt or liability or somebody who will be entitled to payment only when executory matters have been performed can properly be called a creditor: he has not got there yet. If that is right, where would liability for future rent under a lease fit in? This is a right, essentially one of property, tied into a bundle of rights and obligations, the enjoyment of the estate for a period by the tenant and also consideration of the landlord's covenants. The obligation to pay a service charge, which is in general terms the indemnity for the performance of the landlord's covenants, is a fortiori this. I cannot see it is any different from the executory contract scenario that I have just postulated….. I am conscious that these general principles, which seem to me to be of central importance, were really not much touched on in argument of me course of preparing this judgement, although they may suffer from a lack of that refinement that reasoned argument might have given them, I do not myself feel much doubt that they afford a means of general guide to one's approach. "

46. In Re Park Air Services plc [2000] 2 AC 172 the matter in issue was the quantification of the landlord's claim for loss consequent upon a disclaimer of the lease; and the precise question was whether rule 11.13 of the Insolvency Rules 1986 should feature in the quantification process. That rule is concerned with the proof of debts payable at a future time; the creditor may prove for the full future sum but the rule provides for a statutory discount of 5% to be applied to the dividend payable to reflect accelerated receipt, with the possibility of payment of the full sum if there are sufficient surplus assets. The House decided that the landlord's claim following disclaimer was for compensation for (amongst other things) "future rent": the compensation was immediately due and could be proved for, but its quantification required a discount (for early receipt of future lost rent) assessed according to ordinary principles, which in the instant case amounted to 8.5%. The House decided that the landlord's claim following disclaimer was not a claim for "future rent", it was not a claim to prove for a debt of which payment was not due within rule 11.13 and so it was not subject to a statutory discount in the dividend payable in respect of the proof.

47. Having reached this conclusion Lord Millet (who gave the leading speech) had to deal with the landlord's argument that it was anomalous to apply a discount in assessing

the sum for which the landlord could *prove* but to allow other creditors with future debts to *prove* in full. Lord Millet dealt with that argument in this way:-

> "But there is no anomaly. The Court of Appeal evidently considered that the landlord could, but for the disclaimer, have proved for the future rent and recovered it without discount. But as I have already pointed out, in practice he could not have proved for the future rent. He would have had to wait until the rent fell due and then prove quarter by quarter. This is because rent is not a simple debt. It is the consideration for the right to remain in possession. The tenant's liability to pay future rent is not *debitum in praesenti solvendum in futuro*. Its existence depends upon future events. Rent in respect of a future rental period may never become payable at all. Rent payable in future under a subsisting lease cannot be treated as a series of future debts making up a pure income stream. There is a critical distinction between contracts which have been fully performed by the creditor and contracts which remain executory on his part. The creditor who has lent money which has not been repaid or supplied goods or services which have not been paid for sues or proves in respect of debt. If the debt is not yet due at the date on which the dividend is declared, the dividend is subject to adjustment under rule 11.13. The creditor who has contracted for payment for goods or services still to be supplied by him, however, it is not and may never become entitled to payment cannot sue all prove in respect of debt. The office holder may adopt the contract and enforce it in return for payment in full. But if the creditor is entitled to treat the contract as discharged by breach the office holder disclaims the contract, the creditor is entitled to compensation. He may quantify his loss and prove for it, giving credit for the cost of the goods or services which he is no longer bound to supply. Rule 11.13 has no application to such proof."

48. Counsel are agreed that Re Park Air establishes that "future rent" cannot be proved for in a liquidation as a future debt. Counsel are also agreed that David Richards J was right to say in Re T & N Ltd [2006] 1 WLR 1728 at [42] that there is no clear requirement that "creditors" for the purposes of CVAs should be restricted to persons with provable debts. David Richards J summarised the position thus:-

> "The state of the authorities therefore shows that (i) the holder of a contingent claim is a creditor for the purposes of the provisions governing both schemes of arrangement and CVAs and (ii) the claim need not be a provable debt. The nature of contingent claims is such that a creditor for these purposes need not have an accrued cause of action. "

49. But Mr Bayfield QC argues further that Re Park Air also establishes that because the right to continued possession is "executory" (notwithstanding creation and vesting in the tenant of a term of years) the ability of the landlord to insist that the tenant retains possession and performs the covenants as to rent "[does] not give rise to any sort of

claim - not even a future or contingent claim" because "future rent is not a debt at all" but only "a contractual right which has not been earned". If it is not a debt at all then, he argues, it cannot be within the scope of a CVA because the term "creditor" necessarily connotes the existence of a debt.

50. Mr Smith QC for the Company challenges this conclusion. He submits that although future rent cannot be treated as a *future debt* it can be treated as a *contingent debt or liability*. He relies on Re Nortel [2014] AC 209. The issue in the case was how administrators should deal with financial support directions that had been issued by the Pensions Regulator after the commencement of the administration. Of critical importance was a correct understanding of the words now found in IR 14.1 which included within the definition of "debt"

> "any debt or liability to which the company may become subject after [the date on which the company entered administration] by reason of any obligation incurred before that date ."

Whilst being careful to avoid suggesting a universally applicable formula Lord Neuberger said at [77]:-

> "I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under [the rule] it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship) and which (b) resulted it in being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred."

An existing lease precisely fits that profile, and "future rent" fits the description of a future liability to which the company may become subject by reason of it.

51. Mr Smith QC submitted that in accordance with that analysis "future rent" would be capable of being proved in an administration or liquidation as a contingent debt (subject to estimation in accordance with IR14.14). I cannot accept the submission in the light of Jervis v Pillar Denton Ltd [2015] Ch 87. The question at issue in that case was whether rent payable in advance could be "apportioned" in an administration. But in setting out the background Lewison LJ (to whom Re Park Air Services had been cited) said (at paragraphs [12] and [13]):-

> "On the face of it liability to pay rent as it accrues due under a lease taken by the company before its entry into administration (or liquidation) is a liability to which it becomes subject as a result of an obligation incurred before the relevant date. Accordingly, it falls within the definition of "debt". The general rule is that all debts are provable… However, special provision is made for rent and other periodical payments."

He then referred to what is now IR14.22 which deals with what proofs may be submitted in respect of rent.

52. This seems to me a holding that "future rent" is a contingent liability (and so a "debt") but not one that is capable of proof, proof being restricted to instalments of rent accrued due at the date of the insolvency or as they fall due thereafter in accordance with IR14.22. For the question I have to decide "provability" is not important: status as a "contingent liability" (and so a "debt") is important.

53. Mr Smith QC submitted that there were many cases in which "future rent" was in fact treated as a "debt" (in its extended sense) for the purposes of inclusion within a CVA. In Doorbar v Alltime Securities Ltd (No.1) [1994] BCC 994 a District Judge had declared that Alltime's claim for future rent arising under its lease to Doorbar was not included in Doorbar's voluntary arrangement. On appeal Counsel for the landlord argued that the District Judge was correct because as a matter of law future rent due under a lease was incapable of being included in a voluntary arrangement, founding herself upon HHJ Cooke's observations in Burford Midland Properties Ltd. Knox J declined to follow those obiter remarks saying (at 1003H):-

> "For it to be established that it is not possible to include future payments of rent under a lease, it would in my view have to be shown that the expression… "a scheme of arrangement of his affairs" was not wide enough to comprehend the liability to make such future payments. That is not a subject addressed by Judge Cooke in the Burford Midland Properties case… No other authority was cited in favour of the proposition that it is legally impossible to include liability make future payments of rent under an existing lease in a voluntary arrangement and I do not feel able to accept such a proposition."

