In Practice

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Oceanfill: an atoll of hope for landlords in an ocean of economic uncertainty

KEY POINTS

- The legal effect of a restructuring plan pursuant to Part 26A of the Companies Act 2006 is to bind the creditors to whom the plan applies by operation of law, and not by actual or deemed agreement by the creditors affected, or, in other words, a restructuring plan does not affect the rights of creditors bound by the plan against third parties also liable for the same debt (for example, guarantors).
- Landlords should brace themselves for potentially being made subject to a cross-class cramdown in a restructuring plan, particularly if, as many restructuring professionals champion should be the case, restructuring plans start to be used more routinely by SMEs.
- Those drafting restructuring plans ought to be mindful of not effectively defusing potential 'ricochet claims'.

In *Oceanfill Ltd v Nuffield Health Wellbeing Ltd & Cannons Group Ltd* [2022] EWHC 2178 (Ch) the High Court Deputy Master Arkush ruled in favour of a landlord whose original tenant (under an AGA – see further below) and original guarantor (under a GAGA – see further below) were held to be liable for arrears of rent in relation to a gym in Leeds, despite the subsequent tenant being made subject to a restructuring plan under Part 26A of the Companies Act 2006 ('Part 26A') which compromised those arrears.

BACKGROUND

In 1998 the freeholder, Oceanfill Ltd ('Oceanfill'), let the ground and lower floors of Centaur House, 91 Great George Street, Leeds to Nuffield Health Wellbeing Ltd (then known as Vardon Health and Fitness Ltd) ('Nuffield') for a term of 25 years (the 'Lease'). Cannons Group Ltd (then known as Vardon PLC) ('Cannons'), was a party to the Lease as guarantor of Nuffield's obligations. In 2000 Nuffield assigned the lease to Virgin Active Ltd ('VAL') under a licence to assign (the 'Licence'), Nuffield entered into an authorised guarantee agreement guaranteeing the performance of VAL as tenant (the 'AGA'), and Cannons entered into a guarantee of Nuffield's obligations under the AGA (the 'GAGA').

The sums claimed by Oceanfill would, in the ordinary course, have fallen due for payment by VAL as the current tenant under the Lease. However, in May 2021 the High Court had approved a restructuring plan for VAL (and certain other companies in its group (together the 'Plan Companies')) pursuant to Part 26A (the 'Plan'), amonst other things compromising the arrears. After the Plan was sanctioned, Oceanfill issued proceedings, applying for summary judgment, seeking payment from Nuffield and Cannons under the AGA and GAGA. The arrears comprised rent and additional sums for legal costs and disbursements payable under the Lease, totalling £141,255.

The central issue in this case was whether the effect of the Plan was to re-write the terms of the Lease and release the tenant from liability for rent and other sums, so that the sums claimed by Oceanfill had not fallen due pursuant to the Lease, and, consequently, were not due under the AGA and GAGA (as Nuffield and Cannons contended), or whether the Plan merely altered the liability of VAL (and the other Plan Companies) by operation of law, leaving the liabilities of Nuffield and Cannons under the AGA and GAGA unaffected (as Oceanfill contended).

RESTRUCTURING PLANS AND CROSS-CLASS CRAMDOWN

Restructuring plans, as provided in Part 26A, were introduced with effect from 26 June 2020 by the Corporate Insolvency and Governance Act 2020. Part 26A includes, amongst other things, a 'cross-class cramdown' mechanism that allows dissenting classes of creditors to be bound to a restructuring plan. This is only permissible if the court is satisfied that, if the plan was sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the 'relevant alternative'. The 'relevant alternative' is whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned. This means that classes of creditors who vote against a restructuring plan, but who would be no worse off under the restructuring plan than they would be in the relevant alternative, cannot prevent it from proceeding.

The sanctioning of the Plan was opposed by certain landlords of the gym premises used by the companies. The landlords were owed approximately £30m in rent and other unsecured debt. Under the Plan, Oceanfill was a 'Class D Landlord' and the Lease was a 'Class D Lease'. The effect of the Plan in respect of Class D Leases was summarised by Snowden J (as he was then) in his judgment concerning the approval of the Plan at para 66 of his judgment as follows:

> '... no past, present or future rent, service charge, insurance or other liabilities will be payable and the relevant Plan Company will no longer have any obligations towards them. In exchange, each Class D Landlord will be entitled to a Restructuring Plan Return.'

