Choppy waters ahead? The significance of Oceanfill

Restructuring plans could feature heavily in the property market in 2023, but proponents need to watch for 'ricochet' claims from rent guarantors that could undermine their viability, say **Elizabeth Alibhai**, **Paul Bagon** and **Will Beck**

As we enter 2023, the economic outlook for the UK remains uncertain. It seems almost certain that more companies may need to look to restructure their businesses in the coming months to ensure their continued survival. For companies with a large rental exposure, this may include looking to restructure, amongst other things, their rental liabilities through some form of compromise arrangement, such as through a CVA, scheme of arrangement or restructuring plan.

Restructuring plans and CVAs

It is nearly three years since the restructuring plan became part of UK insolvency law, allowing for the possibility of 'cross-class cram down'.

Whilst initial uptake was cautious, 2021 saw a raft of larger companies propose restructuring plans, including, notably from a property perspective, Virgin Active.

In the Insolvency Service's final evaluation report on CIGA published in December 2022, it was noted that, in general, the view from stakeholders within the restructuring and insolvency market was that the restructuring plan and, in particular, the cross-class cram down provision, were viewed as "an effective addition to the UK's rescue toolkit".

However, it was also clear that concerns remained that the process can be too costly and time-consuming for use by smaller companies. Until recently, the only restructuring plan to have been successfully proposed by an SME was Amicus Finance in 2021.

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The sanctioning of the restructuring plan for Houst Limited in July 2022, however, opens up the possibility that the process may become more viable and attractive for other SMEs. In this case, the court was mindful of the cost burden potentially faced by Houst – a SME property management service provider – in bringing the restructuring plan. In light of this, the court sought to adopt an approach which was described by the Insolvency Service in their report as "showing an encouraging pragmatism" with regards to the level and detail of the supporting documentation that Houst was required to produce in support of the plan. Furthermore, when exercising its discretion to sanction the plan, the court noted that "while it would in theory be possible to require [Houst] to start again and seek to negotiate with HMRC, that is highly undesirable, where the costs and delay in requiring it to do so would impose a disproportionate burden on the [company], a small to medium enterprise".

The CVA has traditionally been the compromise tool of choice for many companies looking to restructure their rental liabilities. This can, in part, be attributed to their relative ease of implementation, with a court not generally becoming involved unless the CVA is challenged. As a result, the costs of undertaking a CVA can be less than the respective costs of pursuing a scheme of arrangement or restructuring plan, which both involve court processes.

But CVAs are not without their challenges, for instance, see New Look, Regis, Caffè Nero, etc. There is also the added drawback that the claims of secured creditors and preferential creditors cannot be compromised (unless such creditors consent), or even crammed down, under the terms of the CVA itself.

This is not the case in a restructuring plan, where for example in Houst, the claims of HMRC (as preferential creditor) were successfully included within the plan.

As businesses continue to grapple with an uncertain and challenging economic outlook, we expect that CVAs will continue to play a role in the restructuring market; although, for the reasons set out above, that role may be less prominent than in recent years.

> **In light of the Oceanfill case, the scope of future [restructuring] plans may be expanded further to seek to compromise the liabilities of third party guarantors**

If the approach of the court in Houst is adopted by other SMEs, restructuring plans, with their potential to cram down classes of dissenting creditors, may feature heavily in the property market in 2023. This is reflected in the Insolvency Service report where it is noted that the sanction of the Houst restructuring plan "can be seen as being indicative of a 'tipping point' in that the situation seems to be changing due to more companies making use of the [restructuring plan] measure and it becoming more accessible to the SME market due to established principles being created through case law".

Oceanfill

In this context, the recent case of Oceanfill (*Oceanfill Limited v Nuffield Health Wellbeing Limited, Cannons Group Limited [2022] EWHC 2178 (Ch)*) may have important implications for future restructuring plans (and potentially other compromise arrangements, such as a CVA) which are proposed by, or affecting, tenants, landlords or guarantors.

This case arose out of the Virgin Active restructuring plan sanctioned in 2021. That plan had the effect of (amongst other things) compromising Virgin Active's rental liabilities under its lease with its landlord, Oceanfill Limited.

The lease had previously been assigned by Nuffield Health to Virgin Active in 2000. In connection with that assignment, Nuffield Health and Cannons Group had agreed to

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guarantee Virgin Active's obligations under the lease.

Following the sanction of the Virgin Active restructuring plan, Oceanfill brought a claim against Nuffield Health and Cannons Group as guarantors for the outstanding rent under the Virgin Active lease.

The court held that, despite Virgin Active's obligations for the rent having been compromised by its restructuring plan, Nuffield Health and Cannons Group, as guarantors, remained liable for the outstanding rental liabilities. This was on the basis that the plan had only compromised Virgin Active's liabilities as the tenant under the lease. The liabilities of the guarantors for such debts had not been included within the scope of the plan. As such, the status of those liabilities remained unaltered and Oceanfill could seek to recover the outstanding rent from the guarantors.

The case illustrates that, depending on the terms of the restructuring plan and the underlying guarantees, a landlord may still be able to recover outstanding rent from extant guarantors, even where the plan has compromised the landlord's ability to recover those sums from the tenant.

This may have significant implications for future restructuring plans.

Where the rental guarantee has been given by another entity in the same corporate group as the proponent of the plan, or the guarantor is otherwise connected to the proponent, then it may be more likely that the proponent would also seek to compromise the guarantor's obligations through the plan. However, it is possible that, in the context of the Oceanfill case, the scope of future plans may be expanded further to seek to compromise the liabilities of third party guarantors and/or address any 'ricochet' claims that such guarantors might be able to bring against the primary obligor if they pay out under the guarantees.

Timely reminder

Faced with an uncertain and challenging economic outlook, companies, including those operating in the commercial real estate market, may increasingly turn to compromise tools in 2023, such as a restructuring plan or CVA, to restructure their liabilities and 'right-size' balance sheets.

Where this is the case, the judgment in Oceanfill comes as a timely reminder that, whether you are the proponent of a plan or one of the parties affected by it, it is always important to carefully consider the terms of the plan, the extent of the liabilities it is intending to address and the scope of any releases. In a real estate context, taking this approach should limit the prospect of 'ricochet' claims from guarantors that could otherwise threaten the underlying viability and purpose of the plan.

Outgoing tenants and guarantors who guarantee the obligations of assignees in order to step out of leases should also be increasingly mindful of being left in the 'hot seat' post-restructure, in light of the Oceanfill decision.

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