Mr Bayfield QC was rather disparaging of this "failure" to engage with "the executory contracts" argument: but it seems to me that Knox J identified the key issue in the first sentence of the quoted passage. When the case reached the Court of Appeal Counsel no longer argued that a future rent liability could not be included in a voluntary arrangement ([1996] 1 WLR 456 at 462E); a concession which the Court accepted.

54. In Re Cancol Ltd [1995] BCC 1133 Knox J was faced with an application by a landlord for a declaration that future rent under a lease was payable by the tenant in full and was not affected by a CVA. Knox J declined to grant the declaration, again basing himself upon the width of the words "a scheme of arrangement of its affairs" . When accepting an argument that voluntary arrangements were intended to provide a cheaper and commercially more beneficial alternative to bankruptcy or winding up Knox J said that it was "undisputed" that both in bankruptcy and winding up claims to future rent were susceptible of being included as relevant claims. Mr Bayfield QC submits that that is an error of law which vitiates the conclusion. I do not accept this submission. Knox J based himself upon the decision of the Court of Appeal in Craig's Claim that every person having a pecuniary claim against a company could be bound by a scheme of arrangement. That case stands in a line of cases in which claims to future rent are recognised as relevant claims that must be dealt with in the insolvency albeit not capable of immediate proof.

55. Doorbar and Cancol have been treated by judges at first instance as correctly decided in Re Sweatfield [1997] BCC 744, Re T & N Ltd [2006] 1 WLR 728, Chittenden v

Pepper [2007] BCC 195 and Re Cotswold [2010] BCC 812. But it is right to note what was said in Thomas v Ken Thomas Ltd [2007] Bus LR 429.

56. That case concerned the interrelationship between a voluntary arrangement and the right to forfeit for non-payment of rent. In a passage that was clearly obiter Neuberger LJ said:-

> "There is no doubt that the rent which accrued due but was not paid before the CVA was proposed in this case would be expected to be caught, at least in its capacity as a debt, within the CVA. As at present advised, it appears to me that the rent falling due after the CVA should by no means necessarily be expected to be caught by the terms of the CVA, even if it is capable of being so caught (as was held at first instance in Re Cancol….). It strikes me that, at least normally, it would seem wrong in principle that the tenant should be able to trade under a CVA for the benefit of its past creditors at the present and future expense of its landlord. If the tenant is to continue occupying the landlord's property for the purposes of trading under the CVA (and hopefully trading out of the CVA) should normally, as it currently appears to me, expect to pay the full rent to which the landlord is contractually entitled…. Therefore as at present advised I consider that the CVA should so provide, or if it does not provide, in the absence of special circumstances the landlord may well be entitled to object to the proposal as unreasonable."

In that passage Neuberger LJ appears to express a doubt as to the *jurisdiction* to include "future rent" in a CVA ("even if it is capable of being so caught"), though he goes on to deal with the matter as one of *fairness.*

57. Where does this leave a first instance judge? Pulling together these threads the position seems to me to be this. A CVA requires a proposal to be put to creditors. The term "creditor" must be given a wide meaning, but a "creditor" must have a "debt". The term "debt" has a meaning that extends well beyond a debt strictly so called. It includes pecuniary liabilities (obligations that may turn into debts strictly so called) that might spring out of an existing legal relationship.

58. "Future rent" may not be a provable debt: a dictum in the Court of Appeal says that the non-provability of future rent might be open to review, and a dictum in the House of Lords explains why "future rent" should not be provable. In a strict sense it might not be a debt at all: dicta at first instance and in the House of Lords explain why. But "future rent" is a least a pecuniary liability to which the company may become subject in the future by reason of an existing obligation. That is clearly so in the case of a tenant whose landlord insists (by refusal to accept a surrender or exercise a right of re-entry) that the lease remain in being and that the tenant continue to be exposed to performance of the covenant for rent, under which as time passes rent will accrue due, payable as a debt.

59. This liability might be characterised as a contingent claim (as the liability under an indemnity against rent is treated) or as a contingent claim that the Insolvency Rules

require to be treated in a special way. It might by its nature (because of the difficulty of assessing the contingency) simply be a non-provable claim. But it is well established at first instance (and affirmed by the House of Lords) that provision must be made in any winding-up for this claim (whatever its exact nature). As such it is a "debt" within the extended meaning of that term, and the landlord is a "creditor" (within the extensive meaning of that term) in relation to it.

60. It is established at first instance (applying Craig's Claim) that a landlord is a "creditor" for the purposes of proposing a CVA and that "future rent" can fall within a scheme. The Court of Appeal in Thomas expressed tentative doubt (not echoed in Jervis) whether this was indeed possible: but Doorbar and Cancol have not been overruled and have been followed and I should do the same unless persuaded that they are wrong. I am not so persuaded: and lest it be thought that I am simply sheltering beneath the doctrine of precedent I should make clear that I positively think both decisions were right. "Future rent" is a pecuniary liability (although not a presently provable debt) to which the company may become subject by reason of the covenant to pay rent in the existing lease: whilst the term endures the company is "liable" for the rent, and the fact that in the future the landlord may bring the term to an end by forfeiture does not mean that there is no present "liability".

61. Accordingly, Ground 1 fails. As a matter of jurisdiction "future rent" can be included in a CVA.

Ground 2: a CVA cannot operate to reduce rent payable under leases, because it is automatically unfairly prejudicial to do so, or because there is no jurisdiction to do so

62. The effect of the CVA is to reduce the rent payable under the Leases for the Rent Concession Period. Mr. Bayfield QC for the Applicants submits that as a matter of basic fairness (and a correct application of the principles insolvency law) this cannot be done ("the basic fairness argument"). Alternatively, he submits, there is simply no jurisdiction to do so ("the new obligations argument").

63. The "basic fairness" argument is straightforward. Mr Bayfield QC submits that a company which makes beneficial use of premises let to it must pay the full contractual rent referable to that period of occupation, regardless of what the market rent might be. The argument is grounded the principle expressed in Re Lundy Granite (1870–71) LR 6 Ch App 462. The case itself concerned the levying of distress (so that the landlord could recover the full value of the outstanding rent) and the ability of the court to control that. At p.466 James LJ said:-

> "The Court has dealt with it by putting the landlord… in the same position as any other creditor, as he may go in and prove, which appears to be the result of what has been done in this case. But in some cases between the landlord and the company, if the company for its own purposes, and with a view to the realisation of the property to better advantage, remains in possession of the estate, which the lessor is therefore not able to obtain possession of, common sense and ordinary justice require the Court to see that the landlord receives the full value of the property. He must have the same rights as any other creditor, and if the company choose to keep the estates for their

> own purposes, they ought to pay the full value to the landlord, as they ought to pay any other person for anything else, and the court ought to take care that he received it"

64. In a more modern context the question is whether the landlord should receive a dividend in respect of the rent due or whether the rent due to him should be treated as an expense of the insolvency and paid in full. As Vaughan Williams J stated in Re New Oriental Bank Corporation at p.757

> "[If] a company remains in beneficial occupation of the lease – that is to say, if it occupies the demised premises, or takes the rent, and thus obtains the benefit of the lease – the court ought to do its very best to make the company pay the rent in full, and not merely a dividend."

