NEWS BRIEF

Arcadia Group CVAs: given the green light

On 12 June 2019, after a tense meeting with landlords and creditors, the company voluntary arrangements (CVAs) proposed by the Arcadia Group Ltd (Arcadia) were approved by the requisite majority of creditors, allowing the group to restructure its balance sheet and stave off, at least for the time being, a liquidation or administration proceeding.

Arcadia's decline

Arcadia, the retail group founded in 1903 and currently run by Sir Philip Green, has dominated the British high street for decades. However, rising business rates, increased competition and the shift to online shopping are just some of the factors that have affected the group's financial health, and it has recently joined a growing number of high street retailers that are struggling in the challenging UK retail market.

On 22 May 2019, Arcadia's financial difficulties culminated in it announcing that it had launched seven CVAs, alongside a comprehensive turnaround plan, in order to restructure the business.

What is a CVA?

A CVA is a compromise or arrangement between a company and its unsecured creditors that allows the company to renegotiate certain of its debts in order to avoid potentially terminal insolvency proceedings.

A CVA is proposed by the directors of a company (unless it is already in administration or liquidation) and an insolvency practitioner is appointed to supervise its implementation. It must be approved by at least 75% in value of creditors voting in the creditors' meeting and, to the extent that there are connected creditors, 50% by value of voting unconnected creditors must also vote in favour (*section 249, Insolvency Act 1986*) (1986 Act).

Once a CVA has been approved, all unsecured creditors are bound by its terms whether or not they voted in favour, although creditors have 28 days from the date of approval to challenge a CVA on the grounds of unfair prejudice or material irregularity (*section 6, 1986 Act*).

CVAs may be used in a number of different contexts, including a rescheduling or reduction of a company's debts, or as a distribution mechanism in an administration, but most commonly in recent years have been used by retailers to "right-size" their lease portfolios (*see feature article "Challenges to the consumer sector: adapting to the new reality", this issue*). The Arcadia CVAs primarily sought to address its lease liabilities through the closure of 23 of 566 stores in the UK and Ireland, and by reducing rental costs and revising certain lease terms across a further 194 locations.

Landlords and risk of challenge

The use of CVAs to compromise lease and other property liabilities has led to a growing concern among landlords that CVAs are being used by companies to obtain more favourable lease liabilities, while not addressing the root cause of these companies' financial difficulties. This is compounded by the fact that landlords can, to a certain extent, be crammed down by other unsecured creditors (*see box "Merits of a CVA"*).

Landlords have therefore been vocal in their complaints against the terms of numerous recent CVAs, including those of BHS, New Look and Mothercare, and Arcadia is no exception. A number of Arcadia's landlords, including Aberdeen Standard, Aviva, Intu and Land Securities, initially refused to consent to the CVAs in order to create leverage and negotiate better terms (*www.theguardian.com/business/2019/jun/11/arcadia-on-the-brink-after-intu-rejects-revised-cva-plan*).

As a result, Arcadia was forced to modify its CVA proposals so that the proposed rent reductions were reduced to 25% to 50% (from 30% to 70%), with the shortfall being funded by Arcadia's majority shareholder, Lady Green. In addition, as is often the case to secure creditor support for a CVA, Arcadia's landlords were also offered a sweetener in the form of a 20% equity stake in the group in the event of any future sale (*https://uk.reuters.com/article/us-arcadia-restructuring-meeting/philip-greens-arcadia-faces-key-vote-as-administration-looms-idUKKCN1TD114*).

While the modifications were enough for Arcadia to achieve sufficient creditor support for its CVAs, the group will be mindful that landlords have challenged other recent CVAs, such as the Debenhams CVA, on the grounds of unfair prejudice. In that scenario, the court will consider the treatment of the challenging creditor as against other CVA creditors, as well as the position the challenging creditor is in versus their anticipated recovery in an insolvent liquidation scenario.

Pension liabilities

Addressing pension liabilities is an important consideration for many UK corporate groups in restructuring situations. The lodging of CVA proposals typically starts an assessment period for the Pension Protection Fund (PPF), meaning that the pension scheme's creditor rights are exercised by the PPF to the exclusion of the scheme trustees. The PPF will want to ensure that the CVA's financial return to the scheme is significantly better than it would be in an administration or liquidation. Given that pension claims are typically valued on a full buy-out basis, the pension trustee or the PPF will often have a majority capable of blocking a CVA.