The Plan itself provided, at para 7.4, as follows:

> 'Save as expressly provided in this Restructuring Plan or in the Restructuring Implementation Deed, nothing contained herein

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Biog box

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> effects a modification or cancellation of any Landlord Creditor's rights under the Leases to which it is a party, other than in the manner and to the extent explicitly contemplated herein or therein.'

All of the Class D Landlords (including Oceanfill) voted against the Plan. The court nonetheless sanctioned the Plan because, when applying the provisions of Part 26A, it considered that the Class D Landlords would not be any worse off than they would be in the 'relevant alternative', which the court considered to be entry into administration followed by an accelerated sale of the businesses of the Plan Companies.

THE JUDGMENT

The court held that, like a scheme of arrangement under Part 26 of the Companies Act 2006, a restructuring plan under Part 26A, binds the creditors to whom the plan applies by operation of law, and not by actual or deemed agreement by the creditors affected, or, in other words, a restructuring plan does not affect the rights of a creditor bound by a plan against third parties also liable for the same debt.

Nuffield and Cannons' first line of defence was that the effect of the Plan was such that the rents claimed against them were not sums that had fallen due pursuant to the Lease. The court rejected that argument:

> 'To the extent that it provides for a tenant to be released from future obligations under a lease, as the Plan did in this case, it does so by means of a statutory scheme that releases or discharges the tenant from liability. In my view it is not correct to say that the Plan re-writes the Lease. It is more correct to say that it releases the Plan Company from future liability under the Lease terms by providing that the rent and other liabilities are not payable on its part. Alternatively, to the extent that this can be described as re-writing the Lease, it is a re-writing only as between the landlord affected by the Plan and the Plan Company. It leaves unaffected the rights of the landlord against third party guarantors.'

Nuffield and Cannons' second line of defence was that their obligations under the Licence were '*to pay the rents and observe and perform the covenants*' in the form those covenants existed, as varied, at the relevant time. Accordingly, there were no arrears that had arisen pursuant to the Lease and no breaches of covenant by VAL which could have rendered either Nuffield or Cannons in breach of their obligations under the Licence. The court rejected that argument too, noting that the Licence contained a clear provision that Nuffield and Cannons would not be released by variations of the Lease, and that, somewhat curiously pursuant to the terms of the Licence, any such release could only be by way of release under seal given by Oceanfill (which had not been given).

RICOCHET CLAIMS

Where a third party guarantor discharges the obligations of an underlying obligor, the guarantor has a subrogated claim against the obligor for the same amount; a so-called 'ricochet' claim. Deputy Master Arkush in his judgment [31] stated:

> 'Such claims ['ricochet' claims by third parties] are unaffected [by] the Plan. Whether this was deliberate, because of their restricted amounts or otherwise, or inadvertent due to the point being missed, or because no-one thought about them, seems to me not to matter'.

Whether the learned Deputy Master was correct that such claims were not defused by the Plan is beyond the scope of this article. Nevertheless, it is a reminder that those drafting schemes or restructuring plans should consider whether 'ricochet' claims by third parties have been adequately compromised.

CONCLUSION

This case is a timely reminder to landlords to carefully consider the terms and effects of restructuring plans. In particular whether or not former tenants or third-party guarantors will remain available as a means of circumventing the restructuring plan to recover rent (and other sums reserved by the relevant lease) in full.

However, in many circumstances there will be no former tenants or guarantors to pursue and the use of restructuring plans, including those that deploy the cross-class cram down mechanic, will be causing landlords some understandable consternation. Restructuring plans recently promulgated by Amicus Finance plc (in administration) and Houst Ltd, both SMEs, demonstrate restructuring plans' increasing popularity in the mid-market.

The Insolvency Service recently published a report proposing certain streamlining of the restructuring plan process for SMEs. Amongst other things, the report proposed that a standardised form or template of restructuring plan be introduced to lower the burden on business and make restructuring plans more accessible. This might mean, at least in some instances, that companies that might have proposed a company voluntary arrangement will propose a restructuring plan instead. In contrast to a CVA, a restructuring plan can bind dissenting secured or preferential creditors, making it a more muscular tool. ■

Further reading

- LexisPSL Banking & Finance; Restructuring; Restructuring options and processes; English court sanctions Virgin Active's restructuring plans, following major challenge from landlords (*Re Virgin Active Holdings Ltd*)
- LexisPSL Restructuring & Insolvency; Restructuring; Restructuring Plan; Effect of restructuring plan on liability of original tenant and guarantor (*Oceanfill Ltd v Nuffield Health and Cannons Group Ltd*)
- LexisPSL Restructuring & Insolvency; Property insolvency; Tenant/landlord issues; Former tenants, guarantors and overriding leases