There can, of course, be no question of varying the amount due by way of rent: the only question is how the rent due should be treated in the administration or liquidation – as a proved debt or as an insolvency expense?

65. But the CVA was introduced to provide greater flexibility for companies in financial difficulty. In a scheme of arrangement of the company's affairs obligations arising under existing instruments *can* be compromised or varied. A bondholder may find that the maturity date of the bond is extended or its interest payable reduced. He may have contracted to lend until 31 December 2030 (though having the right to accelerate the payment date in the event of default) in return for a promise to pay interest at a rate of 8% but find that under the scheme that those bonds are to be cancelled and he is to be reissued with bonds maturing on 31 December 2032 bearing an interest rate of 6%. A rent concession period in a lease is in principle no different. The landlord has created a fixed term (subject to re-entry on default) in return for a promise to pay an escalating rent, but that obligation can vary to provide a fixed or reduced rent. A reduction in contractual rent plainly falls within the scope of an "arrangement".

66. Of course, the fundamental question is whether the new arrangement under the CVA is "fair": and in that regard the observations Neuberger LJ in Thomas (quoted above) are highly pertinent. Normally, it would seem wrong in principle that a tenant should be able to trade under a CVA for the benefit of past creditors at the present and future expense of its landlord. But suppose the past creditors consisted of suppliers who provided goods under "one-off" contracts or "short-term supply" deals that would naturally reflect the current market price for such supplies: and suppose the landlord could under the lease charge a rent fixed at an historic high or which automatically escalated by a fixed percentage unrelated to the value of money or the state of the market, so that what was actually chargeable very substantially exceeded the market rent (say by 100%). Would it not be "unfair" for the suppliers to be unable to receive the market price for their goods in order that the landlord should receive a 100% premium over the market price for his supply? What would be "unfair" about a scheme the object of which was to ensure that everybody got the market price for what they supplied? As a matter of *principle* I would not have thought it "unfair" that a landlord might receive less than his contracted-for rent in such circumstances.

67. In the instant case none of the Applicants has said that under the CVA it will receive less than the current market rent for the premises: and the disinclination to exercise

the right of re-entry on the insolvency of Debenhams may indicate a view of the current market for vacant department stores. In fairness to the Applicants it is right to note that the categorisation of the Leases has not proceeded by reference to the degree of "over-renting". Stores are measured by reference to financial performance and typically the constitution of each category is explained in these terms:-

> "The rent at such stores is above market level and/or at a level that it is not able to sustain a reasonable level of profit."

However, the unchallenged evidence of Mr Tucker (one of the Supervisors) is that the valuation advice received was that all stores were over-rented. The fact that distinctions were drawn as between over-rented stores by reference to their financial performance does not seem to me to rule out, as a matter of basic principle, reductions in contractual rents.

68. Mr Smith QC submits that once it is accepted that a temporary rent reduction is not a contravention of basic principle then it is a question of assessing the fairness of the actual proposal: and he points out that the significant majority of the landlords whose rents were reduced but who nonetheless supported the CVA suggests that the "fairness" test was passed.

69. First, he points out that although during the concessionary period rents are reduced (and may continue to be reduced thereafter), no landlord is compelled to accept the reduced rent. The CVA gives every landlord whose contractual rent is reduced the option to determine the lease by giving 60 days' notice after "the Next Payment Date". The Applicants accept that in principle that would eliminate any potential unfairness: but they submit (i) that they are bound to accept the reduced rent during the notice period; (ii) the notice period has been fixed not by reference to the time that it would take to empty the relevant premises but (according to the evidence of Ms Osborne) by reference to the period required for the tenant to liquidate its anticipated 12-week forward cover of stock i.e. to trade out for the benefit of creditors generally; and (iii) the Lundy Granite principle establishes that where the continued occupation is for the purposes of enabling the company to make a better realisation of its assets then common sense and ordinary justice require the court to see that the landlord receives "the full value of his property" (which they submit is the contractual rent).

70. The response of Mr Smith QC to this point was (i) to accept that the reduction in the rent payable during the notice period was not *de minimis* but (ii) to argue that the Lundy Granite principle applied only where the property is retained *solely* for the benefit of the insolvency process. He cited Re HH Realisations Ltd (1975) 31 P& CR 249. That established that upon liquidation (i) whilst the liquidator was making up his mind what to do the landlord was only entitled to prove for the rent (ii) whilst the liquidator retained the property for the convenience of the winding up he had to pay rent in full (iii) once the liquidator had decided to disclaim and given notice the landlord was only entitled to prove. I do not think this case helps him. It simply shows that on the dividend/liquidation expense question the liquidator has time to make up his mind and time to give effect to his decision. Here it is the landlord who must make the decision: and the CVA stipulates that if he decides to take the property back he must allow the tenant (who has under the CVA elected to keep possession *pro tempore* as part of its continuing operations) to keep the property to achieve a beneficial realisation of stock.

71. The Lundy Granite principle has no direct application, though Thomas suggests that it may indicate a norm for CVAs. I do not, however, regard the language used in Thomas as determining the question I have to decide. The principle of "basic fairness" here does not require a choice between full rent as an expense of the insolvency or a dividend at the rate paid on unsecured debts generally. It arises here in the context of a jurisdiction which permits the modification of obligations. Here common justice and "basic fairness" require that the landlord should receive at least the market value of the property he is providing. He should not subsidise other creditors but nor should they be compelled to overcompensate him. To that basic principle should be engrafted the principle that a contractual rent should be interfered with to the minimum extent necessary in the circumstances, the modification being limited to what is necessary to achieve the purpose of the CVA. If those principles are observed the fact that under the exit arrangements in CVA a varied rent is payable during the notice period does not, in my judgment, make the arrangement "unfair".

72. Secondly it is submitted on behalf of the Company that a reduction in rent cannot be "unfair" if the vertical comparator is satisfied. It is the unchallenged evidence of Mr Tucker that on the computations of KPMG the "vertical comparator" is satisfied, as is demonstrated by the Estimated Outcome Statement prepared in relation to Category 5 landlords (the only such statement prepared because they represent a "worst-case"). In the case of the Fifth Applicant this demonstrated that it would receive a return of £242,397 under the CVA as compared with an estimated total return of £106,421 in administration (making certain assumptions about the course of the administration).

73. The Applicants say that this, however, cannot be taken at face value because it fails to take into account the fact that the Category 5 landlords will, in accordance with the Local Government Finance Act 1988 and the Non-domestic Rating (Unoccupied Property) (England) Regulations 2008 have to pay business rates on the premises returned to them as from 24 April 2020 this being the date three months after the new termination date of the Category 5 leases (as 24 January 2020). In the counterfactual scenario of an administration business rates would not have to be paid for the duration of the administration.

74. Liability to pay business rates from 24 April 2020 and for some estimated period is not a direct outcome of the implementation of the CVA; it is a financial consequence of a landlord electing to opt out of the CVA and then to offer his property to the market on terms such that it does not attract a new tenant within a three-month marketing period (or such further period as the benefit of the CVA would have "funded"). There will be other financial consequences to a landlord of having the lease returned. But the Company cannot be expected to anticipate all financial consequences to each creditor for the purpose of constructing and applying a "vertical comparator" to the scheme as a whole. It is for the Company to construct a proposal to put to the body of creditors, and to compare it with the estimated outcome for each creditor group of the realistic alternative to the CVA, leaving it to individual members of that creditor group to decide the extent to which that model applies to their individual case and to vote accordingly.