Arcadia's pension deficit was reported in April 2019 to be £750 million (on a full buyout basis), and it was therefore important for the group to reach an agreement with the Pensions Regulator (the Regulator) and the PPF (*https://news.sky.com/story/green-risks-new-pensions-row-over-topshop-funding-cut-11684912*). In addition, the Arcadia pension liabilities will have been a particular focus for Sir Philip, following his protracted dispute with the Regulator after the collapse of BHS in 2017, which culminated in him making a £363 million contribution to the BHS scheme (*www.bbc.co.uk/news/business-36139828*).

Arcadia had been making annual £50 million payments into its pension scheme to address its deficit. As part of its restructuring, Arcadia reached an agreement with the Regulator and the PPF to halve those annual payments for the next three years, and also to use certain assets, in the amount of £210 million, to secure scheme contributions. Again, Lady Green agreed to fund the shortfall plus an additional £25 million (*www.ft.com/content/291d42cc-8602-11e9-a028-86cea8523dc2*). As a result, the Regulator and the PPF agreed to support the Arcadia CVAs in the creditors' meetings.

A nervous wait

Arcadia now faces a nervous wait to see if any creditors challenge the CVAs within the statutory 28-day period. Following that, Arcadia's near-term future on the UK high street will look somewhat more secure.

However, Arcadia has joined an ever-growing list of high street retailers whose future now depends on a fundamental improvement in their trading performance, and the ability to adapt to changing market conditions and consumer preferences. If Arcadia can successfully undertake the necessary operational restructuring to complement the balance sheet support provided by the CVAs, it may yet be able to re-establish itself as a shining light in the UK retail market.

On the other hand, if this restructuring proves unsuccessful, the CVAs may be seen as no more than a sticking plaster on the way to an eventual break-up or collapse of the business. Landlords, suppliers and employees alike will be hoping that this can be avoided, and that Arcadia's CVAs can light the way for a sustained recovery of the business and a return to former glories.

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Merits of a CVA

In recent years, company voluntary arrangements (CVAs) have primarily been used by companies in the retail and casual dining sectors as the CVA has a number of advantages that make it an attractive restructuring tool for UK-based companies with extensive lease liabilities. However, there are a number of disadvantages to their use in complex, cross-border capital structures.

Advantages	Disadvantages
Informal insolvency procedure. A CVA allows a company to continue trading, and avoid liquidation or administration (at least in the short term), and therefore the stigma that is typically associated with other types of insolvency proceeding does not attach to CVAs. This is particularly important for high street retailers that heavily rely on consumer confidence.	**International use.** A company can use a CVA only if it is incorporated in England and Wales or if its centre of main interests is clearly in the UK, and so they are of limited assistance for international corporate groups with a material presence outside the UK.
Flexibility. The CVA is a flexible tool: there is no requirement for a company to be insolvent, and a CVA's terms may be tailored to treat various creditors differently, provided that the CVA as a whole provides fair treatment to all creditors.	**Moratorium.** There is no statutory moratorium other than for small companies (*section 382, Companies Act 2006*).
Classes or cram-down. Unlike a scheme of arrangement, creditors do not vote on a CVA in separate classes and, once the requisite majority of creditors have approved a CVA, it is binding on all unsecured creditors irrespective of whether or not they voted in favour.	**Secured creditors.** A CVA does not bind secured or preferential creditors unless they consent to its terms, meaning that its use is limited for restructuring secured liabilities.
No court involvement. The court is not involved in a CVA process unless there is a challenge or associated litigation. This can reduce the cost.	**Delaying the inevitable.** Companies are reluctant to use CVAs other than as a last resort, and landlords and other creditors are equally reluctant to accept any impairments other than those which are strictly necessary to preserve the business in the short term. CVAs have therefore been criticised as being "too little, too late" and there are numerous examples of companies entering liquidation or administration shortly after implementing a CVA, which proved insufficient to resolve the business's underlying problems.