

Power of guarantees

On 1 May 2007 judgment was handed down by the High Court in proceedings brought by a number of the UK's largest landlords, including Prudential and Land Securities.

They claimed that they had been unfairly prejudiced by a company voluntary arrangement ("CVA") entered into by the insolvent electrical retailer PRG Powerhouse Limited ("Powerhouse"). The CVA sought to release its parent company, PRG Group Ltd ("PRG") from guarantees provided to landlords of Powerhouse's premises. The property industry has been nervously awaiting the judgment given its implications for the value of properties where there is a parent company guarantee. Whilst the judgment will provide some reassurance to landlords, there remains cause for concern.

A CVA is a formal agreement between a debtor and its creditors regarding payment of its debts. It is approved by the debtor and a majority of over 75% by value of its creditors at a meeting. Once the arrangement is approved, creditors are bound by its terms. It, therefore, offers a company in financial difficulties a way of seeking to avoid the more severe consequence of going into liquidation.

In the present case, Powerhouse proposed to close a number of underperforming stores. It further proposed that it would enter into a CVA under which all creditors in respect of the closed stores would be provided with a fund of £1.5m to provide a dividend of approximately 28p in the pound on their respective claims. The CVA also provided for the release of the guarantees given by PRG. The CVA was approved at a meeting of the company's creditors by the requisite majority.

The claimants sought a declaration that the CVA was invalid as it purported to affect the rights of the claimants against persons other than Powerhouse i.e. PRG. They also sought an order that the creditors' approval of the CVA be revoked on the ground that it was unfairly prejudicial to the claimants. In relation to the first issue, the court held that the CVA could provide that a creditor could not take steps to enforce the guarantee given by PRG. It can, therefore, be expected that, in future, CVA tenants will seriously consider seeking to include a similar provision. Creditor landlords faced with such a proposed CVA would, as a result, be advised to consider challenging it.

Fortunately, the Court decision on the second issue provides such landlords with ammunition. The Court held that, in all circumstances, the CVA was unfairly prejudicial to the claimants. It deprived them of the benefit of guarantees that were of value, both in themselves and as a lever for negotiation. It would leave the claimants in the same position as those creditors that did not have the benefit of guarantees. In particular, the Court was influenced by the fact that if Powerhouse had gone into liquidation rather than entering into a CVA then the claimants would have benefited from the valuable guarantees. As a class, therefore, the claimants would have suffered the least on an insolvent liquidation but were most prejudiced by the CVA.

It follows, though, that in different circumstances, the terms of a CVA, which include the release of parent company guarantees, may not be held to be unfairly prejudicial. As a result, landlords would be well-advised to consider whether to accept a parent guarantee from an incoming tenant or whether alternative security, for example a rent deposit, is to be preferred.



Contact

Jon Mowbray

Partner

Email jon.mowbray@ibblaw.co.uk

Tel 01895 207988

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