75. I do not think that there is anything in the "business rates" point. But I do accept Mr Bayfield QC's point that satisfaction of the "vertical comparator" does not of itself mean that the scheme must be fair, simply because the Court will consider the "fairness" of the CVA in the round.

76. I hold that a CVA that reduces rent under existing lease is not automatically "unfair" as breaching some fundamental principle of common sense and ordinary justice. The ability of a landlord to bring to an end the varied relationship renders it fair in the instant case. The challenge to the "fairness" of the scheme in this case based on the alleged failure to take into account business rates fails. But the fact that the "vertical comparator" is satisfied does not of itself make the scheme "fair". "Fairness" must be judged in the round.

77. This brings me to the jurisdictional argument advanced under Ground 2: namely, that the CVA imposes "new obligations" which are outside the scope of Part 1 of the Act.

78. In my judgment the CVA does not impose "new obligations", save in the sense that it varies existing obligations. But variations of existing obligations are "arrangements" of the company's affairs which it is the very object of Part 1 of the Act to enable. The landlord was and is obliged to permit quiet enjoyment of the demised premises for the duration of the term granted: the covenants (upon breach of which the landlord can put an end to the term) have been varied (because the rent has been reduced).

79. Mr Bayfield QC relied upon some observations of Hildyard J in Re APCOA Parking Holdings GmbH [2015] Bus LR 374. Some scheme creditors provided an indemnity to banks who issued guarantees under a secured facility: under the arrangement it was proposed that they should provide the indemnity to the new and different banks who were to provide guarantees under the new secured facility. Some scheme creditors objected and the arrangement was amended, so Hildyard J did not have to express a final new. He said (at [164]):-

> "All I will say for the present is that in my view, the imposition of a new obligation to third parties is very different from the release in whole or in part of an obligation to such third parties. More generally, I am not persuaded that obligations may be imposed under a scheme of arrangement under Part 26: in creditors' scheme, it appears to me likely that the jurisdiction exists for the purpose of varying the rights of creditors in their capacity as such, and not imposing on such creditors new obligations…. But I should make clear that nothing in what I say should be taken to cast doubt on mere extensions or the rolling over of existing facilities involving no new contract or more extensive obligation, such as may be the case in a revolving credit facility."

80. These observations received the provisional support of Snowden J in Re Noble Group [2018] EWHC 2911 at [103].

81. In my view these observations do not cast any doubt on what is proposed in the instant case. What is proposed here is a variation of an existing obligation binding the company and its creditor, not the creation of a new contract requiring the assumption of fresh liabilities to some new third-party. If the creditor/landlord does not like the variation he can bring the obligation to an end. The obligation he brings to an end is the existing obligation (as varied), not some "new obligation" under a new contract.

82. I hold that Ground 2 fails: the fact that future rent is reduced under the CVA does not inevitably transgress the requirements of common justice and basic fairness, and it does not do so here. The CVA varies existing obligations: it does not create new ones.

Ground 3: the right of forfeiture is a proprietary right that cannot be altered by a CVA

83. The terms of the demise in each of the Leases is in this form (omitting immaterial grants and reservations):

> "In consideration of the rents hereby reserved and the covenants on the part of the Tenant and the conditions hereinafter contained the Landlord hereby demises unto the Tenant the Demised Premises… to hold the same unto the Tenant…… for a term of thirty years commencing on and including [date] yielding and paying therefor unto the Landlord […]"

84. The "conditions" are contained in Schedule 5 of each of the Leases. This Schedule provides, *inter alia*, for a right of re-entry in these terms:

> "This Lease is made on the express condition that if and whenever:
>
> […]
>
> The Tenant or any person who shall from time to time have guaranteed to the Landlord the performance of the covenants on the part of the Tenant and conditions imposed on it under this Lease being a company:
>
> […]
>
> be unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986 or shall enter into a composition with its creditors or a scheme of arrangement of its affair or have an administrator or an administrative receiver or a receiver or manager appointed over all or any part of its undertaking or assets […]
>
> then and in any such case the Landlord or its agents may at any time thereafter and notwithstanding the waiver or implied waiver of any previous right of re-entry arising under this Lease re-enter upon the Demised Premises or any part of them in the name of the whole whereupon the Term shall absolutely cease and determine […]"

85. The CVA itself contains a stipulation that any provisions of the Leases that provide a right of early termination, forfeiture or "irritancy" as a result of the terms or effects of the CVA are waived by the landlords, except for the Landlord Break Right and the Mutual Break Right introduced by the CVA. An example of such a provision (drawn from a Category 3 lease though similar provisions exist for the Category 4 and 5 leases):

> "[…] from the Effective Date, any provisions of the Category 3 Leases that provide a right of early termination, forfeiture or irritancy as the case may be:
>
> (a) by virtue of any provisions of this Part 3 – Terms of the CVA; or
>
> (b) by virtue of any CVA Related Event,
>
> are waived and released in relation only to the occurrence or continuation of such events and the Category 3 Lease Landlords shall have no right to determine the Category 3 Leases as a result of the occurrence or continuation of such events or to re-enter the relevant Premises, unless and to the extent that such re-entry is in accordance with Clause 11.9 [which gives effect to the Mutual Break Right and Landlords Break Right]."

86. The relevant parts of the definition of "CVA Related Event" are as follows:

> ""CVA Related Event" means:
>
> the announcement, issue or making or coming into effect of the CVA Proposal or any other step taken in relation to them;
>
> the convening of the Creditors' Meeting;
>
> […]
>
> any other event or circumstance which would not have arisen but for the CVA Proposal or the implementation of the CVA"

87. The argument of Mr Bayfield QC for the Applicants is (in summary) that a right of re-entry is a property right, that it is not a right by way of security, that it is a right as between landlord and tenant and not one between debtor and creditor, and that as such it cannot be altered by a CVA (as authorities show).

88. It is clear from section 1(2)(e) of the Law of Property Act 1925 ("the 1925 Act") that a right of re-entry (which, as a term, is used inter-changeably with the right of forfeiture – see *Woodfall: Landlord and Tenant* at 17.057 and 17.066) is now a legal

interest in land. It now enjoys the usual attributes of a property right: see s.2(2) of the 1925 Act. The vital point to note is that it is a right annexed to the reversion, not to the term of years .

89. This appears from the decision in Cowan v Department of Health [1991] 3 WLR 742. 999-year lease of a hospital contained a right of re-entry in the event that it ceased to be used as such. That event happened. Mummery J held:-

> "[The trustees'] right of entry was and is a legal interest in or over land demised by the leases: see section 1(2)(e) of the [1925 Act]. As such it is capable of alienation. It is even capable of being reserved and held without any reversion being retained, e.g. by an assignor on an assignment of the leasehold property… In the present case however, that right of entry is clearly annexed to, and is an incident of, the freehold reversion in the premises held by the trustees. The right of entry is contained in the lease but it is not annexed to or attached to the term of years thereby created in favour of the corporation. On an assignment of the freehold reversion, for example, the benefit of the right of entry would pass to the assignee. Further, the annexed right of entry is what gives value and substance to the trustees' freehold version. It is the legal means whereby the term of years absolute may be destroyed and that estate re-vested in the persons exercising the right of entry as freehold reversion…"

90. Because the exercise of a right of re-entry enables a landlord to get his *own* property back it is not a "security" i.e. the creation by the tenant of an interest in *his* property which will come to an end when the debt is discharged and of which the landlord can upon default take possession and realise. It may (in the case of non-payment of rent) have the commercial effect of a security, but it lacks the fundamental characteristic of a security interest: see Ezekiel v Orakpo [1977] QB 260 at 267 per Shaw LJ; Razzak v Pala [1997] 1 WLR 1336 at 1341-3 per Lightman J; Re Park Air Services (*supra*) at p186 per Lord Millett; Re Lomax Leisure Ltd [2000] Ch 502 at 510–517 per Neuberger J, and Thomas v Ken Thomas (*supra*) at [43].

91. The question is whether a CVA can deal with such a property right. In my judgment the authorities give a negative answer to that question.

92. Re Naeem [1990] 1 WLR 48 concerned the true construction of an IVA. It was argued that it unfairly affected a landlord's right to forfeit. Hoffman J addressed the construction argument in these terms at [50]:

> "That, in my judgment, is not the right construction of the arrangement. In my view it was only intended to bind the creditors in their character of creditors. It did not affect proprietary rights such as those of the landlord to forfeit the lease. The provision that the premises should be marketed and sold was not, in my judgment, inconsistent with a preservation of the landlord's right to forfeit. Although a condition which

> would entitle that right to be exercised had arisen, that exercise would be subject to the power of the court under section 146 of the Law of Property Act 1925 to grant relief. The arrangement therefore only meant that the premises were to be marketed and sold in so far as the bankrupt was able to obtain relief and do so."

The IVA indirectly affected the right to forfeit because relief from forfeiture could be obtained by payment of the arrears of rent as modified by the arrangement rather than by payment of the full arrears under the original covenant.

93. The quoted passage came to be treated as authority for the proposition that voluntary arrangements did not affect the right to forfeit: see Khan v Permayer [2001] BPIR 95 at [19]. But there was some controversy over the precise relationship between the right to forfeit and a voluntary arrangement.

94. This was addressed in Thomas v Ken Thomas: the decision made was that the voluntary arrangement did not simply have an impact upon the terms upon which relief from forfeiture could be obtained but modified the obligation the breach of which made the right to forfeit exercisable. Neuberger LJ said at [45]:

> "As to Naeem…., the fact that the landlord does not lose his proprietary right to forfeit as result of the CVA is not in dispute any more than it can be suggested that he loses the right to sue. The question is in respect of what he can forfeit, just as it would be for what he can sue. If rent arrears are caught by the CVA it seems to me that the mere fact that forfeiture amounts to a proprietary right should not enable the landlord to invoke the provision as if the rent was still owing when it is not…. In any event the landlord is not deprived of his right to forfeit the lease if, as in this case as under any well drafted lease, he has the right to forfeit in the event of insolvency including the purposing of the CVA, or any other act of insolvency, and he does not waive it."

95. Re Lehman Brothers International [2010] Bus LR 489 addressed the relationship between proprietary rights and an arrangement in the context of a scheme of arrangement under Part 26 of the Companies Act 2006. Lehman Bros provided prime services to institutional clients under a variety of standard form agreements (such as prime brokerage agreements and master custody agreements). A key feature of these agreements was that the counterparty client either obtained or retained proprietary interests in the assets held by Lehman Bros. In the administration of Lehman Brothers it would be impossible to disentangle those property interests, so it was proposed to promote a scheme of arrangement to facilitate distribution. Those with proprietary claims were to release those claims and would receive in return a right to share in an asset pool and prove as an unsecured creditor for any shortfall. The question was whether such a scheme could bind claimants to those funds as beneficial owners i.e.

could the beneficial owners be treated as "creditors" in respect of the rights in rem which they enjoyed over the property held by Lehman Bros?

96. The Court of Appeal answered that question in the negative.

97. Patten LJ held at [65]:-

> "It seems to me that an arrangement between a company and its creditors must mean an arrangement which deals with their right *inter se* as debtor and creditor. That formulation does not prevent the inclusion in the scheme of the release of contractual rights or rights of action against related third parties necessary in order to give effect to the arrangement proposed for the disposition of the debts and liabilities of the company to its own creditors. But it does exclude from the jurisdiction rights of creditors over their own property held by the company for their own benefit as opposed to their rights in the company's own property held by them merely as security. "

98. Lord Neuberger held at [78]:-

> "As a matter of ordinary language section 895 appears quite clearly to be dealing with arrangements between a company and one or both of two groups of people – its members and its creditors. If a person's claim cannot be said to render him a creditor or a member, then it appears to me to follow at the subject matter of the claim could not be covered by the arrangement. The fact that he may, in connection with a different claim, be a creditor, does not justify him treated as a creditor for the purpose of the first claim."

In so saying Lord Neuberger was not casting any doubt on the ability of a scheme to affect security rights. He described the security right as "an incident of the debt" or as "parasitic on the debt": if there is no longer any debt there is no longer any security.

99. These cases seem to me clearly to point to the conclusion that a CVA cannot vary a right of re-entry. The right of re-entry is property belonging to the landlord (not a security right created by the tenant over his own property). It arises out of the relationship of landlord and tenant because (i) it defines the estate which the landlord has granted in creating the term of years and (ii) neither its existence nor its exercise is dependent upon any state of indebtedness as between landlord and tenants. A tenant who had paid all his rent to date but faces insolvency may still have his lease forfeit. The CVA can modify any pecuniary obligation upon breach of which the right of re-entry may be exercised; and the right will then be exercisable only in relation to the pecuniary obligation as so modified. But it cannot modify the right of re-entry itself. It can alter the covenant but must leave the reservation (or condition upon which the lease is granted) untouched. In seeking to prevent the Applicants from forfeiting because of the entry of the CVA or the occurrence of another CVA-related event the Debenhams' CVA purports to do what cannot be done under s1(1).

100. In resisting this conclusion Mr Smith QC advanced a number of arguments.

(a) Lehman Brothers was a Part 26 scheme and the words of s.895 are different from the words of s.1(1). In my judgment, not in any material respect. In each case the "arrangement" has to be addressed to "creditors".

(b) The modern tendency is to regard leases as first and foremost a creation of contract and to play down their medieval origins. In my judgment the creation of property rights by contract poses exactly the same questions, as Lehman Brothers demonstrates.

(c) The Applicants and the Company are plainly creditor and debtor and the right of re-entry is an incident of that relationship. In my judgment the existence and exercise of the right of re-entry is not dependent on the existence of pecuniary obligations and their due performance.

(d) Commercially a right of re-entry is security for the due performance of covenants and should be treated as such. In my judgment a right of re-entry is not a "security": and if it was it could only be dealt with under a CVA with the consent of the security holder (see s. 4(3) of the Act).

(e) A CVA can modify the conditions upon which a right of re-entry can be exercised as Naeem and Thomas demonstrate and technical distinctions should not be drawn between different parts of a forfeiture clause. In my judgment a CVA can modify covenants (or at least covenants that require the payment or expenditure of money) and the right to forfeit will then relate to the covenant as modified: but a CVA cannot directly modify the right to forfeit itself. I think the distinction is fundamental and not "technical".

(f) Lehman Brothers was only about trusts and the ability of schemes to vary beneficial interests. I do not agree: the ratio of Lehman Brothers applies to any rights of the creditor to his own property (but leaves untouched rights of the creditor to property of the debtor).

101. I hold that the challenge on Ground 3 succeeds.

Ground 4: the Applicants are treated less favourably than other unsecured creditors without any proper justification

102. The Applicants say that the "horizontal comparator" is not satisfied. The CVA varies rents payable to some landlords and the business rates payable to local authorities: but it does not impinge of the claims of other unsecured creditors like suppliers. 91% of the local authority creditors who voted in supported the CVA: and none of them

complains that the CVA is unfairly prejudicial. So, I will consider only “unfairness” to landlords.

103. Mr Bayfield QC for the Applicants of course accepts that the mere fact the CVA provides for differential treatment of creditors does necessarily render it “unfair” within the meaning of section 6(1)(b) of the Act. But he submits that the differential treatment must be justified. So much is clear from Re Powerhouse [2007] BCC at [83]-[90] (which points out that differential treatment may be necessary to ensure fairness or to secure the continuation of the company’s business): and from Mourant & Co v Sixty UK Ltd [2010] BCC 882 at [67(d)].

104. The CVA proposal itself explains the differential treatment in these terms:-

> “The majority of the Company’s Leases provide for upwards-only adjustments to rent on rent reviews, and certain property leases provide for automatic periodic escalation of rents. Many of the Leases are very long… As a result, the Group has been susceptible to fluctuations in the property rental market, in addition to contingent liabilities arising from the transfer of leases…... The Directors have concluded, for a number of reasons, that the Company’s current store portfolio mix is no longer viable. In particular, rental costs associated with stores are unsustainable. Whilst at the end of the last financial year the Group had c.10 loss-making stores at an operating level, given current store sales trends this number will increase substantially this year, and this is a trend that is expected to continue over the next 3 to 5 years.”

It was the unchallenged evidence of Mr Tucker that the Supervisors had been advised that all leases were “over-rented” when compared with rents payable in the current property market meaning that the leases themselves had no value. He explained:-

> “… unlike other liabilities, if landlords are unwilling to negotiate the release of the company from their liabilities under lengthy leases or the reduction of the companies leases thereunder, the company can find itself bound into these unviable leases for the long term, notwithstanding prevailing market conditions or the detriment they may cause to the company’s position”

105. On the other hand the CVA explained:

> “Certain of the Ordinary Unsecured Creditors in respect of any Ordinary Unsecured Liabilities (including suppliers), employees and the pensions stakeholders will not have their claims compromised, as the Directors consider them critical creditors and it is necessary to pay them in full in order to keep the business operating. This is necessary for successful implementation of the CVA Proposal, which is in the interests of all of the CVA Creditors ….. The CVA Proposal does not

> affect the rights of any Secured Creditor in respect of any Secured Liabilities due from the Company…"

The unchallenged evidence of Mr Tucker was that this was the usual approach

> ".. due to the relevant company's desire to preserve its underlying trading in as undisturbed a manner as is realistically possible. Due to the very fact of proposing to enter into an insolvency procedure under the Act such as a company voluntary arrangement, the company is in a vulnerable state."

106. The written evidence of Mr Hazell, a senior manager with responsibility for the day-to-day management of all corporate finance and treasury issues, was that

> "Compromising trade suppliers in the CVA would, in the view of management, likely have led to the suppliers whose claims were compromised refusing to further supply or only providing such supply on onerous terms. This would have also posed a significant "contagion risk" whereby other suppliers whose claims were not themselves being compromised would have become concerned about supplying the Company in the future. In particular management considered it likely that (a) some, and probably many, suppliers would have sought to impose tighter credit terms or remove them altogether which would have had a materially detrimental effect on the company's cash flow position ….and/or (b) some, and probably many, suppliers would have cancelled outstanding orders and limited or withheld supply thereby materially impacting the Group's ability to trade as a result of poor stock availability and operational service failures. This would have led to poor customer experience and brand damage that in turn would further impact the group's trading performance, cash flows and prospects of survival".

107. Mr Bayfield QC made a wholesale attack on this "contagion risk". First, he said that some of those who would be paid in full could not in any sense be regarded as "critical suppliers" (e.g. a minicab firm, a firm of accountants, a firm of solicitors). But as to that, in my judgment both the directors and the nominees were entitled to look at the matter in the round having regard to the likely reaction of the 1600 suppliers of goods and services, rather than to single out a small number of individual suppliers for separate treatment where such separate treatment would make a wholly immaterial contribution to the outcome. As Mr Hazell indicated in cross-examination, the question was not whether their supplies were critical to the business but whether their treatment was critical to the success of the CVA.

108. Second, Mr Bayfield QC said that the whole "contagion argument" was illogical. A "critical supplier" would not be put off further supply by the fact that he was to be paid in full whereas a "non-critical" supplier might only receive part of the debt due; and if a "non-critical" supplier was put off then *ex hypothesi* there was an alternative available. Everybody knew that the company was insolvent and that they were at risk in trading with it. But Mr Hazell (who was an impressive witness) patiently explained

that the market was not driven by logic but by rumour, that fear of non-payment translates into immediate action (cancellation of delivery, a revision to credit terms, a refusal to accept an order, a failure to respond to an enquiry), that these reactions had to be dealt with on a day-by-day basis to maintain supply during a period of vulnerability whilst the CVA was put in place and (importantly) during continued trading after the CVA and throughout the restructuring.

109. Third Mr Bayfield QC put to Mr Hazell that if failure to pay suppliers constituted a "contagion risk" then so also did failure to pay landlords. Mr Hazell said that suppliers were well able to draw a distinction between supplies of goods and services (even supplies under equipment leases) on the one hand and the very long-term liabilities to landlords under historic deals on the other. "We may have to re-set the bargain we made 8 years ago, at least for the next 5 years" has a wholly different ring to "We may have to re-set the bargain we made last month at least for the current delivery".

110. I am satisfied on the evidence that differential treatment of landlords (providing long-term accommodation at above market rates) from suppliers (providing goods and services on an order-by-order basis which, given competitive pressures, are likely to be at market rates) is justified by the need for business continuity (and itself embodies a principle of "fairness"). There would have been "unfairness" if landlords were expected to take reductions in rent to below the market value of the premises concerned: but none of the Applicants suggests that is the case.

111. I hold that Ground 4 fails.

<u>Ground 5: the CVA fails to comply with the content requirement of IR2.3(1)</u>

112. IR2.3 of the Rules sets out the content requirements for a CVA. The relevant parts of the rule are as follows:

> "The proposal must set out the following so far as known to the proposer—"
>
> > (a) how the company's liabilities will be met, modified, postponed or otherwise dealt with by means of the CVA and in particular….(iii) if the company is not in administration or liquidation whether, if the company did go into administration or liquidation, there are circumstances which might give rise to claims under section 238 (transactions at an undervalue), section 239 (preferences), section 244 (extortionate credit transactions), or section 245 (floating charges invalid), and (iv) where there are circumstances that might give rise to such claims, whether, and if so what, provision will be made to indemnify the company in respect of them".

113. Until shortly before the proposal of the CVA the Company's principal sources of debt finance were a £320 million revolving credit facility (the "RCF") and £200 million worth of notes (the "Notes") which were held by the Financial Creditors.

114. During February to March 2019, the Group secured additional funding from certain of its Financial Creditors. In February 2019, a £40m secured bridge loan (the "Bridge Loan") was provided to Debenhams plc as borrower. A fixed and floating charge was taken by the participating financial creditors over substantially all of the Group's assets to secure the Bridge Loan.

115. On 29 March 2019, certain of the Financial Creditors provided further support and a £200m new money facilities agreement (the "New Money Facilities Agreement") was entered into. This provided for an immediate drawdown by Debenhams plc of £101.25m under Facility A of the New Money Facilities Agreement, which refinanced the Bridge Loan, funded certain fees and provided additional working capital to the Group to address its immediate financing needs. The New Money Facilities Agreement was secured through first ranking fixed and floating charges over substantially all of the Group's assets, albeit Debenhams plc only provided security in relation to Facility A of the New Money Facilities Agreement. As a condition of the New Money Facilities Agreement, this security was also granted to secure the RCF and the Notes.

116. The CVA contains a detailed account of these financing activities in the period before the CVA was proposed (and annexes a Schedule of every security granted by the Company) and concludes this section as follows:

> "The Directors understand that, as the transactions described above were entered into recently, they could be subject to review under various sections of the Act in the event of an administration or liquidation of the Company commencing within the timeframes assumed in the Estimated Outcome Statement. The Directors do not believe, acknowledge or accept that any such review would result in any of the transactions being set aside, including the grant of security in connection with the New Money Facilities Agreement and its confirmation in connection with the Newco Facility Agreement. Consequently, adopting a prudent assumption for the purposes of the Estimated Outcome Statement, it is only in respect of the proceeds of the New Money Facilities Agreement and the Newco Facility Agreement which have been made freely available to the Company, totalling £180.5m, that floating charge security has been recognised."

117. For the Applicants Mr Bayfield QC submits that in order to comply with IR2.3 the CVA should have set out that if the Company were to go into administration or liquidation, circumstances existed which might give rise to potential claims under section 239 or section 245 of the Act (identifying the sections and explaining why the claims were arguable).

118. Section 239 of the Act provides that where at a relevant time a company has given a preference to any person, the administrator or liquidator may apply to the court for an order. For the purposes of this section, the relevant time is a period of six months ending with the appointment of an administrator (section 240 of the Act). (It is this time limit that has justified expedition of the trial and set the timetable for delivery of judgment). Section 239(4) and (5) of the Act set out when a company will give a preference to a person:

> "(4) For the purposes of this section and section 241, a company gives a preference to a person if—"
>
> (a) that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities, and
>
> (b) the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done.
>
> (5) The court shall not make an order under this section in respect of a preference given to any person unless the company which gave the preference was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (4)(b)."

119. The Applicants argue that the Company's grant of security over the previously unsecured RCF and Notes on 29 March 2019 constitutes the giving of a preference at the time when the Company was balance sheet insolvent. But this depends upon the fulfilment of s.239(5). The proposers of the CVA (the directors) are therefore required to consider whether there are circumstances which might give rise to a claim that they themselves were influenced by a desire to prefer the Financial Creditors. Fortunately, the matter is not entirely down to them. In practice the directors will formulate the terms of the proposal with the assistance of an insolvency practitioner (as the intended nominee): and in any event the nominee is obliged under s.2(2) of the Act to report to the Court whether (and if so why) the creditors should be invited to consider the proposal or (under IR2.9(2)(b)) whether (and if so why) they should *not* be invited to consider it. In relation to the discharge of that duty the nominee must maintain an independent stance, act in good faith, and only support the CVA if satisfied that it will not unfairly prejudice the interests of any creditor. (I have adopted the summary by Henderson J in Mourant at [88] of the duties of an administrator proposing a CVA). There is no suggestion in the instant case that Mr Tucker or Mr Boyle of KPMG failed to discharge their duties in that regard in relation to the Debenhams CVA.

120. The timing of the provision of security is not in issue; and it is in itself striking. The Company's desperate need for additional working capital was not in issue; and nor was the restricted source of supply. The Company attempted to obtain alternative

financing from other lenders but was constrained by its financial performance and by the likely need to obtain a waiver of financial covenants under its existing financing arrangements from the Financial Creditors. The Company met the inferences that might be drawn from the timing of events by the direct evidence of Ms Osborne (the Chief Financial Officer of the Debenhams Group since September 2018) who explained in detail why Debenhams had granted security in respect of the RCF and the Notes: it was a non-negotiable condition of the grant of New Money.

121. This was not (at a time when the Sports Direct companies were applicants) the subject of challenge. The case advanced in correspondence was that the Financial Creditors were the sole source of additional working capital only because the Debenhams directors failed to engage with Sports Direct's offers of assistance.

122. The Applicants had the opportunity to advance this case in evidence in reply, but squandered it by seeking to adduce the evidence of a business consultant retained by Sports Direct covering so much of the history concerning Sports Directs' attempts to remove members of the Debenhams' board and to have Mr Ashley appointed CEO, containing such accusations of mismanagement and misrepresentation by the board, and such personal attacks on the integrity of the Debenhams board that it would have been an injustice not to allow them to be tested: yet to permit cross-examination would have de-railed the expedited trial. So I did not admit it.

123. Ms Osborne was therefore cross-examined by reference to the written offers of assistance that Sports Direct had made. She presented as a transparently honest and careful witness who gave what seemed to me a balanced account of the relevant considerations. It emerged that Debenhams needed a banking covenant release at the end of February 2019 and had to address an impending cash-flow crisis at the end of March 2019 and was therefore in discussion with its Financial Creditors. Between 13 March and 25 March 2019, Sports Direct made a number of offers to provide additional financing the Company, including offers of debt financing, equity financing and the purchase of part of the Company's business. These were seriously considered by the Company, but were thought to have conditions which were too onerous or impossible to fulfil. It was a condition of Sports Direct's offers that Mr Ashley, the CEO of Sports Direct, should become CEO of Debenhams. But Sports Direct had recently become a majority shareholder in House of Fraser, one of the Company's direct competitors. The board considered that the appointment as CEO of (in effect) the owner of a direct rival in a turbulent market was not good governance, might breach listing rules and might give rise to competition issues; that accepting such an appointment as a condition of obtaining a loan of £150m was itself problematic; that the provision of commercially sensitive information to the owner of one of their biggest competitors was not acceptable (save insofar as it was truly necessary to enable Sports Direct to formulate an offer) and that the arrangement would require the consent of the RCF creditors. Dealings were also constrained by the reluctance of Sports Direct to sign up to a Non-Disclosure Agreement (to enable it to receive material non-public information): from Sports Directs' point of view such an NDA would have inhibited its ability to deal with its holding of shares in Debenhams.

124. By the end of the cross-examination of Ms Osborne it seemed clear to me that the case that the directors might (in granting security for existing indebtedness in order to obtain New Money) have been influenced by a desire to prefer the Financial Creditors "did not have legs": and that the account in the CVA (as approved by the nominees)

was fair, alerting the creditors as a whole to the existence of the issue and enabling any creditor to ask further questions before or at the meeting. It appears that none did so.

125. Section 245 of the Act provides that, subject to various exceptions which are not relevant to the present case, a floating charge created over a company's assets within a period of 12 months ending with the appointment of an administrator will be invalid, save to the extent of any new money advanced to the Company upon the creation of the floating charge. The Company granted a floating charge to secure the RCF and the Notes on 29 March 2019, at which point the Company was balance sheet insolvent. The Applicants therefore contend that if the Company goes into administration upon an administration application made on or before 29 March 2020, the floating charge will be invalid. They submit that the failure to identify s.245 of the Act and to state its effect are failures to comply with IR2.3 which constitute a material irregularity within the meaning of section 6(1)(b)

126. Shortly put, the argument is that the Company has misrepresented the existence of a defence to a section 245 claim (when none exists in law) in expressing the view that the Directors did not believe, acknowledge or accept that any such review would result in any of the transactions being set aside. That expression of view was, of course, a preface to the disclosure that, notwithstanding that view, the fresh floating charge security would (for the purposes of analysis) be treated as limited to New Money.

127. The conflation of the claim under s.245 with the other avoidance claims did not assist clarity of exposition: but the creditors were assisted to assess the CVA in the correct way i.e. on the assumption that the s.245 claim was a good one. This in my judgment suffices. The self-evident policy of the Insolvency Rules 2016 is to focus on the conveying of content and not on the completion of forms. It would be a curious irony if the Court were to hold that IR2.3 required a particular form of words to be adopted notwithstanding that the required substance was communicated.

128. Furthermore, an irregularity under section 6(1)(b) of the Act will be considered "material" if (and only if) objectively assessed, there is a substantial chance that if the irregularity had not occurred it would have made a material difference to the way in which the creditors would have considered and assessed the terms of the CVA: see Re Trident Fashions (No.2) [2004] 2 BCLC 35 per Lewison J at [46] and SISU Capital Fund v Tucker [2006] per Warren J at [80]-[81]. Mr Bayfield QC has not persuaded me that if the CVA had said (i) that there might be a claim under s.239 of the Act but that no provision for costs or allowance for recovery had been made in the CVA; and/or (ii) that there was a claim under s.245 to which there was no defence but that the CVA anyway proceeded on the footing that the floating charge could secure new money, then there is any substantial chance that the creditors would have looked at the CVA differently.

129. So far as s.245 of the Act is concerned, given the way the claim was in fact treated by the CVA it is wholly implausible that any elucidation of the reason *why* it was treated in that way would be regarded as in any degree material. The taking of the point betrays a degree of desperation.

130. So far as s.239 of the Act is concerned it is to be borne in mind that the CVA had the support of 94.71% of the £1.044bn creditors voting (and 82.07% of the landlord creditors). There is no material on the basis of which to conclude that prospect of a modest "clawback" would have influenced compromised creditors to view the CVA differently. Even if the enhancement of a "clawback" meant that all compromised landlords and all rating authorities who in fact approved the CVA would instead have opposed it, that would not have caused the CVA to fail. The furthest Mr Bayfield QC went was to submit that a return in an administration enhanced by a successful s.239 claim might have meant that Category 5 landlords would have voted differently: but that would have meant only that £5.4m by value of votes would have shifted – a wholly immaterial amount.

131. I hold that Ground 5 fails.

The Court's discretion to make an order in respect of the CVA

132. If the court is satisfied that a CVA unfairly prejudices the interests of a creditor, or there was a material irregularity in the relation to the holding of the creditors' meeting or the qualifying decision making process, the court may make an order under section 6(4) of the Act to revoke or suspend the decision approving the CVA, directing any person to summon a further company meeting to consider a revised proposal, or directing any person to seek a decision from the company's creditors as to whether they approve a revised proposal.

133. Mr Smith QC for the Company contends that this discretion is to be exercised with reference to the legitimate interest of the party requesting an order to be made. He relies on Deloitte & Touche A.G. v Johnson [1999] 1 W.L.R. 1605 where at 1611D Lord Millett said:

> "Where the court is asked to exercise a statutory power, therefore, the applicant must show that he is a person qualified to make the application. But this does not conclude the question. He must also show that he is a proper person to make the application. This does not mean, as the plaintiff submits, that he "has an interest in making the application or may be affected by its outcome." It means that he has a legitimate interest in the relief sought."

134. The principle was applied in Walker Morris (a firm) v Khalastchi [2001] 1 BCLC where a firm of solicitors (a creditor in a liquidation for £237) applied to the court for directions to be given to the liquidator (with the objective of securing that the liquidator did not disclose to HMRC information concerning a client's tax affairs). As creditors they were qualified applicants: but their application did not promote their interest as creditors but served a different purpose (and one adverse to the interest of the creditors as a whole).

135. Mr Smith QC for the Company submits that this case is the same. The First, Second, Third, Fourth and Sixth Applicants appear to accept that, as matters stand, they are financially better off under the CVA than they would be under an administration (subject to the "business rates" point if they exercise termination rights). The Fifth Applicant, as a Category 5 landlord, might potentially be better off under an

administration if there were a substantially successful preference claim: but the prospect is remote and the degree of benefit small. Without the costs indemnity from Sports Direct the Applicants simply would not present or pursue the Application.

136. Mr Smith QC submits that in truth, the Applicants are simply seeking to disrupt the CVA (to the disadvantage of the £988m of creditors who voted in favour of it) to the advantage of their paymaster, Sports Direct. The advantage to Sports Direct is said to be (i) facilitating the acquisition of the business at an advantageous price (probably by acquiring the intellectual property and goodwill from the office-holders and then seeking to renegotiate directly with the landlords of such premises as Sports Direct requires); or (ii) the elimination of a competitor to House of Fraser. The advantage to Mr Ashley personally is said to be that it enables him to pursue his grievance at the manner in which his attempt to acquire Debenhams pre-administration was frustrated.

137. On the material before me that analysis is entirely plausible. But it does not mean that the Applicants have no legitimate interest in pursuing the Application. First, because if matters do pan out as anticipated then the Applicants have the "benefit" of a "gentlemen's agreement" with Mr Ashley that in *his* negotiations they will be treated more favourably that they are under the CVA. Second, the Applicants take a jurisdiction point in relation to which the merits of their conduct and the exact nature of their interest are irrelevant.

138. But I do not intend to give directions. The question of relief was not much discussed. The Company's Skeleton Argument had contained the submission that that if the Applicants were right on a (subsequently abandoned) jurisdiction point then the consequence would simply be that that part of the CVA would be ineffective and would be severed under the conventional "severance" provision to be found in clause 43.1 of the CVA. When Mr Smith QC repeated the submission at trial (in the context of a different jurisdiction point) Mr Bayfield QC said he was surprised by it and wished to argue the point.

139. I am anxious to hand down judgment in a form in which it can be appealed (the possibility of an appeal within the time limited for launching the preference claim having factored into the timetable for the expedited trial and delivery of judgment). To that end I will:

(a) Declare that the provisions in clauses 11.14, 12.14 and 13.14 of the CVA ("the Forfeiture Restraint Provisions") are in excess of the jurisdiction conferred by Part 1 of the Insolvency Act 1986;

(b) Direct that the Forfeiture Restraint Provisions be deleted from the CVA pursuant to clause 43.1 of the CVA;

(c) Declare that as so modified the CVA is valid and remains enforceable;

(d) Direct that the Applicants have permission to apply to vary the order deleting the Forfeiture Restraint Provisions from the CVA (and the consequential declaration of validity).

140. To facilitate the speediest delivery I will hand down this judgment at 10.30 am on 19 September 2019 without attendance of parties. I will consider any application(s) for permission to appeal on the basis of ***short*** written submissions and a draft Notice. I adjourn the question of costs generally with permission to restore.